TRICO BANCSHARES /
Form 10-K
March 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2016

Commission File Number 0-10661

TriCo Bancshares

(Exact name of Registrant as specified in its charter)

California	**94-2792841**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
63 Constitution Drive, Chico, California	**95973**

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code:(530) 898-0300

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

Common Stock, without par value	Nasdaq Global Select Market
(Title of Class)	(Name of each exchange on which registered)

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

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES NO

Indicate by check mark whether the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by

reference in Part III of the Form 10-K or any amendment to this Form 10-K. YES 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Act (check one).

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

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, as of June 30, 2016, was approximately $580,894,777 (based on the closing sales price of the Registrant s common stock on the date). This computation excludes a total of 3,587,007 shares that are beneficially owned by the officers and directors of Registrant who may be deemed to be the affiliates of Registrant under applicable rules of the Securities and Exchange Commission.

The number of shares outstanding of Registrant s common stock, as of February 24, 2017, was 22,871,154.

DOCUMENTS INCORPORATED BY REFERENCE

The information required to be disclosed pursuant to Part III of this report either shall be (i) deemed to be incorporated by reference from selected portions of the Registrant s definitive proxy statement for the 2017 annual meeting of shareholders, if such proxy statement is filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the end of the Registrants s most recently completed fiscal year, or (ii) included in an amendment to this report filed with the Commission on Form 10-K/A not later than the end of such 120 day period.

Table of Contents

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements about TriCo Bancshares (the Company, TriCo or we) and its subsidiaries for which it claims the protection of the safe harbor provisions contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on Management s current knowledge and belief and include information concerning the Company s possible or assumed future financial condition and results of operations. When you see any of the words believes , expects , anticipates , estimates , or similar expressions, these generally indicate that we are making forward-looking statements. A number of factors, some of which are beyond the Company s ability to predict or control, could cause future results to differ materially from those contemplated. These factors include those listed at Item 1A Risk Factors, in this report.

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.

Table of Contents

PART I

ITEM 1. BUSINESS

Information about TriCo Bancshares Business

TriCo Bancshares is a bank holding company incorporated in California in 1981 and registered under the Bank Holding Company Act of 1956, as amended (the BHC Act). The Company s principal subsidiary is Tri Counties Bank, a California-chartered commercial bank (the Bank). The Bank offers banking services to retail customers and small to medium-sized businesses through 68 branch offices in Northern and Central California and had total assets of approximately $4.5 billion at December 31, 2016. The Bank s deposits are insured by the Federal Deposit Insurance Corporation (the FDIC) up to applicable limits. See Business of Tri Counties Bank . The Company and the Bank are headquartered in Chico, California.

As a bank holding company, TriCo is subject to the supervision of the Board of Governors of the Federal Reserve System (the FRB) under the BHC Act. The Bank is subject to the supervision of the California Department of Business Oversight (the DBO) and the FDIC. See Regulation and Supervision.

TriCo has five capital trusts, which are all wholly-owned trust subsidiaries formed for the purpose of issuing trust preferred securities (Trust Preferred Securities) and lending the proceeds to TriCo. For more information regarding the trust preferred securities please refer to Note 17, Junior Subordinated Debt to the financial statements at Item 8 of this report.

Additional information concerning the Company can be found on our website at www.tcbk.com. Copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports are available free of charge through the investors relations page of our website, www.tcbk.com, as soon as reasonably practicable after the Company files these reports with the U.S. Securities and Exchange Commission (SEC). The information on our website is not part of this annual report.

Business of Tri Counties Bank

The Bank was incorporated as a California banking corporation on June 26, 1974, and received its certificate of authority to conduct banking operations on March 11, 1975. The Bank engages in the general commercial banking business in 26 counties in Northern and Central California. The Bank currently operates from 58 traditional branches and 10 in-store branches.

The Bank conducts a commercial banking business including accepting demand, savings and time deposits and making commercial, real estate, and consumer loans. It also offers installment note collection, issues cashier s checks, sells travelers checks and provides safe deposit boxes and other customary banking services. Brokerage services are provided at the Bank s offices by the Bank s arrangement with Raymond James Financial Services, Inc., an independent financial services provider and broker-dealer. The Bank does not offer trust services or international banking services.

The Bank has emphasized retail banking since it opened. Most of the Bank s customers are retail customers and small to medium-sized businesses. The Bank emphasizes serving the needs of local businesses, farmers and ranchers, retired individuals and wage earners. The majority of the Bank s loans are direct loans made to individuals and businesses in Northern and Central California where its branches are located. At December 31, 2016, the total of the Bank s consumer loans net of deferred fees outstanding was $362,303,000 (13.1%), the total of commercial loans outstanding was $217,047,000 (7.9%), and the total of real estate loans including construction loans of $122,419,000 was

$2,180,243,000 (79.0%). The Bank takes real estate, listed and unlisted securities, savings and time deposits, automobiles, machinery, equipment, inventory, accounts receivable and notes receivable secured by property as collateral for loans.

Most of the Bank s deposits are attracted from individuals and business-related sources. No single person or group of persons provides a material portion of the Bank s deposits, the loss of any one or more of which would have a materially adverse effect on the business of the Bank, nor is a material portion of the Bank s loans concentrated within a single industry or group of related industries.

Acquisition of Three Branch Offices and Deposits from Bank of America

On March 18, 2016, the Bank completed its acquisition of three branch banking offices from Bank of America originally announced October 28, 2015. The acquired branches are located in Arcata, Eureka and Fortuna in Humboldt County on the North Coast of California, and have significant overlap compared to the Company s then-existing Northern California customer base and branch locations. As a result, these branch acquisitions create potential cost savings and future growth potential. With the levels of capital at the time, the acquisitions fit well into the Company s growth strategy. Also on March 18, 2016, the electronic customer service and other data processing systems of the acquired branches were converted into the Bank s systems, and the effect of revenue and expenses from the operations of the acquired branches are included in the results of the Company. The Bank paid a premium of $3,204,000 for deposit relationships with balances of $161,231,000 and loans with balances of $289,000, and received cash of $159,520,000 from Bank of America.

Table of Contents

The assets acquired and liabilities assumed in the acquisition of these branches were accounted for in accordance with ASC 805 Business Combinations, using the acquisition method of accounting and were recorded at their estimated fair values on the March 18, 2016 acquisition date, and the results of operations of the acquired branches are included in the Company s consolidated statements of income since that date. The excess of the fair value of consideration transferred over total identifiable net assets was recorded as goodwill. The goodwill arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of the Company and the acquired branches. $849,000 of the goodwill is deductible for income tax purposes because the acquisition was accounted for as a purchase of assets and assumption of liabilities for tax purposes.

See Note 2 in the financial statements at Item 8 of this report for a discussion about this transaction.

Acquisition of North Valley Bancorp

On October 3, 2014, TriCo completed the acquisition of North Valley Bancorp following receipt of shareholder approval for both institutions and all required regulatory approvals. As part of the acquisition, North Valley Bank, a wholly-owned subsidiary of North Valley Bancorp, merged with and into Tri Counties Bank. In the acquisition, the outstanding shares of North Valley common stock were converted into an aggregate of approximately 6.58 million shares of TriCo common stock to North Valley Bancorp shareholders, which was valued at a total of approximately $151 million based on the closing trading price of TriCo common stock on October 3, 2014 of $23.01. In addition, the outstanding options to purchase shares of North Valley Bancorp common stock were cancelled and the holders of the options received a total of $1,061,000 in cash. In connection with the merger, TriCo assumed North Valley Bancorp s obligations with respect to its outstanding trust preferred securities.

North Valley Bank was a full-service commercial bank headquartered in Redding, California. North Valley conducted a commercial and retail banking services which included accepting demand, savings, and money market rate deposit accounts and time deposits, and making commercial, real estate and consumer loans. North Valley Bank had $935 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at June 30, 2014.

Other Activities

The Bank may in the future engage in other businesses either directly or indirectly through subsidiaries acquired or formed by the Bank subject to regulatory constraints. See Regulation and Supervision.

Employees

At December 31, 2016, the Company employed 1,063 persons, including six executive officers. Full time equivalent employees were 1,013. No employees of the Company are presently represented by a union or covered under a collective bargaining agreement. Management believes that its employee relations are good.

Competition

The banking business in California generally, and in the Bank s primary service area of Northern and Central California specifically, is highly competitive with respect to both loans and deposits. It is dominated by a relatively small number of national and regional banks with many offices operating over a wide geographic area. Among the advantages such major banks have over the Bank is their ability to finance wide ranging advertising campaigns and to allocate their investment assets to regions of high yield and demand. By virtue of their greater total capitalization such institutions have substantially higher lending limits than does the Bank.

In addition to competing with other banks, the Bank competes with savings institutions, credit unions and the financial markets for funds. Yields on corporate and government debt securities and other commercial paper may be higher than on deposits, and therefore affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for available funds with money market instruments and mutual funds. During past periods of high interest rates, money market funds have provided substantial competition to banks for deposits and they may continue to do so in the future. Mutual funds are also a major source of competition for savings dollars.

The Bank relies substantially on local promotional activity, personal contacts by its officers, directors, employees and shareholders, extended hours, personalized service and its reputation in the communities it services to compete effectively.

Table of Contents

Regulation and Supervision

General

The Company and the Bank are subject to extensive regulation under both federal and state law. This regulation is intended primarily for the protection of depositors, the FDIC deposit insurance fund and the banking system as a whole, and not for the protection of shareholders of the Company. Set forth below is a summary description of the significant laws and regulations applicable to the Company and the Bank. The description is qualified in its entirety by reference to the applicable laws and regulations.

Regulatory Agencies

The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. As a bank holding company, the Company is regulated under the BHC Act, and is subject to supervision, regulation and examination by the FRB. The Company is also subject to the disclosure and regulatory requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934, each administered by the SEC. The Company s common stock is listed on the Nasdaq Global Select market (Nasdaq) under the trading symbol TCBK and the Company is, therefore, subject to the rules of Nasdaq for listed companies.

The Bank, as a state chartered bank, is subject to broad federal regulation and oversight extending to all its operations by the FDIC and to state regulation by the DBO.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) created the Consumer Financial Protection Bureau (the CFPB) as an independent entity with broad rulemaking, supervisory and enforcement authority over consumer financial products and services. The CFPB s functions include investigating consumer complaints, rulemaking, supervising and examining bank consumer transactions, and enforcing rules related to consumer financial products and services. CFPB regulations and guidance apply to all financial institutions, including the Bank. Banks with $10 billion or more in assets are subject to examination by the CFPB. Banks with less than $10 billion in assets, including the Bank, are subject to the CFPB s rules but continue to be examined for compliance with federal consumer laws by their primary federal banking agency.

The Bank Holding Company Act

The Company is registered as a bank holding company under the BHC Act. In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. As a bank holding company, TriCo is required to file reports with the FRB and the FRB periodically examines the Company. Under the Dodd-Frank Act, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary bank and, under appropriate circumstances, to commit resources to support the subsidiary bank. Qualified bank holding companies that elect to be financial holding companies may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity or (ii) complementary to a financial activity, and that does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as determined solely by the FRB). Activities that are financial in nature include securities underwriting and dealing, insurance underwriting and agency, and making merchant banking investments. The Company has not elected to become a financial holding company.

The BHC Act, the Bank Merger Act, and other federal and state statutes regulate acquisitions of commercial banks. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition of more than 5 percent of the voting shares of a commercial bank or its parent holding company. Under the Bank Merger Act, the prior approval of an acquiring bank s primary federal regulator is required before it may merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the applicant s performance record under the Community Reinvestment Act, consumer compliance, fair housing laws and the effectiveness of the subject organizations in combating money laundering activities.

Safety and Soundness Standards

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) implemented certain specific restrictions on transactions and required the regulators to adopt overall safety and soundness standards for depository institutions related to internal control, loan underwriting and documentation, and asset growth. Among other things, FDICIA limits the interest rates paid on deposits by undercapitalized institutions, the use of brokered deposits and the aggregate extension of credit by a depository institution to an executive officer, director, principal stockholder or related interest, and reduces deposit insurance coverage for deposits offered by undercapitalized institutions for deposits by certain employee benefits accounts.

Table of Contents

Section 39 to the Federal Deposit Insurance Act requires the agencies to establish safety and soundness standards for insured financial institutions covering:

- internal controls, information systems and internal audit systems;
- loan documentation;
- credit underwriting;
- interest rate exposure;
- asset growth;
- compensation, fees and benefits;
- asset quality, earnings and stock valuation; and
- excessive compensation for executive officers, directors or principal shareholders which could lead to material financial loss.

If an agency determines that an institution fails to meet any standard established by the guidelines, the agency may require the financial institution to submit to the agency an acceptable plan to achieve compliance with the standard. If the agency requires submission of a compliance plan and the institution fails to timely submit an acceptable plan or to implement an accepted plan, the agency must require the institution to correct the deficiency. An institution must file a compliance plan within 30 days of a request to do so from the institution s primary federal regulatory agency. The agencies may elect to initiate enforcement action in certain cases rather than rely on an existing plan particularly where failure to meet one or more of the standards could threaten the safe and sound operation of the institution.

Restrictions on Dividends and Distributions

A California corporation such as TriCo may make a distribution to its shareholders to the extent that either the corporation s retained earnings meet or exceed the amount of the proposed distribution or the value of the corporation s assets exceed the amount of its liabilities plus the amount of shareholders preferences, if any, and certain other conditions are met. It is the FRB s policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. In addition, TriCo s ability to pay dividends may be restricted if it does not maintain an adequate capital conservation buffer under the FRB s capital rules. See Regulatory Capital Requirements.

The primary source of funds for payment of dividends by TriCo to its shareholders has been and will continue to be the receipt of dividends and management fees from the Bank. TriCo s ability to receive dividends from the Bank is limited by applicable state and federal law. Under the California Financial Code, funds available for cash dividend payments by a bank are restricted to the lesser of: (i) retained earnings or (ii) the bank s net income for its last three fiscal years (less any distributions to shareholders made during such period). However, with the prior approval of the Commissioner of the DBO, a bank may pay cash dividends in an amount not to exceed the greatest of the: (1) retained earnings of the bank; (2) net income of the bank for its last fiscal year; or (3) net income of the bank for its current fiscal year. However, if the DBO finds that the shareholders equity of the bank is not adequate or that the payment of a dividend would be unsafe or unsound, the Commissioner may order the bank not to pay a dividend to shareholders.

Additionally, under FDICIA, a bank may not make any capital distribution, including the payment of dividends, if after making such distribution the bank would be in any of the undercapitalized categories under the FDIC s Prompt Corrective Action regulations. A bank is undercapitalized for this purpose if its leverage ratios, Tier 1 risk-based capital level and total risk-based capital ratio are not at least four percent, four percent and eight percent, respectively. In addition, the Bank s ability to pay dividends to TriCo may be restricted if the Bank does not maintain an adequate capital conservation buffer under the FDIC s capital rules. See Regulatory Capital Requirements.

The FRB, FDIC and the DBO have authority to prohibit a bank holding company or a bank from engaging in practices which are considered to be unsafe and unsound. Depending on the financial condition of TriCo and the Bank and other factors, the FRB, FDIC or the DBO could determine that payment of dividends or other payments by TriCo or the Bank might constitute an unsafe or unsound practice.

The Community Reinvestment Act

The Community Reinvestment Act of 1977 (the CRA) requires the federal banking regulatory agencies to periodically assess a bank s record of helping meet the credit needs of its entire community, including low- and moderate-income neighborhoods. The CRA also requires the agencies to consider a financial institution s record of meeting its community credit when evaluating applications for, among other things, domestic branches and mergers or acquisitions. The federal banking agencies rate depository institutions compliance with the CRA. The ratings range from a high of outstanding to a low of substantial noncompliance. A less than satisfactory rating could result in the suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of its most recent CRA examination, the Bank s CRA rating was Satisfactory.

Table of Contents

Consumer Protection Laws

The Bank is subject to many federal consumer protection statues and regulations, some of which are discussed below.

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

The Truth-in-Lending Act is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably.

The Fair Housing Act regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status.

The Home Mortgage Disclosure Act, which includes a fair lending aspect, requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

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

In addition, the CFPB has taken a number of actions that may affect the Bank s operations and compliance costs, including the following:

The issuance of final rules for residential mortgage lending, which became effective January 10, 2013, including definitions for qualified mortgages and detailed standards by which lenders must satisfy themselves of the borrower s ability to repay the loan and revised forms of disclosure under the Truth in Lending Act and the Real Estate Settlement Procedures Act

The issuance of a policy report on arbitration clauses which could result in the restriction or prohibition of lenders including arbitration clauses in consumer financial services contracts.

Actions taken to regulate and supervise credit bureaus and debt collections.

Positions taken by CFPB on fair lending, including applying the disparate impact theory in auto financing, which could make it harder for lenders, such as the Bank, to charge different rates or apply different terms to loans to different customers.

Penalties for violations of the above laws may include fines, reimbursements, injunctive relief and other penalties.

Regulatory Capital Requirements

The Company and the Bank are subject to the minimum capital requirements of the FDIC and the FRB, respectively. These capital requirements may restrict the Company s and the Bank s profitability and ability to pay dividends. If the Company or the Bank lacks adequate capital to increase its assets without violating the minimum capital requirements or if it is forced to reduce the level of its assets in order to satisfy regulatory capital requirements, its ability to generate earnings would be reduced.

The Company s and the Bank s primary federal regulators, the FRB and the FDIC, have adopted guidelines utilizing a risk-based capital structure. Under the risk-based capital rules applicable through December 31, 2014, banking organizations were required to maintain minimum ratios of Tier 1 capital and total capital to total risk-weighted assets (including certain off-balance sheet items, such as letters of credit). Qualifying capital is divided into two tiers. Tier 1 capital consists generally of common stockholders equity, retained earnings, qualifying noncumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual preferred stock (at the holding company level) and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and certain other intangible assets. Tier 2 capital consists of, among other things, allowance for loan and lease losses up to 1.25% of weighted risk assets, other perpetual preferred stock, hybrid capital instruments, perpetual debt, mandatory convertible debt, subordinated debt and intermediate-term preferred stock, subject to limitations. Tier 2 capital qualifies as part of total capital up to a maximum of 100% of Tier 1 capital. Under these risk-based capital guidelines, the Company is required to maintain total capital equal to at least 8% of its assets, of which at least 4% must be in the form of Tier 1 capital. In addition, the Bank is subject to minimum capital ratios under the regulatory framework for prompt corrective action discussed below under Prompt Corrective Action.

The Company and the Bank are also required to maintain a minimum leverage ratio of 4% of Tier 1 capital to total assets (the leverage ratio). The leverage ratio is determined by dividing an institution s Tier 1 capital by its quarterly average total assets, less goodwill and certain other intangible assets. The minimum leverage ratio constitutes a minimum requirement for the most well-run banking organizations. See Note 29 in the financial statements at Item 8 of this report for a discussion about the Company s risk-based capital and leverage ratios.

Table of Contents

In July, 2013, the federal banking agencies approved new capital rules implementing the Basel III regulatory capital reforms and other changes required by the Dodd-Frank Act. Basel III refers to capital guidelines adopted by the Basel Committee on Banking Supervision, which is a committee of central banks and bank supervisors/regulators from the major industrialized countries. The new capital rules include new risk-based capital and leverage ratios, which are being phased in from 2015 to 2019, and which refine the definition of what constitutes capital for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Company and the Bank as of January 1, 2015 under the new capital rules include: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from previous rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The new capital rules also establish a capital conservation buffer above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: The buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. Under the new capital rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its common equity capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The new capital rules provide regulators discretion to impose an additional capital buffer, the countercyclical buffer, of up to 2.5% of common equity Tier 1 capital to take into account the macro-financial environment and periods of excessive credit growth. However, the countercyclical buffer only applies to larger banks with $250 billion or more in total assets or $10 billion or more in total foreign exposures and is not expected to have an impact on the Company or the Bank.

The new capital rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments including trust preferred securities that will no longer qualify as Tier 1 capital, some of which will be phased out over time. However, the new capital rules provide that depository institution holding companies with less than $15 billion in total assets as of December 31, 2009, such as the Company, will be able to continue to include non-qualifying instruments that were issued and included in Tier 1 capital prior to May 19, 2010, such as the Company s Trust Preferred Securities, as Tier 1. This treatment is grandfathered and will apply even if the Company exceeds $15 billion assets due to organic growth. However, if the Company exceeds $15 billion in assets as the result of a merger or acquisition, then the Tier 1 treatment of its outstanding trust preferred securities will be phased out but may still be treated as Tier 2 capital.

The new capital rules also include changes for the calculation of risk-weighted assets, which are being phased in beginning January 1, 2015. The new capital rules utilizes an increased number of credit risk exposure categories and risk weights, and also addresses: (i) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (ii) revisions to recognition of credit risk mitigation; (iii) rules for risk weighting of equity exposures and past due loans; (iv) revised capital treatment for derivatives and repo-style transactions; and (v) disclosure requirements for top-tier banking organizations with $50 billion or more in total assets that are not subject to the advance approach rules that apply to banks with greater than $250 billion in consolidated assets.

We believe that we were in compliance with the requirements applicable to us as set forth in the new capital rules as of January 1, 2016.

Prompt Corrective Action

Prompt Corrective Action regulations of the federal bank regulatory agencies establish five capital categories in descending order (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized), assignment to which depends upon the institution s total risk-based capital ratio, Tier 1 risk-based capital ratio, and leverage ratio. The new capital rules revised the prompt corrective action framework. Under the new prompt corrective action framework, which is designed to complement the capital conservation buffer included in the new capital rules, insured depository institutions will be required to meet the following increased capital level requirements in order to qualify as well capitalized: (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%). Institutions classified in one of the three undercapitalized categories are subject to certain mandatory and discretionary supervisory actions, which include increased monitoring and review, implementation of capital restoration plans, asset growth restrictions, limitations upon expansion and new business activities, requirements to augment capital, restrictions upon deposit gathering and interest rates, replacement of senior executive officers and directors, and requiring divestiture or sale of the institution. The Bank has been classified as well-capitalized since adoption of these regulations.

Table of Contents

Deposit Insurance

Deposit accounts in the Bank are insured by the FDIC, generally up to a maximum of $250,000 per separately insured depositor. The Bank pays deposit insurance assessments based on its consolidated total assets less tangible equity capital. The assessment rate is based on the risk category of the institution. To determine the total base assessment rate, the FDIC first establishes an institution s initial base assessment rate and then adjusts the initial base assessment based upon an institution s levels of unsecured debt, secured liabilities, and brokered deposits. The total base assessment rate ranges from 2.5 to 45 basis points of the institution s average consolidated total assets less tangible equity capital.

The Bank is generally unable to control the amount of premiums that it is required to pay for FDIC insurance. If there are additional bank or financial institution failures or if the FDIC otherwise determines, the Bank may be required to pay even higher FDIC premiums than the recently increased levels. Increases in FDIC insurance premiums may have a material and adverse affect on the Company s earnings and could have a material adverse effect on the value of, or market for, the Company s common stock.

The FDIC may terminate a depository institution s deposit insurance upon a finding that the institution s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of the bank s depositors. The termination of deposit insurance for the Bank would also result in the revocation of the Bank s charter by the DBO.

Interstate Branching

The Dodd-Frank Act authorized national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks will be able to enter new markets more freely.

Anti-Money Laundering Laws

A series of banking laws and regulations beginning with the bank Secrecy Act in 1970 requires banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the USA Patriot Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships, requirements regarding the Customer Identification Program, as well as enhanced due diligence and know your customer standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities.

Transactions with Affiliates

Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders (including the Company) or any related interest of such persons. Extensions of credit must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with persons not affiliated with the bank, and must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to such persons. Regulation W requires that certain transactions between the Bank and its affiliates, including its holding company, be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving nonaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies.

Impact of Monetary Policies

Banking is a business that depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and other borrowings, and the interest rate earned by banks on loans, securities and other interest-earning assets comprises the major source of banks   earnings. Thus, the earnings and growth of banks are subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the FRB. The FRB implements national monetary policy, such as seeking to curb inflation and combat recession, by its open-market dealings in United States government securities, by adjusting the required level of reserves for financial institutions subject to reserve requirements and through adjustments to the discount rate applicable to borrowings by banks which are members of the FRB. The actions of the FRB in these areas influence the growth of bank loans, investments and deposits and also affect interest rates. The nature and timing of any future changes in such policies and their impact on the Company cannot be predicted. In addition, adverse economic conditions could make a higher provision for loan losses a prudent course and could cause higher loan loss charge-offs, thus adversely affecting the Company   s net earnings.

Table of Contents

ITEM 1A. RISK FACTORS

In analyzing whether to make or continue holding an investment in the Company, investors should consider, among other factors, the following:

Risks Related to the Nature and Geographic Area of Our Business

We are exposed to risks in connection with the loans we make.

As a lender, we face a significant risk that we will sustain losses because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. Our earnings are significantly affected by our ability to properly originate, underwrite and service loans. We have underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that we believe appropriately address this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying our respective loan portfolios. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect our results of operations. We could sustain losses if we incorrectly assess the creditworthiness of our borrowers or fail to detect or respond to deterioration in asset quality in a timely manner.

Our allowance for loan losses may not be adequate to cover actual losses.

Like other financial institutions, we maintain an allowance for loan losses to provide for loan defaults and non-performance. Our allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses would reduce our earnings could materially and adversely affect our business, financial condition, results of operations and cash flows. The allowance for loan losses reflects our estimate of the probable losses in our loan portfolio at the relevant balance sheet date. Our allowance for loan losses is based on prior experience, as well as an evaluation of the known risks in the current portfolio, composition and growth of the loan portfolio and economic factors. Determining an appropriate level of loan loss allowance is an inherently difficult process and is based on numerous assumptions. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, that may be beyond our control and these losses may exceed current estimates. Federal and state regulatory agencies, as an integral part of their examination process, review our loans and allowance for loan losses. While we believe that our allowance for loan losses is adequate to cover current losses, we cannot assure you that we will not increase the allowance for loan losses further or that the allowance will be adequate to absorb loan losses we actually incur. Either of these occurrences could have a material adverse affect on our business, financial condition and results of operations.

Our business may be adversely affected by business conditions in Northern and Central California.

We conduct most of our business in Northern and Central California. As a result of this geographic concentration, our financial results may be impacted by economic conditions in California. Deterioration in the economic conditions in California could result in the following consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows:

- problem assets and foreclosures may increase,
- demand for our products and services may decline,

- low cost or non-interest bearing deposits may decrease, and

- collateral for loans made by us, especially real estate, may decline in value, in turn reducing customers borrowing power, and reducing the value of assets and collateral associated with our existing loans.

In view of the concentration of our operations and the collateral securing our loan portfolio in both Northern and Central California, we may be particularly susceptible to the adverse effects of any of these consequences, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

A significant majority of the loans in our portfolio are secured by real estate and a downturn in our real estate markets could hurt our business.

A downturn in our real estate markets in which we conduct our business in California could hurt our business because most of our loans are secured by real estate. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies and acts of nature. As real estate prices decline, the value of real estate collateral securing our loans is reduced. As a result, our ability to recover on defaulted loans by foreclosing and selling the real estate collateral could then be diminished and we would be more likely to suffer losses on defaulted loans. As of December 31, 2016, approximately 91.0% of the book value of our loan portfolio consisted of loans collateralized by various types of real estate. Substantially all of our real estate collateral is located in California. So if there is a significant adversely decline in real estate values in California, the collateral for our loans will provide less security. Real estate values could also be affected by, among other things, earthquakes, drought and national disasters in our markets. Any such downturn could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We depend on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the California community banking industry. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of our senior management team of Messrs. Smith, Bailey, Carney, Fleshood, O Sullivan and Reddish, who have expertise in banking and collective experience in the California markets we serve and have targeted for future expansion. We also depend upon a number of other key executives who are California natives or are long-time residents and who are integral to implementing our business plan. The loss of the services of any one of our senior executive management team or other key executives could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We are exposed to the risk of environmental liabilities with respect to properties to which we take title.

In the course of our business, we may foreclose and take title to real estate and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we become subject to significant environmental liabilities, our business, financial condition, results of operations and cash flows could be materially adversely affected.

Strong competition in California could hurt our profits.

Competition in the banking and financial services industry is intense. Our profitability depends upon our continued ability to successfully compete. We compete exclusively in Northern and Central California for loans, deposits and customers with commercial banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage firms and Internet-based marketplace lending platforms. In particular, our competitors include major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous locations and mount extensive promotional and advertising campaigns. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions may have larger lending limits which would allow them to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain loan and deposit customers and a range in quality of products and services provided, including new technology-driven products and services. Technological innovation continues to contribute to greater competition in domestic and international financial services markets as technological advances enable more companies, such as Internet-based marketplace lenders, to provide financial services, often without many of regulatory and capital restrictions that we face.. We also face competition from out-of-state financial intermediaries that have opened loan production offices or that solicit deposits in our market areas. If we are unable to attract and retain banking customers, we may be unable to continue our loan growth and level of deposits and our business, financial condition, results of operations and cash flows may be adversely affected.

Our previous results may not be indicative of our future results.

We may not be able to sustain our historical rate of growth and level of profitability or may not even be able to grow our business or continue to be profitable at all. Various factors, such as economic conditions, regulatory and legislative considerations and competition, may also impede or prohibit our ability to expand our market presence and financial performance. If we experience a significant decrease in our historical rate of growth, our results of operations and financial condition may be adversely affected due to a high percentage of our operating costs being fixed expenses.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral that we hold cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse affect on our financial condition and results of operations.

Severe weather, natural disasters and other external events could adversely affect our business.

Severe weather, drought, fires, natural disasters such as earthquakes, or acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could also affect the stability of the Bank s deposit base; impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans and cause significant property damage, result in losses of revenue and/or cause us to incur additional expenses. Although we have established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, financial condition and results of operations.

Market and Interest Rate Risk

Low interest rates could hurt our profits.

Our ability to earn a profit, like that of most financial institutions, depends on our net interest income, which is the difference between the interest income we earn on our interest-earning assets, such as mortgage loans and investments, and the interest expense we pay on our interest-bearing liabilities, such as deposits. Our profitability depends on our ability to manage our assets and liabilities during periods of changing market interest rates. Recently, the FRB has maintained the targeted federal funds rate at record low levels. A sustained decrease in market interest rates could adversely affect our earnings. When interest rates decline, borrowers tend to refinance higher-rate, fixed-rate loans at lower rates. Under those circumstances, we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on the prepaid loans on investment securities. In addition, our commercial real estate and commercial loans, which carry interest rates that adjust in accordance with changes in the prime rate, will adjust to lower rates.

Our business is subject to interest rate risk and variations in interest rates may negatively affect our financial performance.

Because of the differences in the maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our interest rate spread and, in turn, our profitability. In addition, loan origination volumes are affected by market interest rates. Rising interest rates, generally, are associated with a lower volume of loan originations while lower interest rates are usually associated with higher loan originations. Conversely, in rising interest rate environments, loan repayment rates may decline and in falling interest rate environments, loan repayment rates may increase. Although we have been successful in generating new loans during 2016, the continuation of historically low long-term interest rate levels may cause additional refinancing of commercial real estate and 1-4 family residence loans, which may depress our loan volumes or cause rates on loans to decline. In addition, an increase in the general level of short-term interest rates on variable rate loans may adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations or reduce the amount they wish to borrow. Additionally, if short-term market rates rise, in order to retain existing deposit customers and attract new deposit customers we may need to increase rates we pay on deposit accounts. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest spread, asset quality, loan origination volume, business, financial condition, results of operations and cash flows.

Regulatory Risks

Recently enacted financial reform legislation has, among other things, created a new Consumer Financial Protection Bureau, tightened capital standards and resulted in new laws and regulations that are expected to increase our costs *of operations.*

The Dodd-Frank Act, which was enacted in 2010, significantly changed the current bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. Among other things, the Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit unfair, deceptive or abusive acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks with $10 billion or less in assets, such as the Bank, are subject to the CFPB s rules but continue to be examined for compliance with the consumer laws by their primary bank regulators. In addition, the Dodd-Frank Act required the FDIC and FRB to adopt new, more stringent capital rules that apply to us. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

Table of Contents

It is difficult to predict the continuing impact that the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

We operate in a highly regulated environment and we may be adversely affected by new laws and regulations or changes in existing laws and regulations. Regulations may prevent or impair our ability to pay dividends, engage in acquisitions or operate in other ways.

We are subject to extensive regulation, supervision and examination by the DBO, FDIC, and the FRB. See Item 1 Regulation and Supervision of this report for information on the regulation and supervision which governs our activities. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Banking regulations, designed primarily for the protection of depositors, may limit our growth and the return to our shareholders by restricting certain of our activities, such as:

- the payment of dividends to our shareholders,
- possible mergers with or acquisitions of or by other institutions,
- desired investments,
- loans and interest rates on loans,
- interest rates paid on deposits,
- service charges on deposit account transactions,
- service charges on deposit account transactions
- the possible expansion of branch offices, and
- the ability to provide securities or trust services.

We also are subject to regulatory capital requirements and could be subject to enforcement actions to the extent that we don t meet these requirements. Federal and state governments and regulators could pass legislation and adopt policies responsive to current credit conditions that would have an adverse effect on the Company and its financial performance. We cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material adverse impact on our operations.

Compliance with changing regulation of corporate governance and public disclosure may result in additional risks and expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Act, the Sarbanes-Oxley Act of 2002 and new SEC regulations, are creating additional expense for publicly-traded companies such as TriCo. The application of these laws, regulations and standard may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased expenses and a diversion of management time and attention. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding management s required assessment of its internal control over financial reporting and its external auditors audit of that assessment requires, and will continue to require, the commitment of significant financial and managerial resources. Further, the members of our board of directors, members of our audit or compensation and management succession committees, our chief executive officer, our chief financial officer and certain other executive officers could face an increased risk of personal liability in connection with the performance of their duties. It may also become more difficult and more expensive to obtain director and officer liability insurance. As a result, our ability to attract and retain executive officers and qualified board and committee members could be more difficult.

Risks Related to Growth and Expansion

Goodwill resulting from the acquisition of North Valley Bancorp may adversely affect our results of operations.

Goodwill and other intangible assets have increased substantially as a result of the acquisition of North Valley Bancorp. Potential impairment of goodwill and amortization of other intangible assets could adversely affect our financial condition and results of operations. We assess our goodwill and other intangible assets and long-lived assets for impairment annually and more frequently when required by U.S. GAAP. We are required to record an impairment charge if circumstances indicate that the asset carrying values exceed their fair values. Our assessment of goodwill, other intangible assets, or long-lived assets could indicate that an impairment of the carrying value of such assets may have occurred that could result in a material, non-cash write-down of such assets, which could have a material adverse effect on our results of operations and future earnings.

Table of Contents

If we cannot attract deposits, our growth may be inhibited.

We plan to increase the level of our assets, including our loan portfolio. Our ability to increase our assets depends in large part on our ability to attract additional deposits at favorable rates. We intend to seek additional deposits by offering deposit products that are competitive with those offered by other financial institutions in our markets and by establishing personal relationships with our customers. We cannot assure that these efforts will be successful. Our inability to attract additional deposits at competitive rates could have a material adverse effect on our business, financial condition, results of operations and cash flows.

There are potential risks associated with future acquisitions and expansions.

We intend to continue to explore expanding our branch system through opening new bank branches and in-store branches in existing or new markets in Northern and Central California. In the ordinary course of business, we evaluate potential branch locations that would bolster our ability to cater to the small business, individual and residential lending markets in California. Any given new branch, if and when opened, will have expenses in excess of revenues for varying periods after opening that may adversely affect our results of operations or overall financial condition.

In addition, to the extent that we acquire other banks in the future, our business may be negatively impacted by certain risks inherent with such acquisitions. These risks include:

- incurring substantial expenses in pursuing potential acquisitions without completing such acquisitions,
- losing key clients as a result of the change of ownership,
- the acquired business not performing in accordance with our expectations,
- difficulties arising in connection with the integration of the operations of the acquired business with our operations,
- needing to make significant investments and infrastructure, controls, staff, emergency backup facilities or other critical business functions that become strained by our growth,
- management needing to divert attention from other aspects of our business,
- potentially losing key employees of the acquired business,
- incurring unanticipated costs which could reduce our earnings per share,

assuming potential liabilities of the acquired company as a result of the acquisition, and

an acquisition may dilute our earnings per share, in both the short and long term, or it may reduce our tangible capital ratios.

As result of these risks, any given acquisition, if and when consummated, may adversely affect our results of operations or financial condition. In addition, because the consideration for an acquisition may involve cash, debt or the issuance of shares of our stock and may involve the payment of a premium over book and market values, existing shareholders may experience dilution in connection with any acquisition.

Our growth and expansion may strain our ability to manage our operations and our financial resources.

Our financial performance and profitability depend on our ability to execute our corporate growth strategy. In addition to seeking deposit and loan and lease growth in our existing markets, we may pursue expansion opportunities in new markets. Continued growth, however, may present operating and other problems that could adversely affect our business, financial condition, results of operations and cash flows. Accordingly, there can be no assurance that we will be able to execute our growth strategy or maintain the level of profitability that we have recently experienced.

Our growth may place a strain on our administrative, operational and financial resources and increase demands on our systems and controls. This business growth may require continued enhancements to and expansion of our operating and financial systems and controls and may strain or significantly challenge them. In addition, our existing operating and financial control systems and infrastructure may not be adequate to maintain and effectively monitor future growth. Our continued growth may also increase our need for qualified personnel. We cannot assure you that we will be successful in attracting, integrating and retaining such personnel.

Our decisions regarding the fair value of assets acquired from North Valley Bancorp, Citizens Bank of Northern California and Granite Community Bank, including the FDIC loss sharing assets or liabilities associated with Granite, could be inaccurate which could materially and adversely affect our business, financial condition, results of operations, and future prospects.

Management makes various assumptions and judgments about the collectability of acquired loans, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of secured loans. In FDIC-assisted acquisitions that include loss sharing agreements, such as our acquisition of Granite

Table of Contents

Community Bank, we may record a loss sharing asset or liability that we consider adequate to absorb future losses or recoveries which may occur in the acquired loan portfolio. In determining the size of the loss sharing asset or liability, we analyze the loan portfolio based on historical loss experience, volume and classification of loans, volume and trends in delinquencies and nonaccruals, local economic conditions, and other pertinent information.

If our assumptions are incorrect, the balance of the FDIC indemnification asset or liability may at any time be insufficient to cover future loan losses or recoveries, and credit loss provisions may be needed to respond to different economic conditions or adverse developments in the acquired loan portfolio. Any increase in future loan losses could have a negative effect on our operating results.

Our ability to obtain reimbursement under the loss sharing agreement on covered assets purchased from the FDIC depends on our compliance with the terms of the loss sharing agreement.

We must certify to the FDIC on a quarterly basis our compliance with the terms of the FDIC loss sharing agreement as a prerequisite to obtaining reimbursement from the FDIC for realized losses on covered assets. The required terms of the agreements are extensive and failure to comply with any of the guidelines could result in a specific asset or group of assets permanently losing their loss sharing coverage. Additionally, Management may decide to forgo loss share coverage on certain assets to allow greater flexibility over the management of certain assets. As of December 31, 2016, $3,399,000, or 0.08%, of the Company s assets were covered by these FDIC loss sharing agreements.

Risks Relating to Dividends and Our Common Stock

Our future ability to pay dividends is subject to restrictions.

As a holding company with no significant assets other than the Bank, we depend on dividends from the Bank to fund our operations and for a substantial portion of our revenues. Our ability to continue to pay dividends depends in large part upon our receipt of dividends or other capital distributions from the Bank. The ability of the Bank to pay dividends or make other capital distributions to us is subject to the restrictions in the California Financial Code. As of December 31, 2016, the Bank could have paid approximately $82,615,000 in dividends to TriCo without the prior approval of the DBO. The amount that the Bank may pay in dividends is further restricted due to the fact that the Bank must maintain a certain minimum amount of capital to be considered a well capitalized institution as well as a separate capital conservation buffer, as further described under Item 1 Supervision and Regulation Regulatory Capital Requirements in this report.

From time to time, we may become a party to financing agreements or other contractual arrangements that have the effect of limiting or prohibiting us or the Bank from declaring or paying dividends. Our holding company expenses and obligations with respect to our trust preferred securities and corresponding junior subordinated deferrable interest debentures issued by us may limit or impair our ability to declare or pay dividends. Finally, our ability to pay dividends is also subject to the restrictions of the California Corporations Code. See Regulation and Supervision Restrictions on Dividends and Distributions.

Anti-takeover provisions and federal law may limit the ability of another party to acquire us, which could cause our stock price to decline.

Various provisions of our articles of incorporation and bylaws could delay or prevent a third party from acquiring us, even if doing so might be beneficial to our shareholders. These provisions provide for, among other things, specified actions that the Board of Directors shall or may take when an offer to merge, an offer to acquire all assets or a tender offer is received and the authority to issue preferred stock by action of the board of directors acting alone, without obtaining shareholder approval.

The BHC Act and the Change in Bank Control Act of 1978, as amended, together with federal regulations, require that, depending on the particular circumstances, either FRB approval must be obtained or notice must be furnished to the FRB and not disapproved prior to any person or entity acquiring control of a bank holding company such as TriCo. These provisions may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

The amount of common stock owned by, and other compensation arrangements with, our officers and directors may make it more difficult to obtain shareholder approval of potential takeovers that they oppose.

As of December 31, 2016, directors and executive officers beneficially owned approximately 8.9% of our common stock and our Employee Stock Ownership Plan owned approximately 5.5%. Agreements with our senior management also provide for significant payments under certain circumstances following a change in control. These compensation arrangements, together with the common stock and option ownership of our board of directors and management, could make it difficult or expensive to obtain majority support for shareholder proposals or potential acquisition proposals of us that our directors and officers oppose.

Table of Contents

We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing shareholders.

In order to maintain our capital at desired or regulatorily-required levels, or to fund future growth, our board of directors may decide from time to time to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of our common stock. The sale of these shares may significantly dilute your ownership interest as a shareholder. New investors in the future may also have rights, preferences and privileges senior to our current shareholders which may adversely impact our current shareholders.

Holders of our junior subordinated debentures have rights that are senior to those of our common stockholders.

We have supported our continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2016, we had outstanding trust preferred securities and accompanying junior subordinated debentures with face value of $62,889,000. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us. Further, the accompanying junior subordinated debentures we issued to the trusts are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures before any dividends can be paid on our common stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on our common stock.

Risks Relating to Systems, Accounting and Internal Controls

If we fail to maintain an effective system of internal and disclosure controls, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential shareholders could lose confidence in our financial reporting, which would harm our business and the trading price of our securities.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We continually review and analyze our internal control over financial reporting for Sarbanes-Oxley Section 404 compliance. As part of that process we may discover material weaknesses or significant deficiencies in our internal control as defined under standards adopted by the Public Company Accounting Oversight Board that require remediation. Material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected in a timely basis. Significant deficiency is a deficiency or combination of deficiencies, in internal control over financial reporting that is less severe than material weakness, yet important enough to merit attention by those responsible for the oversight of the Company s financial reporting.

As a result of weaknesses that may be identified in our internal control, we may also identify certain deficiencies in some of our disclosure controls and procedures that we believe require remediation. If we discover weaknesses, we will make efforts to improve our internal and disclosure control. However, there is no assurance that we will be successful. Any failure to maintain effective controls or timely effect any necessary improvement of our internal and disclosure controls could harm operating results or cause us to fail to meet our reporting obligations, which could affect our ability to remain listed with Nasdaq. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a negative effect on the trading price of our securities.

We rely on communications, information, operating and financial control systems technology and we may suffer an interruption in or breach of the security of those systems.

We rely heavily on our communications, information, operating and financial control systems technology to conduct our business. We rely on third party services providers to provide many of these systems. Any failure, interruption or breach in security of these systems could result in failures or interruptions in our customer relationship management, general ledger, deposit, servicing and loan origination systems. We cannot assure you that such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed by us or the third parties service providers on which we rely. The occurrence of any failures, interruptions or security breaches could damage our reputation, result in a loss of customers, expose us to possible financial liability, lead to additional regulatory scrutiny or require that we make expenditures for remediation or prevention. Any of these circumstances could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Table of Contents

A failure to implement technological advances could negatively impact our business.

The banking industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources than we do to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or successfully market such products and services to our customers.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company is engaged in the banking business through 68 offices in 26 counties in Northern and Central California including twelve offices in Shasta County, eight in Butte County, six in Humboldt and Nevada Counties, four in Placer and Sacramento Counties, three in Siskiyou and Stanislaus Counties, two each in Glenn, Mendocino, Sutter and Trinity Counties, and one each in Colusa, Contra Costa, Del Norte, Fresno, Kern, Lake, Lassen, Madera, Merced, Sonoma, Tehama, Tulare, Yolo and Yuba Counties. All offices are constructed and equipped to meet prescribed security requirements.

The Company owns twenty-nine branch office locations, five administrative buildings, and two other buildings that it leases out. The Company leases thirty-nine branch office locations, two loan production offices, and three administrative locations. Most of the leases contain multiple renewal options and provisions for rental increases, principally for changes in the cost of living index, property taxes and maintenance.

ITEM 3. LEGAL PROCEEDINGS

On September 15, 2014, a former Personal Banker at one of the Bank s in-store branches filed a Class Action Complaint against the Bank in Butte County Superior Court, alleging causes of action related to the observance of meal and rest periods and seeking to represent a class of current and former hourly-paid or non-exempt personal bankers, or employees with the same or similar job duties, employed by the Bank within the State of California during the preceding four years. On or about June 25, 2015, Plaintiff filed an Amended Complaint expanding the class definition to all current and formerly hourly-paid or non-exempt branch employees employed by the Bank within the State of California at any time during the period from September 15, 2010 to final judgment. The Bank responded to the First Amended Complaint, denying the charges, and the parties engaged in written discovery. The parties engaged in non-binding mediation of this action during the third quarter of 2016.

On January 20, 2015, a then-current Personal Banker at one of the Bank s in-store branches filed a First Amended Complaint against Tri Counties Bank and TriCo Bancshares, dba Tri Counties Bank, in Sacramento County Superior Court, alleging causes of action related to wage statement violations. Plaintiff seeks to represent a class of current and former exempt and non-exempt employees who worked for the defendants during the time period beginning October 18, 2013 through the date of the filing of this action. The Company and the Bank responded to the First Amended Complaint, denying the charges, and engaged in written discovery with Plaintiff. The parties engaged in non-binding mediation of this action during the third quarter of 2016.

During the third quarter of 2016, the Bank agreed to settle the two foregoing matters. In connection with the settlement and in consideration for the full settlement and release of all claims, the Bank would pay up to $1.9 million. The actual cost of the settlement will depend on the number of claims submitted by purported class members and the Bank estimates that the actual cost of settlement will be approximately $1,450,000. In the event that the parties enter into a stipulation of settlement, hearings will be scheduled at which the court will consider the settlement. The settlement is subject to customary conditions, including court approval following notice to members of the purported classes. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that the court will approve the settlement even if the parties were to enter into such stipulation.

ITEM 4. MINE SAFETY DISCLOSURES

Inapplicable.

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common Stock Market Prices and Dividends

The Company s common stock is traded on the Nasdaq under the symbol TCBK. The following table shows the high and the low closing sale prices for the common stock for each quarter in the past two years, as reported by Nasdaq:

	High	Low
2016:		
Fourth quarter	$ 34.46	$ 25.49
Third quarter	$ 28.40	$ 25.40
Second quarter	$ 28.90	$ 24.60
First quarter	$ 27.44	$ 23.80
2015:		
Fourth quarter	$ 29.39	$ 24.25
Third quarter	$ 25.55	$ 23.08
Second quarter	$ 24.75	$ 23.18
First quarter	$ 24.77	$ 22.82

As of February 24, 2017 there were approximately 1,616 shareholders of record of the Company s common stock. On February 24, 2017, the closing sales price was $37.18.

The Company has paid cash dividends on its common stock in every quarter since March 1990, and it is currently the intention of the Board of Directors of the Company to continue payment of cash dividends on a quarterly basis. There is no assurance, however, that any dividends will be paid since they are dependent upon earnings, financial condition and capital requirements of the Company and the Bank. As of December 31, 2016 $82,615,000 was available for payment of dividends by the Bank to the Company, under applicable laws and regulations. The Company paid cash dividends of $0.15 per common share in each of the quarters ended December 31, 2016, September 30, 2016, June 30, 2016, March 31, 2016, and December 31, 2015, and $0.13 per common share in each of the quarters ended September 30, 2015, June 30, 2015, and $0.11 per common share in the quarter ended March 31, 2015.

Issuer Repurchases of Common Stock

The Company adopted a stock repurchase plan on August 21, 2007 for the repurchase of up to 500,000 shares of the Company s common stock from time to time as market conditions allow. The 500,000 shares authorized for repurchase under this plan represented approximately 3.2% of the Company s approximately 15,815,000 common shares outstanding as of August 21, 2007. This plan has no stated expiration date for the repurchases. As of December 31, 2016, the Company had purchased 166,600 shares under this plan.

The following table shows the repurchases made by the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) during the fourth quarter of 2016:

Period	(a) Total number of shares purchased[1]	(b) Average price paid per share	(c) Total number of shares purchased as of part of publicly announced plans or programs	(d) Maximum number shares that may yet be purchased under the plans or programs[2]
Oct. 1-31, 2016				333,400
Nov. 1-30, 2016	176,779	$ 30.72		333,400
Dec. 1-31, 2016	1,407	$ 34.18		333,400
Total	178,186	$ 30.74		333,400

(1) Includes shares purchased by the Company s Employee Stock Ownership Plan and pursuant to various other equity incentive plans. See Note 19 to the consolidated financial statements at Item 8 of Part II of this report, for a discussion of the Company s stock repurchased under equity compensation plans.

(2) Does not include shares that may be purchased by the Company s Employee Stock Ownership Plan and pursuant to various other equity incentive plans.

Table of Contents

The following graph presents the cumulative total yearly shareholder return from investing $100 on December 31, 2011, in each of TriCo common stock, the Russell 3000 Index, and the SNL Western Bank Index. The SNL Western Bank Index compiled by SNL Financial includes banks located in California, Oregon, Washington, Montana, Hawaii and Alaska with market capitalization similar to that of TriCo s. The amounts shown assume that any dividends were reinvested.

TriCo Bancshares

	Period Ending					
Index	**12/31/11**	**12/31/12**	**12/31/13**	**12/31/14**	**12/31/15**	**12/31/16**
TriCo Bancshares	100.00	120.43	207.94	184.41	209.08	266.01
Russell 3000	100.00	116.42	155.47	175.00	175.84	198.23
SNL Western Bank	100.00	126.20	177.56	213.09	220.79	244.77

Equity Compensation Plans

The following table shows shares reserved for issuance for outstanding options, stock appreciation rights and warrants granted under our equity compensation plans as of December 31, 2016. All of our equity compensation plans have been approved by shareholders.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans not approved by shareholders			
Equity compensation plans approved by shareholders	708,126	$ 17.12	637,262
Total	708,126	$ 17.12	637,262

18

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data are derived from our consolidated financial statements. This data should be read in connection with our consolidated financial statements and the related notes located at Item 8 of this report.

TRICO BANCSHARES

Financial Summary

(in thousands, except per share amounts)

Year ended December 31,	2016	2015	2014	2013	2012
Interest income	$ 173,708	$ 161,414	$ 121,115	$ 106,560	$ 108,716
Interest expense	5,721	5,416	4,681	4,696	7,344
Net interest income	167,987	155,998	116,434	101,864	101,372
(Benefit from) provision for loan losses	(5,970)	(2,210)	(4,045)	(715)	9,423
Noninterest income	44,563	45,347	34,516	36,829	37,980
Noninterest expense	145,997	130,841	110,379	93,604	97,998
Income before income taxes	72,523	72,714	44,616	45,804	31,931
Provision for income taxes	27,712	28,896	18,508	18,405	12,937
Net income	$ 44,811	$ 43,818	$ 26,108	$ 27,399	$ 18,994
Earnings per share:					
Basic	$ 1.96	$ 1.93	$ 1.47	$ 1.71	$ 1.19
Diluted	$ 1.94	$ 1.91	$ 1.46	$ 1.69	$ 1.18
Per share:					
Dividends paid	$ 0.60	$ 0.52	$ 0.44	$ 0.42	$ 0.36
Book value at December 31	$ 20.87	$ 19.85	$ 18.41	$ 15.61	$ 14.33
Tangible book value at December 31	$ 17.77	$ 16.81	$ 15.31	$ 14.59	$ 13.30
Average common shares outstanding	22,814	22,750	17,716	16,045	15,988
Average diluted common shares outstanding	23,087	22,998	17,923	16,197	16,052
Shares outstanding at December 31	22,868	22,775	22,715	16,077	16,001
At December 31:					
Loans, net of allowance	$ 2,727,090	$ 2,486,926	$ 2,245,939	$ 1,633,762	$ 1,522,175
Total assets	4,517,968	4,220,722	3,916,458	2,744,066	2,609,269
Total deposits	3,895,560	3,631,266	3,380,423	2,410,483	2,289,702
Other borrowings	17,493	12,328	9,276	6,335	9,197
Junior subordinated debt	56,667	56,470	56,272	41,238	41,238

Shareholders equity	477,347	452,116	418,172	250,946	229,359
Financial Ratios:					
For the year:					
Return on average assets	1.02%	1.11%	0.87%	1.04%	0.75%
Return on average equity	9.46%	10.04%	8.67%	11.34%	8.44%
Net interest margin[1]	4.23%	4.32%	4.17%	4.18%	4.32%
Net loan (recoveries) losses to average loans	(0.09)%	(0.07)%	(0.13)%	0.23%	0.82%
Efficiency ratio[2]	67.9%	64.7%	72.9%	67.3%	70.2%
Average equity to average assets	10.84%	11.01%	10.00%	9.21%	8.91%
Dividend payout ratio	30.6%	27.2%	30.1%	24.9%	30.5%
At December 31:					
Equity to assets	10.57%	10.71%	10.68%	9.15%	8.79%
Total capital to risk-adjusted assets	14.65%	15.09%	15.63%	14.77%	14.53%

1 Fully taxable equivalent.

2 The sum of fully taxable equivalent net interest income and noninterest income divided by noninterest expense.

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

General

As TriCo Bancshares has not commenced any business operations independent of the Bank, the following discussion pertains primarily to the Bank. Average balances, including such balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management s Discussion and Analysis of Financial Condition and Results of Operations, interest income and net interest income are generally presented on a fully tax-equivalent (FTE) basis. The presentation of interest income and net interest income on a FTE basis is a common practice within the banking industry. Interest income and net interest income are shown on a non-FTE basis in this Item 7 this report, and a reconciliation of the FTE and non-FTE presentations is provided below in the discussion of net interest income.

Critical Accounting Policies and Estimates

The Company s discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those that materially affect the financial statements and are related to the adequacy of the allowance for loan losses, investments, mortgage servicing rights, fair value measurements, retirement plans, intangible assets and the fair value of acquired assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company s policies related to estimates on the allowance for loan losses, other than temporary impairment of investments and impairment of intangible assets, can be found in Note 1 in the financial statements at Item 8 of this report.

Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances for the Company. Within Management s Discussion and Analysis of Financial Condition and Results of Operations, certain performance measures including interest income, net interest income, net interest yield, and efficiency ratio are generally presented on a fully tax-equivalent (FTE) basis. The Company believes the use of these non-generally accepted accounting principles (non-GAAP) measures provides additional clarity in assessing its results.

On March 18, 2016, the Bank completed its acquisition of three branch banking offices from Bank of America originally announced October 28, 2015. The acquired branches are located in Arcata, Eureka and Fortuna in Humboldt County on the North Coast of California, and have significant overlap compared to the Company s then-existing Northern California customer base and branch locations. As a result, these branch acquisitions create potential cost savings and future growth potential. With the levels of capital at the time, the acquisitions fit well into the Company s growth strategy. Also on March 18, 2016, the electronic customer service and other data processing systems of the acquired branches were converted into the Bank s systems, and the effect of revenue and expenses from the operations of the acquired branches are included in the results of the Company. The Bank paid a premium of $3,204,000 for deposit relationships with balances of $161,231,000 and loans with balances of $289,000, and received cash of $159,520,000 from Bank of America.

On October 3, 2014, TriCo completed the acquisition of North Valley Bancorp. As part of the acquisition, North Valley Bank, a wholly-owned subsidiary of North Valley Bancorp, merged with and into Tri Counties Bank. In the acquisition, each share of North Valley common stock was converted into the right to receive 0.9433 shares of TriCo common stock. TriCo issued an aggregate of approximately 6.58 million shares of TriCo common stock to North Valley Bancorp shareholders, which was valued at a total of approximately $151 million based on the closing trading price of TriCo common stock on October 3, 2014 of $21.73. TriCo also assumed North Valley Bancorp s obligations with respect to its outstanding trust preferred securities. Beginning on October 4, 2014, the effect of revenue and expenses from the operations of North Valley Bancorp, and the TriCo Bancshares common shares issued in consideration of the merger are included in the results of the Company.

North Valley Bank was a full-service commercial bank headquartered in Redding, California. North Valley conducted a commercial and retail banking services which included accepting demand, savings, and money market rate deposit accounts and time deposits, and making commercial, real estate and consumer loans. North Valley Bank had approximately $935 million in assets and 22 commercial banking offices in Shasta, Humboldt, Del Norte, Mendocino, Yolo, Sonoma, Placer and Trinity Counties in Northern California at June 30, 2014. See Note 2 in the financial statements at Item 8 of Part II of this report for a discussion about this transaction.

On September 23, 2011, the California DBO closed Citizens Bank of Northern California (Citizens), Nevada City, California and appointed the FDIC as receiver. That same date, the Bank assumed the banking operations of Citizens from the FDIC under a whole bank purchase and assumption agreement without loss sharing. With this agreement, the Bank added seven traditional bank branches including two in Grass Valley, and one in each of Nevada City, Penn Valley, Lake of the Pines, Truckee, and Auburn, California. This acquisition is consistent with the Bank s community banking expansion strategy and provides further opportunity to fill in the Bank s market presence in the Northern California market.

Table of Contents

On May 28, 2010, the Office of the Comptroller of the Currency closed Granite Community Bank (Granite), Granite Bay, California and appointed the FDIC as receiver. That same date, the Bank assumed the banking operations of Granite from the FDIC under a whole bank purchase and assumption agreement with loss sharing. Under the terms of the loss sharing agreement, the FDIC will cover a substantial portion of any future losses on loans, related unfunded loan commitments, other real estate owned (OREO)/foreclosed assets and accrued interest on loans for up to 90 days. The FDIC will absorb 80% of losses and share in 80% of loss recoveries on the covered assets acquired from Granite. The loss sharing arrangements for non-single family residential and single family residential loans are in effect for 5 years and 10 years, respectively, and the loss recovery provisions are in effect for 8 years and 10 years, respectively, from the acquisition date. With this agreement, the Bank added one traditional bank branch in each of Granite Bay and Auburn, California. This acquisition is consistent with the Bank s community banking expansion strategy and provides further opportunity to fill in the Bank s market presence in the greater Sacramento, California market.

The Company refers to loans and foreclosed assets that are covered by loss sharing agreements as covered loans and covered foreclosed assets , respectively. In addition, the Company refers to loans purchased or obtained in a business combination as purchased credit impaired (PCI) loans, or purchased not credit impaired (PNCI) loans. The Company refers to loans that it originates as originated loans. Additional information regarding the North Valley Bancorp acquisition can be found in Note 2 in the financial statements at Item 8 of this report. Additional information regarding the definitions and accounting for originated, PNCI and PCI loans can be found in Notes 1, 2, 4 and 5 in the financial statements at Item 8 of this report, and under the heading *Asset Quality and Non-Performing Assets* below.

Geographical Descriptions

For the purpose of describing the geographical location of the Company s loans, the Company has defined northern California as that area of California north of, and including, Stockton; central California as that area of the State south of Stockton, to and including, Bakersfield; and southern California as that area of the State south of Bakersfield.

Results of Operations

Overview

The following discussion and analysis is designed to provide a better understanding of the significant changes and trends related to the Company and the Bank s financial condition, operating results, asset and liability management, liquidity and capital resources and should be read in conjunction with the consolidated financial statements of the Company and the related notes at Item 8 of this report.

Following is a summary of the components of net income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2016	2015	2014
Components of Net Income			
Net interest income	$ 167,987	$ 155,998	$ 116,434
Benefit from (provision for) loan losses	5,970	2,210	4,045
Noninterest income	44,563	45,347	34,516
Noninterest expense	(145,997)	(130,841)	(110,379)
Taxes	(27,712)	(28,896)	(18,508)

Net income	$ 44,811	$ 43,818	$ 26,108
Net income per average fully-diluted share	$ 1.94	$ 1.91	$ 1.46
Net income as a percentage of average shareholders equity	9.46%	10.04%	8.67%
Net income as a percentage of average total assets	1.02%	1.11%	0.87%

Included in the Company s results of operations for the year ended December 31, 2016 is the ongoing impact of the Company s acquisition, on March 18, 2016, of three branch offices from Bank of America that included the acquisition of deposit relationships with balances totaling $161,231,000. Interest expense associated with the acquired deposit relationships was $5,000 from March 18, 2016 to March 31, 2016, and interest income from the net cash received in the transaction was estimated to be $27,000, assuming it was invested in Fed funds at an annualized earnings rate of 0.50%. Direct noninterest income and expense related to these branches from March 18, 2016 to March 31, 2016 were $14,000 and $659,000, respectively. Included in the $659,000 of noninterest expense related to these branches for the three months ended March 31, 2016 was $10,000 of core deposit intangible amortization, and $622,000 of nonrecurring acquisition expenses such as system conversion and customer communication related expenses. Other (indirect) noninterest income and expenses related to these branches and associated deposits, such as, increased data processing expense, are not readily distinguishable on a branch by branch basis. On June 8, 2016, the Company consolidated a preexisting branch into one of the branches acquired from Bank of America.

Also included in the Company s results of operations for the year ended December 31, 2016 is the impact of the sale on December 28, 2016, of twenty performing loans with recorded book value of $1,975,000, and 49 nonperforming loans with recorded book value, including pre-sale write downs and purchase discounts, of approximately $2,709,000. The loans sold on December 28, 2016 had contractual amounts outstanding of $7,100,000. Net sale proceeds of $5,851,000 resulted in the recovery of loan balances previously charged off of $692,000, additional loan charge offs of $316,000, interest income of $586,000 from the recovery of interest payments previously applied to principal balances, and gain on sale of $205,000. In addition, associated with the loans sold on December 28, 2016 were specific allowances for loan loss of $503,000 on September 30, 2016 that were no longer necessary at December 31, 2016; and had these loans not been sold, it is expected that the allowance for loan losses would have been approximately $503,000 higher than reported at December 31, 2016, and the reversal of provision for loan losses for the year ended December 31, 2016 would have been approximately $503,000 less than reported.

Also included in the Company s results of operations for the year ended December 31, 2016 is the impact of the sale on August 22, 2016, of two performing loans with recorded book value of $166,000, and 48 nonperforming loans with recorded book value, including pre-sale write downs and purchase discounts, of approximately $2,757,000. The loans sold on August 22, 2016 had contractual amounts outstanding of $6,558,000. Net sale proceeds of $4,980,000 resulted in the recovery of loan balances previously charged off of $1,727,000, additional loan charge offs of $159,000, and interest income of $488,000 from the recovery of interest payments previously applied to principal balances.

Also included in the Company s results of operations for the year ended December 31, 2016 is the impact of the purchase, on May 19, 2016 of seven performing multi-family commercial real estate loans valued at $22,503,000.

Also included in the Company s results of operations for the year ended December 31, 2016 is the impact of the sale, on March 31, 2016, of twenty-seven nonperforming loans, nine substandard performing loans, and three purchased credit impaired loans with total contractual principal balances outstanding of $31,487,000, and recorded book value, including pre-sale write downs and purchase discounts, of approximately $24,810,000. Net proceeds from the sale of these loans were $27,049,000, and resulted in additional net loan write downs of $21,000, the recovery of $1,237,000 of interest income that was previously applied to the principal balance of loans in nonaccrual status, and a gain on sale of loans of $103,000. The twenty-seven nonperforming loans that were sold had a total recorded value of $13,058,000, and were sold for net proceeds of $14,973,000, resulting in the recovery of $575,000 of previously charged off principal balances, the recognition of $1,237,000 of interest income from interest payments previously applied to principal balances on nonaccrual loans, and a gain on sale of $103,000. The $13,058,000 recorded value of these nonperforming loans was the result of contractual principal balances outstanding of $17,169,000, less $1,578,000 of principal balances previously charged off, less $2,684,000 of interest payments previously applied to principal balances on nonaccrual loans, and the addition of $151,000 of unamortized loan purchase premiums net of unearned deferred loan fees. The nine substandard performing loans that were sold had a total recorded value of $9,508,000, and were sold for net proceeds of $8,912,000, resulting in a net loan principal write down and charge off of $596,000. The $9,508,000 recorded value of these performing loans was the result of contractual principal balances outstanding of $10,438,000, less $930,000 of unamortized loan purchase discounts and unearned deferred loan fees. Prior to their sale, the three loans with deteriorated credit quality acquired in a business combination were accounted for under Accounting Standards Codification Topic 310-30 using the pooled method of accounting for loans acquired with deteriorated credit quality. The Company classifies these types of loans in a category of loan it refers to as Purchased Credit Impaired-other (PCI-other) loans. The combined contractual principal balance of the three PCI-other loans sold on March 31, 2016 was $3,880,000, and they were sold for net proceeds of $3,164,000. The net sale proceeds of $3,164,000, along with other cash flows received on these loans during the three months ended March 31, 2016, represented a $446,000 decrease in estimated cash flows over their estimated remaining lives when compared to their previous estimated cash flows as of December 31, 2015. Previously, these three PCI-other loans were expected to be resolved by September 30, 2017. As a result of the magnitude and timing of the decrease in estimated cash flows for these three PCI-other loans, the loan pools associated with these PCI-other loans experienced an increase in interest income of $23,000 during the three months ended March 31, 2016, but are expected to realize a decrease in interest income of $469,000 over the remaining lives of the associated loan pools when compared to projected interest income under the previous (December 31, 2015) estimated cash flows for these three PCI-other loans.

Also included in the Company s results of operations for the year ended December 31, 2016 is a $1,450,000 litigation contingent liability expense accrual recorded during the three months ended June 30, 2016, and representing the Company s estimate of probable incurred losses associated with the legal proceedings originally brought against the Company on September 15, 2014 and January 20, 2015, and described further under the heading *Legal Proceedings* at Note 18 in Item 1 of Part I of this report.

Also included in the Company s results of operations for the year ended December 31, 2016 was a $716,000 valuation allowance expense (recorded in miscellaneous other noninterest expense) related to a closed branch building held for sale, the value of which was written down to current market value, and subsequently sold during the three months ended September 30, 2016. Net proceeds from the sale of this building were $1,218,000, and resulted in no gain or additional loss being recorded upon the sale of this building.

Table of Contents

Net Interest Income

The Company s primary source of revenue is net interest income, which is the difference between interest income on earning assets and interest expense on interest-bearing liabilities.

Following is a summary of the Company s net interest income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2016	2015	2014
Components of Net Interest Income			
Interest income	$ 173,708	$ 161,414	$ 121,115
Interest expense	(5,721)	(5,416)	(4,681)
Net interest income	167,987	155,998	116,434
FTE adjustment	2,329	905	303
Net interest income (FTE)	$ 170,316	$ 156,903	$ 116,737
Net interest margin (FTE)	4.23%	4.32%	4.17%

Net interest income (FTE) for the year ended December 31, 2016 increased $13,413,000 (8.6%) to $170,316,000 from $156,903,000 during the year ended December 31, 2015. The increase in net interest income (FTE) was due primarily to a $240,292,000 (10.1%) increase in the average balance of loans to $2,629,729,000, a $140,526,000 (13.4%) increase in the average balance of investments to $1,190,509,000, and a seven basis point increase in the average yield of nontaxable investments from 4.85% during the year ended December 31, 2015 to 4.92% during the year ended December 31, 2016 , that were partially offset by a 15 basis point decrease in the average yield on loans from 5.52% during the year ended December 31, 2015 to 5.37% during the year ended December 31, 2016, and a 15 basis point decrease in the average yield on investments taxable from 2.74% during the year ended December 31, 2015 to 2.59% during the year ended December 31, 2016. The $240,292,000 increase in average loan balances during 2016 compared to 2015 was due primarily to organic loan growth. The $140,526,000 increase in average investment balances during 2016 compared to 2015 was due primarily to investment purchases in excess of investment maturities. The increases in average loan and investment balances during 2016 were funded primarily by a $350,461,000 increase in the average balance of deposits, and a $37,528,000 increase in the average balance of shareholders equity during 2016. The $350,461,000 increase in the average balance of deposits during 2016 compared to 2015 included the effect of the purchase of three branches and $161,231,000 of deposits from Bank of America on March 18, 2016. The seven basis point increase in the average yield of investments nontaxable was due to purchases of investments nontaxable with higher average tax-equivalent yields during 2016 compared to the yields on investments nontaxable that the Company owned during 2015. The 15 basis point decrease in average loan yields was due primarily to declines in market yields on new and renewed loans compared to yields on repricing, maturing, and paid off loans. The 15 basis point decrease in the average yield of investments taxable was due to purchases of investments taxable with lower average tax-equivalent yields during 2016 compared to the yields on investments taxable that the Company owned during 2015, and increased amortization of purchase premiums on mortgage backed securities during 2016 compared to 2015. The increased amortization of purchase premiums on mortgage backed securities during 2016 was due primarily to faster prepayment of existing mortgages caused by higher mortgage refinance activity that was caused by reduced mortgage rates during most of 2016 compared to 2015. The increases in average loan and investment balances added $9,948,000 and $4,096,000, respectively, to net interest income (FTE) while the decreases in average loan and investments taxable yields reduced net interest income (FTE) during 2016 by $698,000 and $1,162,000, respectively, compared to 2015. The increase in average investments nontaxable yield increased net interest income (FTE) during 2016 by $1,019,000 compared to 2015. Included in investment interest income during the years ended December 31, 2016 and 2015 were special cash dividend of $578,000 and $626,000, respectively, from the Company s investment in Federal Home Loan Bank of San Francisco stock. Included in loan interest income during the year ended December 31, 2016 was discount accretion from purchased loans of $7,399,000 compared to $10,056,000 during the year ended December 31, 2015. Also included in loan interest income during the year ended December 31, 2016 was interest income of $2,311,000 from the recovery of interest payments previously applied to principal balances of nonperforming loans sold during 2016. Included in loan interest income during the year ended December 31, 2015 was the recovery of $728,000 of loan interest income from the payoff of a single originated loan that was in interest nonaccrual status; and while recoveries of loan interest income from paid off nonaccrual loans occur from time to time, a single recovery of this magnitude is unusual.

Net interest income (FTE) for the year ended December 31, 2015 increased $40,166,000 (34.4%) to $156,903,000 from $116,737,000 during. The increase in net interest income (FTE) was due primarily to a $541,688,000 (29.3%) increase in the average balance of loans to $2,389,437,000, and a $505,217,000 (93%) increase in the average balance of investments to $1,049,983,000 that were partially offset by a 10 basis point decrease in the average yield on loans from 5.62% during the year ended December 31, 2014 to 5.52% during the year ended December 31, 2015, and a 17 basis point decrease in the average yield on investments from 3.01% during the year ended December 31, 2014 to 2.84% during the year ended December 31, 2015. The $541,688,000 increase in average loan balances compared to the prior year was due primarily to the addition of $499,327,000 of loans through the acquisition of North Valley Bancorp on October 4, 2014, and net loan growth of $240,414,000 (10.5%) during the year ended December 31, 2015. The $505,217,000 increase in average investment balances from the prior year was due primarily to the addition of $212,616,000 of investments through the acquisition of North Valley Bancorp on October 4, 2014, and $371,784,000 of investment purchases in excess of investment maturities and paydowns during 2015. The 10 basis point decrease in average loan yields was due primarily to declines in market yields on new and renewed loans compared to yields on repricing, maturing, and paid off loans. The decrease in average investment yields was due primarily to declines in market yields on new investments compared to yields on existing investments. The increases in average loan and investment balances added $30,443,000 and $15,493,000, respectively, to net interest income (FTE) while the decreases in average loan and investment yields reduced net interest income (FTE) during 2015 by $2,494,000 and $2,056,000, respectively, when compared to 2014. Included in investment interest income during the year ended December 31, 2015 was a special cash dividend of $626,000 from the Company s investment in Federal Home Loan Bank of San Francisco stock. Included in loan interest income during the year ended December 31, 2015 was discount accretion from purchased loans of $10,056,000 compared to $6,437,000 of discount accretion from purchased loans during the year ended December 31, 2014. Also included in loan interest income during the year ended December 31, 2015 was the recovery of $728,000 of loan interest income from the payoff of a single originated loan that was in interest nonaccrual status; and while recoveries of loan interest income from paid off nonaccrual loans occur from time to time, a single recovery of this magnitude is unusual.

For more information related to loan interest income, including loan purchase discount accretion, see the *Summary of Average Balances, Yields/Rates and Interest Differential* and Note 30 to the consolidated financial statements at Part II, Item 8 of this report. The Yield and Volume/Rate tables shown below are useful in illustrating and quantifying the developments that affected net interest income during 2016 and 2015.

Summary of Average Balances, Yields/Rates and Interest Differential Yield Tables

The following tables present, for the periods indicated, information regarding the Company s consolidated average assets, liabilities and shareholders equity, the amounts of interest income from average earning assets and resulting yields, and the amount of interest expense paid on interest-bearing liabilities. Average loan balances include nonperforming loans. Interest income includes proceeds from loans on nonaccrual loans only to the extent cash payments have been received and applied to interest income. Yields on securities and certain loans have been adjusted upward to reflect the effect of income thereon exempt from federal income taxation at the current statutory tax rate (dollars in thousands):

	Year ended December 31, 2016		
	Average balance	Interest income/expense	Rates earned/paid
Assets			
Loans	$ 2,629,729	$ 141,086	5.37%
Investment securities taxable	1,064,410	27,578	2.59%
Investment securities nontaxable	126,099	6,210	4.92%
Cash at Federal Reserve and other banks	205,263	1,163	0.57%
Total earning assets	4,025,501	176,037	4.37%
Other assets	347,521		

Total assets	$ 4,373,022		
Liabilities and shareholders equity			
Interest-bearing demand deposits	$ 878,436	441	0.05%
Savings deposits	1,344,304	1,685	0.13%
Time deposits	342,511	1,357	0.40%
Other borrowings	18,873	9	0.05%
Junior subordinated debt	56,566	2,229	3.94%
Total interest-bearing liabilities	2,640,690	5,721	0.22%
Noninterest-bearing demand	1,193,297		
Other liabilities	65,206		
Shareholders equity	473,829		
Total liabilities and shareholders equity	$ 4,373,022		
Net interest spread [1]			4.15%
Net interest income and interest margin [2]		$ 170,316	4.23%

(1) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.

(2) Net interest margin is computed by dividing net interest income by total average earning assets.

24

Table of Contents

Summary of Average Balances, Yields/Rates and Interest Differential Yield Tables (continued)

	Year ended December 31, 2015		
	Average balance	Interest income/expense	Rates earned/paid
Assets			
Loans	$ 2,389,437	$ 131,836	5.52%
Investment securities taxable	1,000,221	27,421	2.74%
Investment securities nontaxable	49,762	2,414	4.85%
Cash at Federal Reserve and other banks	189,506	648	0.34%
Total earning assets	3,628,926	162,319	4.47%
Other assets	335,072		
Total assets	$ 3,963,998		
Liabilities and shareholders equity			
Interest-bearing demand deposits	$ 808,281	476	0.06%
Savings deposits	1,183,201	1,475	0.12%
Time deposits	340,443	1,482	0.44%
Other borrowings	8,668	4	0.05%
Junior subordinated debt	56,345	1,979	3.51%
Total interest-bearing liabilities	2,396,938	5,416	0.23%
Noninterest-bearing demand	1,076,162		
Other liabilities	54,597		
Shareholders equity	436,301		
Total liabilities and shareholders equity	$ 3,963,998		
Net interest spread (1)			4.24%
Net interest income and interest margin (2)		$ 156,903	4.32%

	Year ended December 31, 2014		
	Average balance	Interest income/expense	Rates earned/paid
Assets			
Loans	$ 1,847,749	$ 103,887	5.62%
Investment securities taxable	527,742	15,590	2.95%
Investment securities nontaxable	17,024	808	4.75%
Cash at Federal Reserve and other banks	404,056	1,133	0.28%

Total earning assets	2,796,571	121,418	4.34%
Other assets	216,878		
Total assets	$ 3,013,449		
Liabilities and shareholders equity			
Interest-bearing demand deposits	$ 605,241	484	0.08%
Savings deposits	926,389	1,153	0.12%
Time deposits	291,515	1,637	0.56%
Other borrowings	7,512	4	0.05%
Junior subordinated debt	44,366	1,403	3.16%
Total interest-bearing liabilities	1,875,023	4,681	0.25%
Noninterest-bearing demand	801,056		
Other liabilities	36,085		
Shareholders equity	301,285		
Total liabilities and shareholders equity	$ 3,013,449		
Net interest spread [1]			4.09%
Net interest income and interest margin [2]		$ 116,737	4.17%

(1) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
(2) Net interest margin is computed by dividing net interest income by total average earning assets.

Table of Contents

Summary of Changes in Interest Income and Expense due to Changes in Average Asset and Liability Balances and Yields Earned and Rates Paid Volume/Rate Tables

The following table sets forth a summary of the changes in the Company s interest income and interest expense from changes in average asset and liability balances (volume) and changes in average interest rates for the periods indicated. The rate/volume variance has been included in the rate variance. Amounts are calculated on a fully taxable equivalent basis:

	2016 over 2015			2015 over 2014		
	Volume	Yield/ Rate	Total	Volume	Yield/ Rate	Total
	(dollars in thousands)					
Increase (decrease) in interest income:						
Loans	$ 9,948	$ (698)	$ 9,250	$ 30,443	$ (2,494)	$ 27,949
Investments taxable	1,319	(1,162)	157	13,938	(2,107)	11,831
Investments nontaxable	2,777	1,019	3,796	1,555	51	1,606
Cash at Federal Reserve and other banks	40	475	515	(601)	116	(485)
Total	14,084	(366)	13,718	45,335	(4,434)	40,901
Increase (decrease) in interest expense:						
Demand deposits (interest-bearing)	32	(67)	(35)	162	(170)	(8)
Savings deposits	145	65	210	308	14	322
Time deposits	7	(133)	(126)	274	(428)	(154)
Other borrowings	4	1	5	1	(1)	
Junior subordinated debt	6	245	251	379	196	575
Total	194	111	305	1,124	(389)	735
Increase (decrease) in net interest income	$ 13,890	$ (477)	$ 13,413	$ 44,211	$ (4,045)	$ 40,166

Provision for Loan Losses

The provision for loan losses during any period is the sum of the allowance for loan losses required at the end of the period and any loan charge offs during the period, less the allowance for loan losses required at the beginning of the period, and less any loan recoveries during the period. See the Tables labeled *Allowance for loan losses year ended December 31, 2016 and 2015* at Note 5 in Item 8 of Part II of this report for the components that make up the provision for loan losses for the years ended December 31, 2016 and 2015.

The Company benefited from a $5,970,000 reversal of provision for loan losses during the year ended December 31, 2016 versus a $2,210,000 reversal of provision for loan losses during the year ended December 31, 2015. The increase in the reversal of provision for loan losses for the year ended December 31, 2016 compared to the year ended December 31, 2015 was primarily the result of an increase in net loan recoveries from 0.07% of average loans during 2015 to 0.09% of average loans during 2016, a decrease in nonperforming loans from $37,119,000 at December 31, 2015 to $20,128,000 at December 31, 2016, continued improvement in loan portfolio loss history, and improvements in collateral values and estimated cash flows related to nonperforming loans and purchased credit impaired loans. As shown in the Table labeled *Allowance for Loan Losses year ended December 31, 2016* at Note 5 in Item 8 of Part II of this report, residential real estate loans, home equity lines of credit, home equity loans, and commercial construction loans experienced a reversal of provision for loan losses during the year ended December 31, 2016. The level of provision, or reversal of provision, for loan losses of each loan category during the year ended December 31, 2016 was due primarily to a decrease in the required allowance for loan losses as of December 31, 2016 when compared to the required allowance for loan losses as of December 31, 2015 less net charge-offs during the year ended December 31, 2016. All categories of loans except commercial real estate mortgage loans, C & I loans, and residential construction loans experienced a decrease in the required allowance for loan losses during the year ended December 31, 2016. These decreases in required allowance for loan losses were due primarily to reduced impaired loans, improvements in estimated cash flows and collateral values for the remaining and newly impaired loans, and reductions in historical loss factors that, in part, determine the required loan loss allowance for performing loans in accordance with the Company s allowance for loan losses methodology as described under the heading *Loans and Allowance for Loan Losses* at Note 1 in Item 8 of Part II of this report. These same factors were also present, to some extent, for commercial real estate mortgage loans, C & I loans, and residential construction loans, but were more than offset by the effect of increased loan balances in these loan categories resulting in net provisions for loan losses in these categories during the year ended December 31, 2016. For details of the change in nonperforming loans during the year ended December 31, 2016 see the Tables, and associated narratives, labeled *Changes in nonperforming assets during the year ended December 31, 2016* and *Changes in nonperforming assets during the three months ended December 31, September 30, June 30, and March 31, 2016* under the heading *Asset Quality and Non-Performing Assets* below.

The Company benefited from a $2,210,000 reversal of provision for loan losses during the year ended December 31, 2015 versus a $4,045,000 reversal of provision for loan losses during the year ended December 31, 2014. The decrease in the reversal of provision for loan losses for the year ended December 31, 2015 as compared to the year ended December 31, 2014 was primarily the result of increased loan originations during 2015 compared to 2014, and a decrease in net loan recoveries from 0.13% of average loans during 2014 to 0.07% of average loans during 2015. During 2015, improvements in collateral values and estimated cash flows related to nonperforming loans and purchased credit impaired loans, and reductions in nonperforming loans contributed to the reversal of provision for loan losses. As shown in the Table labeled *Allowance for Loan Losses year ended December 31, 2015* at Note 5 in Item 8 of Part II of this report, residential real estate loans, home equity lines of credit, auto indirect loans, and residential construction loans experienced a reversal of provision for loan losses during the year ended December 31, 2015. The level of provision, or reversal of provision, for loan losses of each loan category during the year ended December 31, 2015 was due primarily to a decrease in the required allowance for loan losses as of December 31, 2015 when compared to the required allowance for loan losses as of December 31, 2014 less net charge-offs during the year ended December 31, 2015, and the effect of the changes in the allowance methodology during the year ended December 31, 2015 as described under the heading *Loans and Allowance for Loan Losses* at Note 1 in Item 8 of Part II of this report. All categories of loans except commercial real estate mortgage loans, C & I loans, and commercial construction loans experienced a decrease in the required allowance for loan losses during the year ended December 31, 2015. These decreases in required allowance for loan losses were due primarily to reduced impaired loans, improvements in estimated cash flows and collateral values for the remaining and newly impaired loans, and reductions in historical loss factors that, in part, determine the required loan loss allowance for performing loans in accordance with the Company s allowance for loan losses methodology as described under the heading *Loans and Allowance for Loan Losses* at Note 1 in Item 8 of Part II of this report. These same factors were also present, to some extent, for commercial real estate mortgage loans, C & I loans, and commercial construction loans, but were more than offset by the effect of increased loan balances in these loan categories resulting in net provisions for loan losses in these categories during the year ended December 31, 2015. For details of the change in nonperforming loans during the year ended December 31, 2015 see the Tables, and associated narratives, labeled *Changes in nonperforming assets during the year ended December 31, 2015* and *Changes in nonperforming assets during the three months ended December 31, September 30, June 30, and March 31, 2015* under the heading *Asset Quality and Non-Performing Assets* below. During the year ended December 31, 2015, the Company made one change to its allowance for loan loss methodology. The change in methodology is described under the heading *Allowance for loan losses* in the section below labeled *Financial Condition* . Excluding the effect of the change in allowance methodology during the year ended December 31, 2015, the reversal of provision for loan losses during the year ended December 31, 2015 would have been approximately $3,528,000, or $1,318,000 more than the $2,210,000 that was actually recorded, and the allowance for loan losses at December 31, 2015 would have been approximately $34,693,000, or $1,318,000 less than the $36,011,000 that was actually recorded.

The provision for loan losses related to Originated and PNCI loans is based on management s evaluation of inherent risks in these loan portfolios and a corresponding analysis of the allowance for loan losses. The provision for loan losses related to PCI loan portfolio is based on changes in estimated cash flows expected to be collected on PCI loans. Additional discussion on loan quality, our procedures to measure loan impairment, and the allowance for loan losses is provided under the heading *Asset Quality and Non-Performing Assets* below.

Management re-evaluates the loss ratios and other assumptions used in its calculation of the allowance for loan losses for its Originated and PNCI loan portfolios on a quarterly basis and makes changes as appropriate based upon, among other things, changes in loss rates experienced, collateral support for underlying loans, changes and trends in the economy, and changes in the loan mix. Management also re-evaluates expected cash flows used in its accounting for its PCI loan portfolio, including any required allowance for loan losses, on a quarterly basis and makes changes as appropriate based upon, among other things, changes in loan repayment experience, changes in loss rates experienced, and collateral support for underlying loans.

Table of Contents

Noninterest Income

The following table summarizes the Company s noninterest income for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2016	2015	2014
Components of Noninterest Income:			
Service charges on deposit accounts	$ 14,365	$ 14,276	$ 11,811
ATM fees and interchange	15,859	13,364	9,651
Other service fees	3,121	2,977	2,206
Mortgage banking service fees	2,065	2,164	1,869
Change in value of mortgage servicing rights	(2,184)	(701)	(1,301)
Total service charges and fees	33,226	32,080	24,236
Gain on sale of loans	4,037	3,064	2,032
Commissions on sale of nondeposit investment products	2,329	3,349	2,995
Increase in cash value of life insurance	2,717	2,786	1,953
Change in indemnification asset	(493)	(207)	(856)
Gain on disposition of foreclosed assets	262	991	2,153
Gain on life insurance death benefit	238	155	
Lease brokerage income	711	712	504
Other noninterest income	1,536	2,417	1,499
Total noninterest income	$ 44,563	$ 45,347	$ 34,516

Noninterest income decreased $784,000 (1.7%) to $44,563,000 in 2016 compared to 2015. The decrease in noninterest income was due primarily to $870,000 of recoveries of loans from acquired institutions that were charged off prior to acquisition of those institutions by the Company that were recorded in other noninterest income during the year ended December 31, 2015, a $1,483,000 decrease in change in value of mortgage servicing rights, a $1,020,000 decrease in commissions on sale of nondeposit investment products, and a $729,000 decrease in gain on sale of foreclosed assets that were partially offset by a $2,495,000 increase in ATM fees and interchange income and a $973,000 increase in gain on sale of loans. The decrease in change in value of mortgage servicing rights (MSRs) is primarily due to a change in the required rate of return on MSRs by market participants and a decrease in estimated future MSR cash flows as a result of reduced mortgage rates and higher rates of early mortgage payoffs from mortgage refinancing, both of which reduced the value of such MSRs during the year ended December 31, 2016 compared to a smaller decrease in the value of MSRs during the year ended December 31, 2015 that was primarily due to a decrease in estimated future MSR cash flows as a result of reduced mortgage rates and higher rates of early mortgage payoffs from mortgage refinancing. The decrease in gain on sale of foreclosed assets was due to decreased foreclosed asset sales during the year ended December 31, 2016, and the uniqueness of individual foreclosed asset sales when compared to the year-ago period. The $2,495,000 increase in ATM fees and interchange revenue was primarily due to the Company s increased focus in this area, including the introduction of new services in this area during the quarter ended March 31, 2016. The $973,000 increase in gain on sale of loans was due to continued high levels of refinance and home purchase activity, and increased focus in this area by the Company. The $4,037,000 of gain on sale of loans during 2016 included $3,729,000 of gain on sale of residential real estate loans originated for sale, and $308,000 of gain on sale of loans not originated for sale. The changes in noninterest income include the effects from the operation of three branches, including $161,231,000 of deposits, acquired from Bank of America on

March 18, 2016.

Noninterest income increased $10,831,000 (31.4%) to $45,347,000 in 2015 compared to 2014. The increase in noninterest income was due primarily to an increase in service charges on deposit accounts of $2,465,000 (20.9%) to $14,276,000, an increase in ATM fees and interchange revenue of $3,454,000 (35.8%) to $13,105,000, and an increase of $1,032,000 (50.8%) in gain on sale of loans to $3,064,000 compared to the year-ago period. These increases and the increases in other categories of noninterest income noted in the table above are primarily the result of the acquisition of North Valley Bancorp on October 4, 2014, and $870,000 of recoveries of loans from acquired institutions that were charged off prior to acquisition of those institutions by the Company that were recorded in other noninterest income during the year ended December 31, 2015. Partially offsetting these increases was a decrease of $1,162,000 in gain on sale of foreclosed assets to $991,000 during the year ended December 31, 2015. The decrease in gain on sale of foreclosed assets is due to decreased foreclosed asset sales during the year ended December 31, 2015, and the uniqueness of individual foreclosed asset sales when compared to the year-ago period.

Table of Contents

Noninterest Expense

The following table summarizes the Company s other noninterest expense for the periods indicated (dollars in thousands):

	Year ended December 31,		
	2016	2015	2014
Components of Noninterest Expense			
Salaries and related benefits:			
Base salaries, net of deferred loan origination costs	$ 53,169	$ 46,822	$ 39,342
Incentive compensation	8,872	6,964	5,068
Benefits and other compensation costs	18,683	17,619	13,134
Total salaries and related benefits	80,724	71,405	57,544
Other noninterest expense:			
Occupancy	10,139	10,126	8,203
Equipment	6,597	5,997	4,514
Data processing and software	8,846	7,670	6,512
Assessments	2,105	2,572	2,107
ATM & POS network charges	4,999	4,190	2,996
Advertising & marketing	3,829	3,992	2,413
Professional fees	5,409	4,545	3,888
Telecommunications	2,749	3,007	2,870
Postage	1,603	1,296	949
Courier service	998	1,154	1,055
Foreclosed asset expense	266	490	528
Intangible amortization	1,377	1,157	446
Operational losses	1,564	737	764
Provision for foreclosed asset losses	140	502	208
Change in reserve for unfunded commitments	244	330	(395)
Legal settlement	1,450		
Merger & acquisition expense	784	586	4,858
Miscellaneous other	12,174	11,085	10,919
Total other noninterest expenses	65,273	59,436	52,835
Total noninterest expense	$ 145,997	$ 130,841	$ 110,379
Merger & acquisition expense:			
Base salaries, net of loan origination costs	$ 187		
Incentive compensation			$ 1,174
Benefits and other compensation costs			94
Data processing and software		$ 108	475
Professional fees	342	120	2,390
Miscellaneous other	255	358	725

Total merger expense	$ 784	$ 586	$ 4,858
Average full time equivalent staff	999	949	783
Noninterest expense to revenue (FTE)	67.9%	64.7%	72.9%

Salary and benefit expenses increased $9,319,000 (13.1%) to $80,724,000 during the year ended December 31, 2016 compared to the year ended December 31, 2015. Base salaries, incentive compensation and benefits & other compensation expense increased $6,347,000 (13.6%), 1,908,000 (27.4%), and 1,064,000 (6.0%), respectively, to $53,169,000, $8,872,000 and $18,683,000, respectively, during the year ended December 31, 2016. The average number of full-time equivalent staff increased 50 (5.3%) from 949 during the year ended December 31, 2015 to 999 for the year ended December 31, 2016. The increase in base salaries was due primarily to annual pay raises, an increase in average full-time equivalent staff, and a $1,409,000 increase in temporary help expense from $63,000 during 2015 to $1,472,000 during 2016. The increase in temporary help expense was due primarily to an expansion of the Bank s customer call center capacity during 2016. All categories of incentive compensation expense increased during 2016 compared to 2015 due to related production and profitability measures, and the general increase in staff, except for commissions on sale of nondeposit investment products for which production was down compared to 2015. The increase in benefits and other compensation expense was due primarily to the increase in full-time equivalent staff during 2016.

Salary and benefit expenses increased $13,861,000 (24.1%) to $71,405,000 during the year ended December 31, 2015 compared to the year ended December 31, 2014. Base salaries, incentive compensation and benefits & other compensation expense increased $7,480,000 (19.0%), 1,896,000 (37.4%), and 4,485,000 (34.1%), respectively, to $46,822,000, $6,964,000 and $17,619,000, respectively, during the year ended December 31, 2015. The increases in these categories of salary and benefits expense are primarily due to the Company s acquisition of North Valley Bancorp on October 4, 2014. The average number of full-time equivalent staff increased 166 (21.2%) from 783 during the year ended December 31, 2014 to 949 for the year ended December 31, 2015.

Table of Contents

Other noninterest expense increased $5,837,000 (9.8%) to $65,273,000 during the year ended December 31, 2016 compared to the year ended December 31, 2015. The increase in other noninterest expense was primarily due to system conversion and capacity expansion expenses during 2016. Expense categories including equipment, data processing and software, ATM & POS network charges and professional (consulting) experienced significant increases due primarily to system conversion and capacity expansion during 2016. The Company recorded a litigation contingency expense of $1,450,000 during 2016. The details of this contingency can be found at Note 18 in Item 8 of Part II of this report. Assessments expense decrease $467,000 (18.2%) to $2,105,000 during 2016 compared to $2,572,000 during 2015 due to a decrease in FDIC insurance premiums during the three months ended September 30, 2016. Nonrecurring expenses related to the acquisition of three branches from Bank of America in March 2016 totaling $784,000 and the acquisition of North Valley Bancorp in October 2014 are included in other noninterest expense for the years ended December 31, 2016 and 2015, respectively. Included in miscellaneous other noninterest expense during 2016 were $782,000 valuation allowance expenses on fixed assets transferred to held for sale including a $716,000 valuation allowance expense related to a closed branch building held for sale, the value of which was written down to current market value, and subsequently sold during the three months ended September 30, 2016. Net proceeds from the sale of this building were $1,218,000, and resulted in no gain or additional loss being recorded upon the sale of this building.

Other noninterest expense increased $6,601,000 (12.5%) to $59,436,000 during the year ended December 31, 2015 compared to the year ended December 31, 2014. The increase in other noninterest expense was primarily due to the Company s acquisition of North Valley Bancorp on October 4, 2014. Nonrecurring merger expenses related to the North Valley Bancorp acquisition totaling $586,000 and $4,858,000 are included in other noninterest expense for the years ended December 31, 2015 and 2014, respectively, of which $0 and $1,269,000 were not deductible for income tax purposes, respectively.

Income Taxes

The effective tax rate on income was 38.2%, 39.7%, and 41.5% in 2016, 2015, and 2014, respectively. The effective tax rate was greater than the federal statutory tax rate due to state tax expense of $7,576,000, $7,412,000, and $4,817,000,respectively, in these years, and $1,310,000 of nondeductible merger expenses in 2014. Federal tax-exempt income of $3,881,000, $1,509,000, and $505,000, respectively, from investment securities, Federal and State tax-exempt income of $2,955,000, $2,786,000, and $1,953,000, respectively, from increase in cash value and gain on death benefit of life insurance, and tax credits of $197,000, $0, and $0 in these years helped to reduce the effective tax rate.

Financial Condition

Investment Securities

The following table presents the available for sale investment securities portfolio by major type as of the dates indicated:

	Year ended December 31,				
(In thousands)	2016	2015	2014	2013	2012
Investment securities available for sale (at fair value):					
Obligations of US government corporations and agencies	$ 429,678	$ 313,682	$ 75,120	$ 97,143	$ 151,701

Obligations of states and political subdivisions	117,617	88,218	3,175	5,589	9,421
Corporate bonds			1,908	1,915	1,905
Marketable equity securities	2,938	2,985	3,002		
Total investment securities available for sale	$ 550,233	$ 404,885	$ 83,205	$ 104,647	$ 163,027

Investment securities available for sale increased $145,348,000 to $550,233,000 as of December 31, 2016, compared to December 31, 2015. This increase is attributable to purchases of $247,717,000, maturities and principal repayments of $71,684,000, a decrease in fair value of investments securities available for sale of $11,015,000, and amortization of net purchase price premiums of $2,598,000.

The following table presents the held to maturity investment securities portfolio by major type as of the dates indicated:

	Year ended December 31,				
(In thousands)	2016	2015	2014	2013	2012
Investment securities held to maturity (at cost):					
Obligations of US government corporations and agencies	$ 597,982	$ 711,994	$ 660,836	$ 227,864	
Obligations of states and political subdivisions	14,554	14,536	15,590	12,640	
Total investment securities held to maturity	$ 602,536	$ 726,530	$ 676,426	$ 240,504	

Table of Contents

Investment securities held to maturity decreased $123,994,000 to $602,536,000 as of December 31, 2016, compared to December 31, 2015. This decrease is attributable to principal repayments of $121,666,000 and amortization of net purchase price discounts/premiums of $2,328,000.

Additional information about the investment portfolio is provided in Note 3 in the financial statements at Item 8 of Part II of this report.

Restricted Equity Securities

Restricted equity securities were $16,956,000 at December 31, 2016 and December 31, 2015. The entire balance of restricted equity securities at December 31, 2016 and December 31, 2015 represents the Bank s investment in the Federal Home Loan Bank of San Francisco (FHLB).

FHLB stock is carried at par and does not have a readily determinable fair value. While technically these are considered equity securities, there is no market for the FHLB stock. Therefore, the shares are considered as restricted investment securities. Management periodically evaluates FHLB stock for other-than-temporary impairment. Management s determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on specific percentages of its outstanding mortgages, total assets, or FHLB advances. The Bank may request redemption at par value of any stock in excess of the minimum required investment. Stock redemptions are at the discretion of the FHLB.

Loans

The Bank concentrates its lending activities in four principal areas: real estate mortgage loans (residential and commercial loans), consumer loans, commercial loans (including agricultural loans), and real estate construction loans. The interest rates charged for the loans made by the Bank vary with the degree of risk, the size and maturity of the loans, the borrower s relationship with the Bank and prevailing money market rates indicative of the Bank s cost of funds.

The majority of the Bank s loans are direct loans made to individuals, farmers and local businesses. The Bank relies substantially on local promotional activity and personal contacts by bank officers, directors and employees to compete with other financial institutions. The Bank makes loans to borrowers whose applications include a sound purpose, a viable repayment source and a plan of repayment established at inception and generally backed by a secondary source of repayment.

Loan Portfolio Composite

The following table shows the Company s loan balances, including net deferred loan costs, at the dates indicated:

	Year ended December 31,				
(dollars in thousands)	2016	2015	2014	2013	2012
Real estate mortgage	$ 2,057,824	$ 1,811,832	$ 1,615,359	$ 1,107,863	$ 1,010,130
Consumer	362,303	395,283	417,084	383,163	386,111
Commercial	217,047	194,913	174,945	131,878	135,528
Real estate construction	122,419	120,909	75,136	49,103	33,054
Total loans	$ 2,759,593	$ 2,522,937	$ 2,282,524	$ 1,672,007	$ 1,564,823

The following table shows the Company s loan balances, including net deferred loan costs, as a percentage of total loans at the dates indicated:

	Year ended December 31,				
	2016	2015	2014	2013	2012
Real estate mortgage	74.6%	71.8%	70.7%	66.3%	64.5%
Consumer	13.1%	15.7%	18.3%	22.9%	24.7%
Commercial	7.9%	7.7%	7.7%	7.9%	8.7%
Real estate construction	4.4%	4.8%	3.3%	2.9%	2.1%
Total loans	100.0%	100.0%	100.0%	100.0%	100.0%

Table of Contents

At December 31, 2016 loans, including net deferred loan costs, totaled $2,759,593,000 which was a 9.4% ($236,656,000) increase over the balances at the end of 2015. Demand for commercial real estate (real estate mortgage) loans was strong during 2016. Demand for residential mortgage loans was strong during 2016. Demand for home equity loans and lines of credit was moderate during 2016.

At December 31, 2015 loans, including net deferred loan costs, totaled $2,522,937,000 which was a 10.5% ($240,413,000) increase over the balances at the end of 2014. Demand for commercial real estate (real estate mortgage) loans was strong during 2015. Demand for home equity loans and lines of credit was weak during 2015.

At December 31, 2014 loans, including net deferred loan costs, totaled $2,282,524,000 which was a 36.5% ($610,517,000) increase over the balances at the end of 2013. This increase in loans during 2014 included $499,327,000 of loans acquired in the North Valley Bancorp acquisition on October 3, 2014, and $32,017,000 of purchased single family residential real estate loans. Demand for commercial real estate (real estate mortgage) loans was moderate during 2014. Demand for home equity loans and lines of credit was weak during 2014.

Asset Quality and Nonperforming Assets

Nonperforming Assets

Loans originated by the Company, i.e., not purchased or acquired in a business combination, are referred to as originated loans. Originated loans are reported at the principal amount outstanding, net of deferred loan fees and costs. Loan origination and commitment fees and certain direct loan origination costs are deferred, and the net amount is amortized as an adjustment of the related loan s yield over the actual life of the loan. Originated loans on which the accrual of interest has been discontinued are designated as nonaccrual loans.

Originated loans are placed in nonaccrual status when reasonable doubt exists as to the full, timely collection of interest or principal, or a loan becomes contractually past due by 90 days or more with respect to interest or principal and is not well secured and in the process of collection. When an originated loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed. Income on such loans is then recognized only to the extent that cash is received and where the future collection of principal is probable. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loan is estimated to be fully collectible as to both principal and interest.

An allowance for loan losses for originated loans is established through a provision for loan losses charged to expense. Originated loans and deposit related overdrafts are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance is an amount that management believes will be adequate to absorb probable losses inherent in existing loans and leases, based on evaluations of the collectability, impairment and prior loss experience of loans and leases. The evaluations take into consideration such factors as changes in the nature and size of the portfolio, overall portfolio quality, loan concentrations, specific problem loans, and current economic conditions that may affect the borrower s ability to pay. The Company defines an originated loan as impaired when it is probable the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired originated loans are measured based on the present value of expected future cash flows discounted at the loan s original effective interest rate. As a practical expedient, impairment may be measured based on the loan s observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance.

In situations related to originated loans where, for economic or legal reasons related to a borrower s financial difficulties, the Company grants a concession for other than an insignificant period of time to the borrower that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). The Company strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where the Company grants the borrower new terms that result in the loan being classified as a TDR, the Company measures any impairment on the restructuring as noted above for impaired loans. TDR loans are classified as impaired until they are fully paid off or charged off. Loans that are in nonaccrual status at the time they become TDR loans, remain in nonaccrual status until the borrower demonstrates a sustained period of performance which the Company generally believes to be six consecutive months of payments, or equivalent. Otherwise, TDR loans are subject to the same nonaccrual and charge-off policies as noted above with respect to their restructured principal balance.

Credit risk is inherent in the business of lending. As a result, the Company maintains an allowance for loan losses to absorb losses inherent in the Company s originated loan portfolio. This is maintained through periodic charges to earnings. These charges are included in the Consolidated Statements of Income as provision for loan losses. All specifically identifiable and quantifiable losses are immediately charged off against the allowance. However, for a variety of reasons, not all losses are immediately known to the Company and, of those that are known, the full extent of the loss may not be quantifiable at that point in time. The balance of the Company s allowance for originated loan losses is meant to be an estimate of these unknown but probable losses inherent in the portfolio.

Table of Contents

The Company formally assesses the adequacy of the allowance for originated loan losses on a quarterly basis. Determination of the adequacy is based on ongoing assessments of the probable risk in the outstanding originated loan portfolio, and to a lesser extent the Company s originated loan commitments. These assessments include the periodic re-grading of credits based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, growth of the portfolio as a whole or by segment, and other factors as warranted. Loans are initially graded when originated. They are re-graded as they are renewed, when there is a new loan to the same borrower, when identified facts demonstrate heightened risk of nonpayment, or if they become delinquent. Re-grading of larger problem loans occurs at least quarterly. Confirmation of the quality of the grading process is obtained by independent credit reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies.

The Company s method for assessing the appropriateness of the allowance for originated loan losses includes specific allowances for impaired originated loans and leases, formula allowance factors for pools of credits, and allowances for changing environmental factors (e.g., interest rates, growth, economic conditions, etc.). Allowance factors for loan pools were based on historical loss experience by product type and prior risk rating.

Loans purchased or acquired in a business combination are referred to as acquired loans. Acquired loans are valued as of acquisition date in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 805, *Business Combinations*. Loans acquired with evidence of credit deterioration since origination for which it is probable that all contractually required payments will not be collected are referred to as purchased credit impaired (PCI) loans. PCI loans are accounted for under FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Under FASB ASC Topic 805 and FASB ASC Topic 310-30, PCI loans are recorded at fair value at acquisition date, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded as of the acquisition date. Fair value is defined as the present value of the future estimated principal and interest payments of the loan, with the discount rate used in the present value calculation representing the estimated effective yield of the loan. Default rates, loss severity, and prepayment speed assumptions are periodically reassessed and our estimate of future payments is adjusted accordingly. The difference between contractual future payments and estimated future payments is referred to as the nonaccretable difference. The difference between estimated future payments and the present value of the estimated future payments is referred to as the accretable yield. The accretable yield represents the amount that is expected to be recorded as interest income over the remaining life of the loan. If after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be more than the originally estimated, an increase in the discount rate (effective yield) would be made such that the newly increased accretable yield would be recognized, on a level yield basis, over the remaining estimated life of the loan. If, after acquisition, the Company determines that the estimated future cash flows of a PCI loan are expected to be less than the previously estimated, the discount rate would first be reduced until the present value of the reduced cash flow estimate equals the previous present value however, the discount rate may not be lowered below its original level at acquisition. If the discount rate has been lowered to its original level and the present value has not been sufficiently lowered, an allowance for loan loss would be established through a provision for loan losses charged to expense to decrease the present value to the required level. If the estimated cash flows improve after an allowance has been established for a loan, the allowance may be partially or fully reversed depending on the improvement in the estimated cash flows. Only after the allowance has been fully reversed may the discount rate be increased. PCI loans are put on nonaccrual status when cash flows cannot be reasonably estimated. PCI loans on nonaccrual status are accounted for using the cost recovery method or cash basis method of income recognition. PCI loans are charged off when evidence suggests cash flows are not recoverable. Foreclosed assets from PCI loans are recorded in foreclosed assets at fair value with the fair value at time of foreclosure representing cash flow from the loan. ASC 310-30 allows PCI loans with similar risk characteristics and acquisition time frame to be pooled and have their cash flows aggregated as if they were one loan. The Company elected to use the pooled method of ASC 310-30 for PCI other loans in the acquisition of certain assets and liabilities of Granite and Citizens.

Acquired loans that are not PCI loans are referred to as purchased not credit impaired (PNCI) loans. PNCI loans are accounted for under FASB ASC Topic 310-20, *Receivables Nonrefundable Fees and Other Costs,* in which interest income is accrued on a level-yield basis for performing loans. For income recognition purposes, this method assumes that all contractual cash flows will be collected, and no allowance for loan losses is established at the time of acquistion. Post-acquisition date, an allowance for loan losses may need to be established for acquired loans through a provision charged to earnings for credit losses incurred subsequent to acquisition. Under ASC 310-20, the loss would be measured based on the probable shortfall in relation to the contractual note requirements, consistent with our allowance for loan loss policy for similar loans.

Table of Contents

When referring to PNCI and PCI loans we use the terms nonaccretable difference , accretable yield , or purchase discount . Nonaccretable difference is the difference between undiscounted contractual cash flows due and undiscounted cash flows we expect to collect, or put another way, it is the undiscounted contractual cash flows we do not expect to collect. Accretable yield is the difference between undiscounted cash flows we expect to collect and the value at which we have recorded the loan on our financial statements. On the date of acquisition, all purchased loans are recorded on our consolidated financial statements at estimated fair value. Purchase discount is the difference between the estimated fair value of loans on the date of acquisition and the principal amount owed by the borrower, net of charge offs, on the date of acquisition. We may also refer to discounts to principal balance of loans owed, net of charge-offs . Discounts to principal balance of loans owed, net of charge-offs is the difference between principal balance of loans owed, net of charge-offs, and loans as recorded on our financial statements. Discounts to principal balance of loans owed, net of charge-offs arise from purchase discounts, and equal the purchase discount on the acquisition date.

Loans are also categorized as covered or noncovered . Covered loans refer to loans covered by a FDIC loss sharing agreement. Noncovered loans refer to loans not covered by a FDIC loss sharing agreement.

Originated loans and PNCI loans are reviewed on an individual basis for reclassification to nonaccrual status when any one of the following occurs: the loan becomes 90 days past due as to interest or principal, the full and timely collection of additional interest or principal becomes uncertain, the loan is classified as doubtful by internal credit review or bank regulatory agencies, a portion of the principal balance has been charged off, or the Company takes possession of the collateral. Loans that are placed on nonaccrual even though the borrowers continue to repay the loans as scheduled are classified as performing nonaccrual and are included in total nonperforming loans. The reclassification of loans as nonaccrual does not necessarily reflect management s judgment as to whether they are collectible.

Interest income on originated nonaccrual loans that would have been recognized during the years ended December 31, 2016, 2015 and 2014, if all such loans had been current in accordance with their original terms, totaled $783,000, $1,840,000, and $2,734,000, respectively. Interest income actually recognized on these originated loans during the years ended December 31, 2016, 2015 and 2014 was $377,000, $170,000, and $81,000, respectively. Interest income on PNCI nonaccrual loans that would have been recognized during the years ended December 31, 2016, 2015 and 2014, if all such loans had been current in accordance with their original terms, totaled $178,000, $386,000, and $254,000. Interest income actually recognized on these PNCI loans during the years ended December 31, 2016, 2015 and 2014 was $11,000, $205,000, and $4,000.

The Company s policy is to place originated loans and PNCI loans 90 days or more past due on nonaccrual status. In some instances when an originated loan is 90 days past due Management does not place it on nonaccrual status because the loan is well secured and in the process of collection. A loan is considered to be in the process of collection if, based on a probable specific event, it is expected that the loan will be repaid or brought current. Generally, this collection period would not exceed 30 days. Loans where the collateral has been repossessed are classified as foreclosed assets. Management considers both the adequacy of the collateral and the other resources of the borrower in determining the steps to be taken to collect nonaccrual loans. Alternatives that are considered are foreclosure, collecting on guarantees, restructuring the loan or collection lawsuits.

Table of Contents

The following table sets forth the amount of the Bank s nonperforming assets as of the dates indicated. For purposes of the following table, PCI other loans that are 90 days past due and still accruing are not considered nonperforming loans. Performing nonaccrual loans are loans that may be current for both principal and interest payments, or are less than 90 days past due, but for which payment in full of both principal and interest is not expected, and are not well secured and in the process of collection:

	December 31,	
(dollars in thousands)	2016	2015