Risk Factors Comparison 2024-03-14 to 2023-03-16 Form: 10-K

Legend: New Text ~~Removed Text~~ Unchanged Text Moved Text Section

We assume and manage a certain degree of risk in order to conduct our business. The material risks and uncertainties that management believes may affect our business are listed below and in ITEM 7A, Quantitative and Qualitative Disclosure about Market Risk. The list is not exhaustive; additional risks and uncertainties that management is not aware of, focused on, or currently deems immaterial may also impair business operations. If any of the following risks, or risks that have not been identified, actually occur, our financial condition, results of operations, and stock trading price could be materially and adversely affected. We manage these risks by promoting sound corporate governance practices, which include but are not limited to, establishing policies and internal controls, and implementing internal review processes. Before making an investment decision, investors should carefully consider the risks, together with all of the other information included or incorporated by reference in this Annual Report on Form 10- K and our other filings with the SEC. This report is qualified in its entirety by these risk factors. Strategic, Financial, and Reputational Risks Growth Strategy or Potential Mergers and Acquisitions May Produce Unfavorable Outcomes We seek to expand our franchise safely and consistently. A successful growth strategy requires us to manage multiple aspects of the business simultaneously, such as following adequate loan underwriting standards, balancing loan and deposit growth without compressing our net interest margin, managing interest rate risk, maintaining sufficient capital, and recruiting, training and retaining qualified professionals. Our strategic plan also includes merger and acquisition opportunities that either enhance our market presence or have potential for improved profitability through financial management, economies of scale or expanded services. We may incur significant acquisition related expenses either during the due diligence phase of acquisition targets or during integration of the acquirees. These expenses have and may continue to negatively impact our earnings prior to realizing the benefits of acquisitions. We may also be exposed to difficulties in combining the operations of acquired institutions into our own operations, which may prevent us from achieving the expected benefits from our acquisition activities. Our earnings, financial condition and prospects after the merger may affect our stock price and will depend in part on our ability to integrate the operations and management of the acquired institution while continuing to implement other aspects of our business plan. Inherent uncertainties exist in integrating the operations of an acquired institution and there is no assurance that we will be able to do so successfully. Among the issues that we could face are: • unexpected problems with operations, personnel, technology or credit; • loss of customers and employees of the acquiree; • difficulty in working with the acquiree' s employees and customers; • the assimilation and integration of the acquiree' s operations, culture and personnel; • instituting and maintaining uniform standards, controls, procedures and policies; and • litigation risk or obligations not discovered during due diligence. Undiscovered factors as a result of an acquisition could bring liabilities against us, our management and the management of the institutions we acquire. These factors could contribute to our not achieving the expected benefits from our acquisitions within desired time frames, if at all. Further, although we generally anticipate cost savings from acquisitions, we may not be able to fully realize those savings. Any cost savings may be offset by losses in revenues or other charges to earnings. Competition with Other Financial Institutions to Attract and Retain Banking Customers We are facing significant competition for customers from other banks and financial institutions located in the markets that we serve. We compete with commercial banks, savings institutions, credit unions, non- bank financial services companies, including financial technology firms, and other financial institutions operating within or near our service areas. Some of our non- bank competitors and peer- to- peer lenders may not be subject to the same extensive regulations as we are, giving them greater flexibility in competing for business. We anticipate intense competition will continue for the coming year due to the **market disruptions in banking in 2023, the continued** consolidation of many financial institutions and more changes in legislation, regulation and technology. National and regional banks much larger than our size have entered our market through acquisitions and they may be able to benefit from economies of scale through their wider branch networks, more prominent national advertising campaigns, lower cost of borrowing, capital market access and sophisticated technology infrastructures. Further, intense competition for creditworthy borrowers could lead to pressure for loan rate concessions and affect our ability to generate profitable loans. Going forward, we may see continued competition in the industry as competitors seek to expand market share in our core markets. Further, our customers may withdraw deposits to pursue alternative investment opportunities ~~in the equity market~~. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit platforms such as online virtual banks and non- bank service providers. Efforts and initiatives we may undertake to retain and increase deposits, including deposit pricing, can increase our costs. Based on our current strong liquidity position, our adjustment to deposit pricing has lagged the market in a rising interest rate environment. If our customers move money into higher yielding deposits or alternative investments, we may lose a relatively inexpensive source of funds, thus increasing our funding costs through more expensive wholesale funding sources, such as ~~federal funds or~~ FHLB borrowings. Financial Challenges at Other Banking Institutions Could Lead to Depositor Concerns That Spread Within the Banking Industry Causing Disruptive Deposit Outflows and Other Destabilizing Results That Could Adversely Affect Our Liquidity, Business, Financial Condition and Results of Operations In ~~March~~ **the first and second quarters of** 2023, certain specialized banking institutions with elevated concentrations of uninsured deposits experienced large deposit outflows, resulting in the institutions being placed into FDIC receiverships. In **addition** ~~the aftermath~~, **media and** ~~there has been substantial~~ market ~~disruption~~ **coverage of the Bay Area economy** and ~~indications that~~ **local financial institutions, have generated significant market volatility among publicly traded bank holding companies and, in particular, regional and community banks like the Company. These market developments have negatively impacted customer confidence in the safety and soundness of regional and community**

banks. As a result, customers may choose to maintain ~~deposit~~ **deposits** ~~outflows and~~ **with larger financial institutions or invest in higher yielding short- term fixed income securities, all of which could materially adversely impact** ~~other~~ -- **the** ~~destabilizing~~ **Company' s liquidity, loan funding capacity, net interest margin, capital and** results **of operations** ~~could spread within the banking industry~~ . We maintain a well- diversified deposit base, with an estimated ~~44~~ **28** % of **uninsured and /** ~~our~~ - **or uncollateralized** deposits as of December 31, ~~2022~~ **2023** ~~in excess of FDIC insurance limits~~ . Such uninsured deposits were fully covered by the Bank' s ~~contingent liquidity at that time~~ **available funding sources, including unrestricted cash, unencumbered available- for- sale securities, and a total available borrowing capacity of $ 1. 967 billion, or 60 % of total deposits, and 213 % of estimated uninsured and / or uncollateralized deposits as of December 31, 2023** . Excluding zero balance accounts, ~~the approximate~~ **59 % of deposit balances were held in business accounts with** average ~~size~~ **balances** of ~~our~~ **$ 120 thousand per account, with the remaining 41 % in** consumer ~~deposit~~ accounts ~~was less than~~ **with average balances of** $ ~~43~~ **41** thousand **per** ~~, and the average size of our business deposit accounts~~ - **account** ~~was less than $ 139 thousand~~ as of December 31, ~~2022~~ **2023** . Although we maintain strong liquidity for the normal operations of the Bank, model various stress scenarios, and maintain significant contingent liquidity sources, general depositor concerns given the recent high profile bank closures could lead to deposit outflows from our Bank. **Our funding costs increased** ~~Significant~~ **significantly in 2023 and may continue to increase if our** ~~deposit~~ **deposits** ~~outflows~~ **decline and we replace them with more expensive sources of funding, such as FHLB and FRB borrowings, and / or brokered deposits, if customers shift their deposits into higher cost products, or if we raise interest rates to avoid losing deposits. In addition, adverse operating results or changes in industry conditions** could ~~negatively affect~~ **lead to difficulty** ~~our~~ - **or an inability to access these additional funding sources, constraining our financial flexibility, and** ability to originate loans, invest in securities, and distribute dividends to our shareholders. In addition, such a lack of liquidity could result in the sale of securities in an unrealized loss position and / or alter our ability to hold our held- to- maturity securities to their maturity dates. All of these factors could have a material adverse impact on our **asset growth,** liquidity, business, financial condition **,** and results of operations. We May Not Be Able to Attract and Retain Key Employees Our success depends in large part on our ability to attract qualified personnel and to retain key employees, as well as the prompt replacement of retiring executives. The loss of key personnel and / or our inability to secure qualified candidates to replace retiring executives could have an unfavorable effect on our business due to the required skills and knowledge of our market and years of industry experience. Bancorp Relies on Dividends from the Bank to Pay Cash Dividends to its Shareholders as Well as to Meet Other Financial Obligations Bancorp is a separate legal entity from its subsidiary, the Bank. Bancorp receives substantially its entire cash stream from the Bank in the form of dividends, which is Bancorp' s principal source of funds to pay cash dividends to Bancorp' s common shareholders, repurchase shares, and cover operational expenses of the holding company. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to Bancorp. In the event that the Bank is unable to pay dividends to Bancorp, Bancorp may not be able to pay dividends to its shareholders. As a result, it could have an adverse effect on Bancorp' s stock price and investment value. Federal law would prohibit capital distributions from the Bank, with limited exceptions, if the Bank were categorized as" undercapitalized" under applicable Federal Reserve or FDIC regulations. In addition, as a California bank, Bank of Marin is subject to state law restrictions on the payment of dividends. For further information on the distribution limit from the Bank to Bancorp, see the section captioned " Bank Regulation " in ITEM 1 above and " Dividends " in Note 8 to the Consolidated Financial Statements in ITEM 8 of this report. The Value of Goodwill and Other Intangible Assets May Decline in the Future As of December 31, ~~2022~~ **2023** , we had goodwill totaling $ 72. 8 million and a core deposit intangible asset totaling $ ~~5~~ **3** . ~~1~~ **8** million from business acquisitions. A significant decline in expected future cash flows, a significant adverse change in the business climate, or a significant and sustained decline in the price of our common stock could necessitate taking charges in the future related to the impairment of goodwill or other intangible assets. If we were to conclude that a future write- down of goodwill or other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, financial condition and results of operations. ~~We May Take Tax Filing Positions or Follow Tax Strategies That May Be Subject to Challenge We provide for current and deferred tax provision in our consolidated financial statements based on our results of operations, business activities and business combinations, legal structure and federal and state legislation and regulations. We may take filing positions or follow tax strategies that are subject to interpretation of tax statutes. Our net income may be reduced if a federal, state or local authority were to assess charges for taxes that have not been provided for in our consolidated financial statements. Taxing authorities could change applicable tax laws and interpretations, challenge filing positions, or assess new taxes and interest charges. If taxing authorities take any of these actions, our business, results of operations or financial condition could be significantly affected.~~ Market, Interest Rate, and Liquidity Risks A Lack of Liquidity could Adversely Affect our Operations ~~and Jeopardize our Business~~ , Financial Condition and Results of Operations Liquidity is essential to our business **and** ~~. We rely on~~ our ability to ~~generate deposits and~~ **fund our operations,** effectively manage the repayment and maturity schedules of our loans and investment securities, ~~respectively,~~ **distribute dividends** to ~~ensure that we have adequate liquidity to fund~~ **our shareholders, and fulfill our debt obligations** ~~our~~ - **or** ~~operations. An inability to raise funds through deposits~~ - **deposit withdrawal demands** ~~, borrowings, securities sales, Federal Home Loan Bank advances, the sale of loans and other sources could have a substantial negative effect on our liquidity~~ . Our most important source of funding consists of deposits ~~. Deposit balances can decrease when~~ **, which is affected by external factors outside the Bank' s control as well as** customers ~~perceive alternative~~ **' perceptions, business operations, and** ~~investments~~ - **investment goals** ~~provide a better risk / return trade- off~~ . If customers move money out of bank deposits and into other investments, then we would lose a relatively low- cost source of funds, increasing our funding costs and reducing our net interest income and net income. **Based on experience, we believe that our deposit accounts are relatively stable sources of funds.** Other primary sources of funds consist of cash flows from operations, investment maturities and sales, loan repayments, and proceeds from the issuance and sale of any equity and debt securities to investors. Additional liquidity is provided by ~~the~~ **our** ability to borrow from the Federal

Reserve Bank of San Francisco **,** ~~and the~~ Federal Home Loan Bank and **other financial institutions, as well as** our ability to raise brokered deposits ~~. We also may borrow funds from third- party lenders, such as other financial institutions~~ . Our access to funding sources in amounts adequate to finance or capitalize our activities, or on terms that are acceptable to us, could be impaired by factors that affect us directly or the bank or non- bank financial services industries or the economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the bank or non- bank financial services industries ~~. Based on experience, we believe that our deposit accounts are relatively stable sources of funds. If we increase interest rates paid to retain deposits, our earnings may be adversely affected, which could have an adverse effect on our business, financial condition and results of operations. Significant declines in available funding could adversely affect our ability to originate loans, invest in securities, pay our expenses, distribute dividends to our shareholders, and fulfill our debt obligations or deposit withdrawal demands. In addition, a lack of liquidity could result in the sale of securities in an unrealized loss position and / or alter our ability to hold our held- to- maturity securities to their maturity dates. All of these factors could have a material adverse impact on our liquidity, business, financial condition and results of operations~~ . Earnings are Significantly Influenced by General Business and Economic Conditions Our success depends, to a certain extent, on local, national and global economic and political conditions. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers primarily in Northern California with particular focus on the local markets in the San Francisco Bay and Greater Sacramento regions. The local economic conditions in these areas have a significant impact on the demand for our products and services as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposits as our primary funding source. Economic pressure on consumers and uncertainty regarding the economy and local business climate may result in changes in consumer and business spending, borrowing and saving habits, which may affect the demand for loans and other products and services we offer. Further, loan defaults that adversely affect our earnings correlate highly with deteriorating economic conditions (such as the California unemployment rate and California gross domestic product), which impact our borrowers' creditworthiness. In addition, health epidemics or pandemics (or expectations about them) ~~such as the novel coronavirus (aka" COVID- 19")~~ , international trade disputes, inflation risks, oil price volatility, the level of U. S. debt and global economic conditions could destabilize financial markets in which we operate. Lastly, actions of the Federal Open Market Committee (" FOMC") of the Federal Reserve could cause financial market volatility, which will affect the pricing of our loan and deposit products. Interest Rate Risk is Inherent in Our Business Our earnings are largely dependent upon our net interest income, which is the difference between interest income earned on interest- earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors outside of our control, including general economic conditions and the policies of various governmental and regulatory agencies and, in particular, the FOMC, which regulates the supply of money and credit in the United States. Changes in monetary policy, including changes in interest rates, can influence not only the interest we receive on loans and securities and interest we pay on deposits and borrowings, but can also affect (i) our ability to originate loans and obtain deposits, (ii) the duration of our securities and loan portfolios, and (iii) the fair value of our financial assets and liabilities. **In fact, the FOMC' s aggressive interest rate increases, discussed more fully below, negatively affected each of these areas of our business recently.** Our portfolio of loans and securities will generally decline in value if market interest rates increase, and increase in value if market interest rates decline. Decreases in the market value of investment securities available for sale negatively impact the Bank' s tangible equity through accumulated other comprehensive losses. In addition, our loans and callable mortgage- backed securities are also subject to prepayment risk when interest rates fall, and the borrowers' credit risk may increase in rising rate or recessionary environments. Factors such as inflation, productivity, oil prices, unemployment rates, and global demand play a role in the FOMC' s consideration of future rate adjustments. ~~In response to the evolving risks to economic activity caused by the COVID- 19 pandemic, the FOMC made two emergency federal funds rate cuts totaling 150 basis points in March 2020.~~ The federal funds rate range remained between 0. 0 % ~~and~~ **to** 0. 25 % **from March 2020** through the beginning of 2022, putting downward pressure on our asset yields and net interest margin. Beginning in March 2022, the FOMC began successive increases to the federal funds rate due to the evolving inflation risks, **complicated by** international political unrest ~~,~~ and ~~oil and other~~ supply chain disruptions. As a result of ~~five~~ **seven** rate adjustments during 2022 ~~and one rate increase so far in 2023~~ , the federal funds target rate ~~range~~ increased to a range of 4. **25 % to 4.** 50 % ~~to 4~~ **at year- end 2022 and our net interest margin increased gradually over the course of the year** . ~~75~~ **In 2023, on each of February 1st, March 22nd, May 3rd, and July 26th the FOMC increased the target rate by 25 basis points to a range of 5. 25** % **to 5. 50 %. Rising interest rates and first quarter disruptions in the banking industry resulted in rapid increases in the cost of funds through rising deposit costs and increased borrowings, putting pressure on net interest margin starting in the second quarter of 2023** . Additional rate increases are **not widely** anticipated in ~~2023~~ **2024** , as Federal Reserve policymakers continue to monitor inflation and economic developments. See the Net Interest Income section of Management' s Discussion and Analysis of Financial Condition and Results of Operations in ITEM 7 and Quantitative and Qualitative Disclosures about Market Risk in ITEM 7A of this report for further discussion related to interest rate sensitivity and our management of interest rate risk **. Rising Interest Rates Have Decreased the Value of the Company' s Held- To- Maturity and Available- for- Sale Securities Portfolio, and the Company Would Realize Losses if It Were Required to Sell Such Securities to Meet Liquidity Needs Because of inflationary pressures and the resulting rapid increases in the federal funds target rate since March 2022, the market value of previously issued government and other fixed income securities has declined significantly. These securities make up a majority of the securities portfolio of most banks in the U. S., including the Company' s, resulting in unrealized losses embedded in the held- to- maturity portion of U. S. banks' securities portfolios and unrealized losses on available-for- sale securities reflected in the Company' s accumulated other comprehensive income (loss). We maintain an investment securities portfolio to provide liquidity and to generate earnings on funds that have not been loaned to**

customers while managing our liquidity and interest rate position, seeking a reasonable yield balanced with risk exposure. While it is neither our intention to sell securities at a net loss in the normal course of business, nor were we required to, we did so for strategic purposes in the third and fourth quarters of 2023 as a source of liquidity and to reposition the balance sheet to bolster net interest margin. If the Company were to sell additional securities in an unrealized loss position, it may incur losses that could impair the Company' s capital, financial condition, and results of operations and may require the Company to raise additional capital on unfavorable terms, thereby negatively impacting its profitability and potentially causing shareholder dilution . Activities of Our Large Borrowers and Depositors May Cause Unexpected Volatilities in Our Loan and Deposit Balances, as well as Net Interest Margin Loans originated at higher interest rates may be paid off and replaced by new loans with lower interest rates, causing downward pressure on our net interest margin. In addition, our top ten depositor relationships accounted for approximately 8 % ~~and 11 %~~ of ~~our~~ total deposit balances at **both** December 31, **2023 and** 2022 ~~and 2021, respectively~~ . The business models and cash cycles of some of our large commercial depositors may also cause short- term volatility in their deposit balances held with us. As our customers' businesses grow, the dollar value of their daily activities may also grow leading to larger fluctuations in daily balances. Any long- term decline in deposit funding would adversely affect our liquidity. For additional information on our management of deposit volatility, refer to the Liquidity section of ITEM 7, Management' s Discussion and Analysis, of this report. Unexpected Early Termination of Interest Rate Swap Agreements May Affect Earnings We have entered into interest- rate swap agreements, primarily as an asset / liability risk management tool, in order to mitigate the interest rate risk that causes fluctuations in the fair value of specified long- term fixed- rate loans **and securities** or firm commitments to originate long- term fixed rate loans. In the event of default by the borrowers on our hedged loans, we may have to terminate these designated interest- rate swap agreements early, resulting in market value losses that could negatively affect our earnings. The Trading Volume of Bancorp' s Common Stock May Be Less than That of Other, Larger Financial Services Companies Our common stock is listed on the Nasdaq Capital Market exchange. Our trading volume is less than that of nationwide or larger regional financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence of willing buyers and sellers of common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the low trading volume of our common stock, significant trades of our stock in a given time **period** , or the expectations of these trades, could cause volatility in the stock price ~~. We are Subject to Uncertainty from the Transition of London Interbank Offered Rate (' LIBOR") as a Reference Rate LIBOR has been one of the most widely used global interest rate benchmark deeply embedded in global financial products. The long- term viability of LIBOR has been undermined due to cases of rate manipulation, low volumes for underlying interbank transactions and the reluctance of panel banks to submit quotes used to calculate LIBOR. As a result, the Financial Conduct Authority of the United Kingdom (the " FCA ") announced that the most commonly used LIBOR rates will cease to be published or cease to be representative after June 30, 2023. The publication of all other LIBOR settings ceased to be published as of December 31, 2021. The Alternative Reference Rates Committee (" ARRC "), a steering committee comprised of U. S. financial market participants selected by the Federal Reserve Bank of New York, published recommended fall- back language for LIBOR- linked financial instruments and recommended alternatives for certain LIBOR rates (e. g., Secured Overnight Financing Rate (" SOFR "), a broad measure of the cost of overnight borrowings collateralized by Treasury securities, for USD LIBOR). As of December 31, 2022, we had twenty- six investment securities with book values totaling $ 30. 0 million, seven loans totaling $ 12. 8 million, and four interest rate swap contracts with notional values of $ 12. 0 million indexed to LIBOR. Almost all of our LIBOR- indexed investment securities were issued by GSEs who are members of ARRC and have transition strategies and timelines for their legacy LIBOR- indexed investment products, including fall- back rates tied to 30- day average SOFR or Term SOFR. We discontinued originating or purchasing LIBOR- based loans and investment securities effective December 31, 2021. Loans currently indexed to LIBOR either have contractual fall- back rates or will be negotiated using replacement indices such as SOFR or Bloomberg Short- Term Bank Yield Index (" BSBY"), a benchmark developed by Bloomberg Professional Services. In addition, our interest rate swap agreements can either be subject to the fall- back index rate stipulated by the ISDA protocol or modified to other reference rates such as Prime or SOFR as mutually agreed by us and our counterparty. While management has identified financial instruments indexed to LIBOR and evaluated contracts and index alternatives, we cannot predict any favorable or unfavorable effects the chosen alternative index may have on financial instruments that are currently indexed to LIBOR after its termination date~~ . Credit Risks We are Subject to Significant Credit Risk and Loan Losses May Exceed Our Allowance for Credit Losses in the Future The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge- offs and may necessitate that we significantly increase our allowance for credit losses on loans, each of which could adversely affect our net income. As a result, any inability to successfully manage credit risk could have a material adverse effect on our business, financial condition or results of operations. We maintain allowances for credit losses on loans and unfunded loan commitments that represent management' s best estimate of expected credit losses over the contractual lives of our loans under the current expected credit loss method. The level of the allowance reflects management' s continuous evaluation of specific credit risks, loan loss experience, current loan portfolio quality and present and forecasted economic, political and regulatory conditions. The determination of the appropriate level of the allowances inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and trends and future economic forecasts, all of which may undergo material changes. Inaccurate assumptions in appraisals or an inappropriate choice of the valuation techniques may lead to an inadequate level of specific reserve or charge- offs. The Small to Medium- sized Businesses that we Lend to may have Fewer Resources to Weather Adverse Economic and Other Developments, which may Impair a Borrower' s Ability to Repay a Loan We focus our business development and marketing strategy primarily on small to medium- sized businesses. Small to medium- sized businesses frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower' s ability to repay a loan. In addition, the success of a small and medium- sized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could adversely affect the business and its ability to repay its loan. If general economic conditions negatively affect the California markets in which we operate and small to medium- sized businesses are adversely affected or our borrowers are otherwise affected by adverse business developments, our business, financial condition and results of operations may be negatively affected. Negative Conditions Affecting Real Estate May Harm Our Business and Our Commercial Real Estate Concentration May Heighten Such Risk Concentration of our lending activities in the California real estate sector could negatively affect our results of operations if adverse changes in our lending area occur. ~~We do not offer traditional first mortgages, nor do we have sub- prime or Alt- A residential loans or significant amounts of securities backed by such loans in the portfolios.~~ As of December 31, ~~2022~~ **2023** , approximately 90 % of our loans had real estate as a primary or secondary component of collateral, ~~with CRE comprising 77~~ **which were comprised of 75** % **commercial real estate** and **25 %** residential real estate ~~the remaining 23 %~~ . Real estate valuations are influenced by demand, and demand is driven by economic factors such as employment rates and interest rates. Loans secured by CRE include those secured by office buildings, owner- user office / warehouses, mixed- use commercial ~~and~~ **,** retail properties **and multi- family residential real estate** . There can be no assurance that properties securing our loans will generate sufficient cash flows to allow borrowers to make full and timely loan payments to us. ~~In recent years~~ **We do not lend on high- rise office towers in San Francisco and the Bay Area generally** , **but we do take office and other** commercial **properties as collateral in our CRE lending. For a discussion of our CRE lending, including detail on the types of properties in our** real estate **secured lending and geographic** ~~markets have been particularly impacted by the economic disruption~~ - **distribution of** ~~resulting from the COVID- 19 pandemic. Some pandemic- driven activity,~~ such **loans, please see the discussion titled " FINANCIAL CONDITION – Loans " herein** ~~as shifts from in- person to online shopping and from office- based to remote work could affect long- term performance of some types of properties~~ . Rising CRE lending concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the CRE market. Concentration risk exists when financial institutions deploy too many assets to any one industry or segment. Concentration stemming from commercial real estate is one area of regulatory concern. The CRE Concentration Guidance provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) **total** commercial real estate loans exceeding 300 % of capital and increasing 50 % or more in the preceding three years; or (ii) construction and land development loans exceeding 100 % of capital. The CRE Concentration Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. As of December 31, **2023 and** 2022 ~~and 2021~~ , using regulatory definitions in the CRE Concentration Guidance, our CRE loans represented **300 % and** 307 ~~% and 332~~ %, respectively, of our total risk- based capital. We ~~are actively working to~~ manage our CRE ~~concentration~~ **concentrations** and ~~we have discussed~~ -- **discuss** ~~the~~ **them as necessary** ~~CRE Concentration Guidance~~ with the **banking** regulatory agencies and believe that our underwriting policies, management information systems, independent credit administration process, and monitoring of real estate loan concentrations are currently sufficient to address the CRE Concentration Guidance. Accounting Estimates and Risk Management Processes Rely on Analytical and Forecasting Models The processes we use to estimate expected credit losses on loans and investment securities, and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market volatility or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset- liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market factors. If the models we use for determining our expected credit losses on loans and investment securities are inadequate, the allowance for credit losses may not be sufficient to support future charge- offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations. Investment Securities May Lose Value due to Credit Quality of the Issuers We invest in significant portions of debt securities issued by government- sponsored enterprises (" GSE"), such as Federal Home Loan Bank (" FHLB"), Federal National Mortgage Association (" FNMA "), and Federal Home Loan Mortgage Corporation (" FHLMC"). We also hold mortgage- backed securities (" MBS ") issued by FNMA and FHLMC, both of which have been under U. S. government conservatorship since 2008. While we consider FNMA and FHLMC securities to have low credit risk as they carry the explicit backing of the U. S. government due to the conservatorship, they are not direct obligations of the U. S. government. The fair value of our securities issued or guaranteed by these two GSE entities may be negatively impacted if the U. S. government ceases to provide support to the conservatorship ~~or phases out its current practice of purchasing treasury and agency mortgage- backed securities~~ . GSE debt is sponsored but not guaranteed by the federal government and carries implicit backing, whereas government agencies such as Government National Mortgage Association (" GNMA") are divisions of the government whose securities are backed by the full faith and credit of the U. S. government. Although Congress has taken steps to improve regulation and consumer protection related to the housing finance system (e. g., **the** Dodd- Frank Act), FNMA and FHLMC have entered their ~~15th~~ **16th** year of U. S. government conservatorship via the Federal Housing Finance Agency (~~the~~ " FHFA"). While proposals to end the conservatorship have considered solutions such as an initial public offering, at the date of this report, its future and ultimate impact on the financial markets and our investments in GSEs are uncertain. While we generally seek to minimize our exposure by strategically diversifying our credit exposure to obligations of issuers in various geographic locations throughout California and the U. S., investing in investment **-** grade securities **,** and actively monitoring the ~~credit worthiness~~ **creditworthiness** of the issuers and / or credit guarantee providers, there is no guarantee that the issuers will remain financially sound or continue their payments on these debentures. Operational and Other Risks Risks Associated with Cybersecurity Could Negatively Affect Our Earnings and Reputation Our business requires the secure management of sensitive client and bank information. We work diligently to implement **layered** security measures that intend to make our communications and information systems **resilient and** safe to conduct business. **With the advent of artificial intelligence (AI),** ~~Cyber~~ **cyber** threats such as social engineering, ransomware, and phishing ~~emails~~ are more **sophisticated and** prevalent now than ever before. These incidents include intentional and unintentional events that may present threats designed to disrupt operations, corrupt data, release sensitive information **,** or cause denial- of- service attacks. A cybersecurity breach of systems operated by the Bank, merchants, vendors, customers, or externally publicized breaches of other financial institutions may significantly harm our reputation, result in a loss of customer business, subject us to regulatory scrutiny, or expose us to civil litigation and financial liability. While we have systems and procedures designed to prevent security breaches, we cannot be certain that advances in **cyberthreats,** criminal capabilities, ~~physical system or~~ network break- ins **,** or inappropriate access will not compromise or breach the technology protecting our networks or proprietary client information. If a material security breach were to occur, the Bank has policies and procedures in place to ensure timely disclosure **. For additional information on cybersecurity management and governance, refer to ITEM- 1C, Cybersecurity, in this report** . The Financial Services Industry is Undergoing Rapid Technological Changes and, As a Result, We Have a Continuing Need to Stay Current with Those Changes to Compete Effectively and Increase Our Efficiencies. We May Not Have the Resources to Implement New Technology to Stay Current with These Changes The financial services industry is undergoing technological changes with frequent introductions of new technology- driven products and services. In addition to providing better client service, the effective use of technology increases efficiency and reduces operational costs. Our future success will depend in part ~~upon~~ **on** our ability to use technology to provide products and services that will satisfy client demands securely and cost- effectively. In connection with implementing new technology enhancements and / or products, we may experience operational challenges (e. g. **,** human error, system error, incompatibility) **,** which could result in us not fully realizing the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner. Climate change and related legislative and regulatory initiatives may materially affect the Company' s business and results of operations. Concerns over the long- term impacts of climate change have led to governmental efforts around the world to mitigate those impacts. As a result, political and social attention to the issue of climate change has increased. The U. S. government, state legislatures and federal and state regulatory agencies are likely to continue to propose and advance numerous legislative and regulatory initiatives seeking to mitigate the effects of climate change. These initiatives and increasing supervisory expectations may require the Company to expend significant capital and incur compliance, operating, maintenance and remediation costs. In addition, given the lack of empirical data on the credit and other financial risks posed by climate change, it is impossible to predict how climate change may impact our financial condition and operations. As a banking organization, the physical effects of climate change may present certain unique risks. For example, our primary market is located in both earthquake and wildfire- prone zones in Northern California, which is also subject to other weather or disasters, such as severe rainstorms, drought or flood. These events have interrupted our business operations unexpectedly **at times** (e. g., PG & E power shutoffs in the North Bay and Sacramento Region) ~~at times~~ . Climate- related physical changes and hazards could also pose credit risks for us. For example, our borrowers may have collateral properties or operations located in areas at risk of wildfires, or coastal areas at risk to rising sea levels and erosion, or subject to the risk of drought in California. The properties pledged as collateral on our loan portfolio could also be damaged by tsunamis, landslides, floods, earthquakes or wildfires and thereby the recoverability of loans could be impaired. A number of factors can affect credit losses, including the extent of damage to the collateral, the extent of damage not covered by insurance, the extent to which unemployment and other economic conditions caused by the natural disaster adversely affect the ability of borrowers to repay their loans, and the cost of collection and foreclosure to us. Additionally, there could be increased insurance premiums and deductibles, or a decrease in the availability of coverage, due to severe weather- related losses. The ultimate outcome on our business of a natural disaster, whether or not caused by climate change, is difficult to predict but could have a material adverse effect on financial condition, results of operations or profitability. We Rely on Third- Party Vendors for Important Aspects of Our Operation We depend on the accuracy and completeness of information and systems provided by certain key vendors, including but not limited to data processing, payroll processing, technology support, investment safekeeping and accounting. For example, we outsource core processing to Fidelity Information Services (" FIS") and wire processing to Finastra, which are leading financial services solution providers that allow us access to competitive technology offerings without having to invest in their development. Our ability to operate, as well as our financial condition and results of operations, could be negatively affected in the event of an interruption of an information system, an undetected error, a cyber- breach, or in the event of a natural disaster whereby certain vendors are unable to maintain business continuity. Regulatory and Compliance Risks Banks and Bank Holding Companies are Subject to Extensive Government Regulation and Supervision Bancorp and the Bank are subject to extensive federal and state governmental supervision, regulation and control. Holding company regulations affect the range of activities in which Bancorp is engaged. Banking regulations affect the Bank' s lending practices, capital structure, investment practices, dividend policy, and compliance costs among other things. Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or non- conformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards set forth by regulators. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of our clients may be ambiguous or untested. This risk exposes Bancorp and the Bank to potential fines, civil money penalties, payment of damages and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and an inability to enforce contracts. The Bank manages these risks through its extensive compliance plan, policies and procedures. For further information on supervision and regulation, see the section captioned " SUPERVISION AND REGULATION " in ITEM 1 of this report. **Any Regulatory Examination Scrutiny or New Regulatory Requirements Arising From the Recent Events in the Banking Industry Could Increase the Company' s Expenses and Affect the Company' s Operations The Company anticipates increased regulatory scrutiny – in the course of routine examinations and otherwise – and new regulations directed towards banks of similar size to the Bank, designed to address the recent negative developments in the banking industry, all of which may increase the Company' s costs of doing business and reduce its profitability.**