

# FEDERAL DEPOSIT INSURANCE CORPORATION

Washington, D.C. 20429

## FORM 10-Q

Mark One

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2022

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

## PREFERRED BANK

(Exact name of registrant as specified in its charter)

<b>California</b> (State or other jurisdiction of incorporation or organization)	<b>33539</b> (FDIC Certificate Number)	<b>95-4340119</b> (I.R.S. Employer Identification No.)
<b>601 S. Figueroa Street, 48<sup>th</sup> Floor, Los Angeles, California</b> (Address of Principal Executive Offices)		<b>90017</b> (Zip Code)

**Registrant's telephone number, including area code: (213) 891-1188**

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

<u>Title of each class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
Common Stock, no Par Value	PFBC	NASDAQ Stock Market LLC

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

☐ Large Accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐ Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☐ No ☐

Number of shares of common stock of the Registrant outstanding as of August 6, 2022 was 14,356,708 shares.

# PREFERRED BANK

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## Forward-Looking Statements

Certain matters discussed in this Quarterly Report on Form 10-Q (this “Report”) may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and as such, may involve risks and uncertainties. We claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995. These forward-looking statements relate to, among other things, the Bank’s financial condition, results of operations, plans, objectives, expectations of the environment in which we operate and projections of future performance or business. Such statements can generally be identified by the use of forward-looking language, such as “is expected to,” “will likely result,” “anticipated,” “projected,” “estimate,” “forecast,” “intends to,” or may include other similar words, phrases, or future or conditional verbs such as “aims,” “believes,” “plans,” “continue,” “remain,” “may,” “might,” “will,” “would,” “should,” “could,” “can,” or similar language. Forward-looking statements by us are based on estimates, beliefs, projections and assumptions of management and are not guarantees of future performance. Our actual results, performance, or achievements may differ significantly from the results, performance, or achievements expected or implied in such forward-looking statements. When considering these statements, you should not place undue reliance on these statements, as they are subject to certain risks and uncertainties, as well as any cautionary statements made within this Annual Report, and should also note that these statements are made as of the date of this Annual Report and based only on information known to us at that time.

Factors causing risk and uncertainty, which could cause future results to be materially different from forward-looking statements contained in this Annual Report as well as from historical performance, include but are not limited to:

- Regulatory decisions regarding the Bank, and impact of future regulatory and governmental agency decisions including Basel III capital standards
- Adequacy of allowance for credit loss estimates in comparison to actual future losses
- Necessity of additional capital in the future, and possible unavailability of that capital on acceptable terms
- Economic and market conditions that may adversely affect the Bank and our industry
- Disruptions to the financial markets as a result of the current or anticipated impact of military conflict, including escalating military tension between Russia and Ukraine, terrorism or other geopolitical events
- Possible loss of members of senior management or other key employees upon whom the Bank heavily relies
- Variations in interest rates which may negatively affect the Bank’s financial performance
- Changes in governmental or bank-established interest rates or monetary policies, including the replacement of the LIBOR index on our loans which are tied to that index
- Strong competition from other financial service entities
- Possibility that the Bank’s underwriting practices may prove to be ineffective
- Changes in the commercial and residential real estate markets that could adversely affect the collateral value supporting our loans and increase charge-offs
- Adverse economic conditions in Asia which could negatively impact the Bank’s business
- Catastrophic events, acts of war or terrorism, or natural disasters, such as earthquakes, drought, pandemic diseases (including the COVID-19 pandemic discussed further below), climate change or extreme weather events, any of which may affect services we use, may affect our customers, employees or third parties with which we conduct business, or could negatively impact the Bank’s business
- Geographic concentration of our operations
- The economic impact of Federal budgetary policies
- Failure to attract deposits, inhibiting growth
- Interruption or break in the communication, information, operating, and financial control systems upon which the Bank relies
- Changes in federal and state laws or the regulatory environment including regulatory reform initiatives and policies of the U.S. Department of Treasury, the Board of Governors of the Federal Reserve Board System, the Federal Deposit Insurance Corporation, the Consumer Financial Protection Bureau and the California Department of Financial Protection and Innovation
- Changes in accounting standards as may be required by the Financial Accounting Standards Board or other regulatory agencies and their impact on critical accounting policies and assumptions
- Potential changes in the U.S. government’s monetary policies
- Environmental liability with respect to properties to which the Bank takes title
- Negative publicity

- Information technology and cyber security incidents, disruptions or attacks and the possible blocking, theft or loss of Bank or customer access, functionality, data, funding or money

On March 11, 2020, the World Health Organization declared the novel coronavirus (“COVID-19”) a worldwide pandemic. On March 12, 2020, the President of the United States declared the COVID-19 outbreak in the United States a national emergency. The COVID-19 pandemic caused significant economic dislocation in the United States as many state and local governments ordered non-essential businesses to close and residents to shelter in place at home. While the business and government shutdowns have been eased over the last several months, the emergence and spread of COVID-19 variants has resulted at times in increased levels of infections, hospitalizations, and deaths. Given its ongoing and dynamic nature, it is difficult to predict the full impact of the COVID-19 outbreak on our business. The extent of such impact will depend on future developments, which are highly uncertain and many of which are outside the Bank's control. Such developments include the availability and effectiveness of vaccines for the COVID-19 virus, COVID-19 vaccine immunization rates, the ultimate geographic spread and duration of the pandemic, the extent and duration of a resurgence of the COVID-19 virus and variant strains such as the delta and omicron variants, new information concerning the severity of the COVID-19 virus, the effectiveness and intensity of measures to contain the COVID-19 virus and the economic impact of the pandemic and reactions to it. As a result of the COVID-19 pandemic and the related adverse local and national economic consequences, our forward-looking statements are subject to the following risks, uncertainties and assumptions:

- Demand for our products and services may decline;
- If the economy is unable to remain open, and high levels of unemployment return and continue for an extended period of time, loan delinquencies, problem assets, and foreclosures may increase;
- Collateral for loans, especially commercial real estate, may decline in value;
- Our allowance for credit losses on loans may have to be increased if borrowers experience financial difficulties;
- The net worth and liquidity of loan guarantors may decline;
- A material decrease in net income or a net loss over several quarters could result in a decrease in the rate of our quarterly cash dividend;
- Our cyber security risks are increased as a result of an increase in the number of employees working remotely; and
- FDIC premiums may increase if the agency experiences additional resolution costs.

These and other risk factors are more fully described in this report and in our 2021 Annual Report on Form 10-K as filed with the Federal Deposit Insurance Corporation (“FDIC”) on March 14, 2022 under the heading “Item 1A. RISK FACTORS – Risk Factors That May Affect Future Results.” We do not undertake, and we specifically disclaim any obligation to update any forward looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

**PART I. FINANCIAL INFORMATION**

**ITEM 1. Financial Statements**

**PREFERRED BANK**  
**Consolidated Statements of Financial Condition**  
(In thousands except share data)

	<b>June 30, 2022</b>	<b>December 31, 2021</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Cash and due from banks	\$ 748,658	\$ 1,030,610
Federal funds sold	20,000	20,000
Cash and cash equivalents	768,658	1,050,610
Securities held-to-maturity, at amortized cost (fair value of \$11,656 as of June 30, 2022 and \$13,928 as of December 31, 2021)	12,784	13,962
Securities available-for-sale, at fair value	400,597	451,911
Loans and leases	4,920,141	4,424,992
Less: allowance for credit losses on loans	(61,396)	(59,969)
Less: unamortized deferred loan fees, net	(9,525)	(6,316)
Net loans and leases	4,849,220	4,358,707
Other real estate owned and repossessed assets	21,449	-
Bank furniture and fixtures, net	9,764	10,533
Customers' liability on acceptances	11,053	10,188
Bank-owned life insurance	10,221	10,088
Accrued interest receivable	16,241	14,646
Investment in affordable housing partnerships	54,874	59,018
Federal Home Loan Bank ("FHLB") stock, at cost	15,000	15,000
Net deferred tax assets	36,703	26,674
Operating lease right-of-use assets	21,024	21,969
Other assets	5,453	2,997
Total assets	\$ 6,233,041	\$ 6,046,303
<b>Liabilities and Shareholders' Equity</b>		
Liabilities:		
Deposits:		
Demand	\$ 1,385,934	\$ 1,305,692
Interest-bearing demand	2,239,501	2,032,819
Savings	39,784	37,839
Time certificates of \$250,000 or more	870,376	934,444
Other time certificates	872,357	914,717
Total deposits	5,407,952	5,225,511
Acceptances outstanding	11,053	10,188
Subordinated debt issuance, net of unamortized costs and premium of \$2,123 and \$2,242 at June 30, 2022 and December 31, 2021, respectively	147,877	147,758
Accrued interest payable	752	715
Commitments to fund investment in affordable housing partnerships	20,036	22,606
Operating lease liability	21,115	22,861
Other liabilities	32,664	29,946
Total liabilities	5,641,449	5,459,585
Commitments and Contingencies – Note 6		
Shareholders' equity:		
Preferred Stock, no par value. Authorized 25,000,000 shares; no issued or outstanding shares at June 30, 2022 and December 31, 2021, respectively	-	-
Common stock, no par value. Authorized 100,000,000 shares; outstanding 14,628,942 and 14,679,769 shares at June 30, 2022 and December 31, 2021, respectively	210,882	210,882
Treasury stock, at cost; 1,406,231 and 1,197,607 shares at June 30, 2022 and December 31, 2021, respectively	(89,411)	(75,207)
Additional paid-in capital	76,526	73,165
Retained earnings	414,393	372,952
Accumulated other comprehensive (loss) income	(20,798)	4,926
Total shareholders' equity	591,592	586,718
Total liabilities and shareholders' equity	\$ 6,233,041	\$ 6,046,303

*See accompanying notes to the unaudited consolidated interim financial statements.*

**PREFERRED BANK**  
**Consolidated Income Statement and Comprehensive Income**  
(In thousands, except share and per share data)  
(Unaudited)

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2022</b>	<b>2021</b>	<b>2022</b>	<b>2021</b>
Interest income:				
Loans and leases	\$ 58,541	\$ 47,906	\$ 110,660	\$ 97,765
Investment securities	3,972	2,548	6,858	4,825
Federal funds sold	46	19	65	43
Total interest income	62,559	50,473	117,583	102,633
Interest expense:				
Interest-bearing demand	2,448	1,530	3,880	2,967
Savings	20	18	39	37
Time certificates of \$250,000 or more	1,211	1,688	2,237	3,606
Other time certificates	1,131	1,731	2,321	3,640
Subordinated debt	1,325	2,145	2,650	3,676
Total interest expense	6,135	7,112	11,127	13,926
Net interest income before provision for credit losses	56,424	43,361	106,456	88,707
Provision for credit losses	2,900	-	2,650	1,400
Net interest income after provision for credit losses	53,524	43,361	103,806	87,307
Noninterest income:				
Fees and service charges on deposit accounts	723	525	1,395	951
Letter of credit fee income	1,329	811	2,261	1,619
BOLI income	100	98	199	194
Net loss on sale of loans	-	(261)	-	(640)
Other income	449	473	1,012	869
Total noninterest income	2,601	1,646	4,867	2,993
Noninterest expense:				
Salaries and employee benefits	11,688	10,285	23,328	21,408
Net occupancy expense	1,441	1,429	2,863	2,830
Business development and promotion expense	176	117	277	190
Professional services	1,460	996	2,703	1,977
Office supplies and equipment expense	459	476	948	914
Other real estate owned related expense, net	385	-	401	-
Other	1,531	1,661	2,777	3,297
Total noninterest expense	17,140	14,964	33,297	30,616
Income before income taxes	38,985	30,043	75,376	59,684
Income tax expense	10,916	8,563	21,280	17,010
Net income	\$ 28,069	\$ 21,480	\$ 54,096	\$ 42,674
Income allocated to participating securities	-	(2)	(2)	(4)
Dividends allocated to participating securities	-	(1)	-	(1)
Net income available to common shareholders – basic and diluted	\$ 28,069	\$ 21,477	\$ 54,094	\$ 42,669
Unrealized net loss on securities available-for-sale	(20,025)	3,530	(35,753)	(416)
Income tax expense related to items of other comprehensive income	5,617	(990)	10,029	117
Other comprehensive loss	(14,408)	2,540	(25,724)	(299)
Comprehensive income	\$ 13,661	\$ 24,020	\$ 28,372	\$ 42,375
Net income per share				
Basic	\$ 1.90	\$ 1.44	\$ 3.66	\$ 2.85
Diluted	\$ 1.87	\$ 1.44	\$ 3.61	\$ 2.85
Weighted-average common shares outstanding				
Basic	14,792,298	14,954,688	14,778,892	14,952,366
Diluted	15,006,801	14,954,688	14,990,989	14,952,366

*See accompanying notes to the unaudited consolidated interim financial statements.*

**PREFERRED BANK**  
**Consolidated Statements of Changes in Shareholders' Equity**  
(In thousands, except for share and per-share amounts)  
(Unaudited)

	Preferred Stock	Common Stock Shares	Common Stock Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b>Balance as of April 1, 2022</b>	\$ -	14,810,635	\$ 210,882	\$ (76,366)	\$ 74,549	\$ 392,610	\$ (6,390)	\$ 595,285
Issuance of common stock	-	10,850	-	-	-	-	-	-
Cash dividend declared (\$0.43 per share)	-	-	-	-	-	(6,286)	-	(6,286)
Restricted stock grant, net	-	-	-	-	1,984	-	-	1,984
Stock surrendered due to employee tax liability	-	(384)	-	(82)	-	-	-	(82)
Stock repurchased	-	(192,159)	-	(12,963)	(7)	-	-	(12,970)
Net income	-	-	-	-	-	28,069	-	28,069
Change in unrealized loss, net of tax	-	-	-	-	-	-	(14,408)	(14,408)
<b>Balance as of June 30, 2022</b>	\$ -	14,628,942	\$ 210,882	\$ (89,411)	\$ 76,526	\$ 414,393	\$ (20,798)	\$ 591,592
<b>Balance as of April 1, 2021</b>	\$ -	14,951,838	\$ 210,882	\$ (57,705)	\$ 65,416	\$ 316,481	\$ 4,195	\$ 539,269
Cash dividend declared (\$0.38 per share)	-	-	-	-	-	(5,685)	-	(5,685)
Restricted stock grant, net	-	10,825	-	-	1,365	-	-	1,365
Stock surrendered due to employee tax liability	-	(499)	-	-	-	-	-	-
Net income	-	-	-	-	-	21,480	-	21,480
Change in unrealized loss, net of tax	-	-	-	-	-	-	2,540	2,540
<b>Balance as of June 30, 2021</b>	\$ -	14,962,164	\$ 210,882	\$ (57,705)	\$ 66,781	\$ 332,276	\$ 6,735	\$ 558,969

*See accompanying notes to the unaudited consolidated interim financial statements.*

**PREFERRED BANK**  
**Consolidated Statements of Changes in Shareholders' Equity, Continued**  
(In thousands, except for share and per-share amounts)  
(Unaudited)

	Preferred Stock	Common Stock Shares	Common Stock Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b>Balance as of January 1, 2022</b>	\$ -	14,679,769	\$ 210,882	\$ (75,207)	\$ 73,165	\$ 372,952	\$ 4,926	\$ 586,718
Issuance of common stock	-	157,797	-	-	-	-	-	-
Cash dividends declared (\$0.86 per share)	-	-	-	-	-	(12,655)	-	(12,655)
Restricted stock grant, net	-	-	-	-	3,368	-	-	3,368
Stock surrendered due to employee tax liability	-	(16,465)	-	(1,241)	-	-	-	(1,241)
Stock repurchased	-	(192,159)	-	(12,963)	(7)	-	-	(12,970)
Net income	-	-	-	-	-	54,096	-	54,096
Change in unrealized loss, net of tax	-	-	-	-	-	-	(25,724)	(25,724)
<b>Balance as of June 30, 2022</b>	\$ -	14,628,942	\$ 210,882	\$ (89,411)	\$ 76,526	\$ 414,393	\$ (20,798)	\$ 591,592
<b>Balance as of January 1, 2021</b>	\$ -	14,931,861	\$ 210,882	\$ (57,502)	\$ 64,064	\$ 300,969	\$ 7,034	\$ 525,447
Cash dividends declared (\$0.76 per share)	-	-	-	-	-	(11,367)	-	(11,367)
Restricted stock grant, net	-	34,825	-	-	2,717	-	-	2,717
Stock surrendered due to employee tax liability	-	(4,522)	-	(203)	-	-	-	(203)
Net income	-	-	-	-	-	42,674	-	42,674
Change in unrealized loss, net of tax	-	-	-	-	-	-	(299)	(299)
<b>Balance as of June 30, 2021</b>	\$ -	14,962,164	\$ 210,882	\$ (57,705)	\$ 66,781	\$ 332,276	\$ 6,735	\$ 558,969

*See accompanying notes to the unaudited consolidated interim financial statements.*



**PREFERRED BANK**  
**Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

	Six months ended June 30, 2022	2021
<b>Cash flows from operating activities:</b>		
Net income	\$ 54,096	\$ 42,674
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	2,650	1,400
Amortization of deferred loan fees, net	(1,651)	(1,208)
Amortization of investment securities discounts and premiums, net	501	440
Amortization of investment in affordable housing partnerships	4,144	7,069
Accretion of discount on borrowings	-	(308)
Amortization of subordinated debt issuance costs	119	990
Loans originated for sale	-	(510)
Loss on sale of loans	-	640
Sale of loans	-	530
Depreciation and amortization	968	934
Share-based compensation expense	3,368	2,717
Income from bank owned life insurance, net	(133)	(129)
Changes in other assets and liabilities:		
Accrued interest receivable and other assets	(4,853)	(3,889)
Accrued interest payable and other liabilities	2,781	(2,027)
Net cash provided by operating activities	<u>61,990</u>	<u>49,323</u>
<b>Cash flows from investing activities:</b>		
Proceeds from maturities and redemptions of securities held-to-maturity	1,123	1,097
Proceeds from maturities and redemptions of securities available-for-sale	14,330	15,186
Proceeds from sale of equity securities	-	-
Proceeds from sale of securities available for sale	7,785	-
Purchase of securities held-to-maturity	-	(10,340)
Purchase of securities available-for-sale	(7,000)	(54,758)
Purchase of investments in affordable housing partnerships	(2,570)	(11,518)
Proceeds from sale of loans from LHFS previously classified as portfolio loans	-	24,661
Proceeds from recoveries of written off loans	-	57
Net increase in loans	(498,726)	(267,615)
Payoff of liens in connection with foreclosure of assets	(14,234)	-
Purchase of bank premises and equipment	(199)	(317)
Net cash used in investing activities	<u>(499,491)</u>	<u>(303,547)</u>
<b>Cash flows from financing activities:</b>		
Increase in deposits	182,441	353,826
Repayment of subordinated debt	-	(100,000)
Proceeds from issuance of subordinated debt	-	147,771
Increase in Treasury shares	(14,211)	(203)
Payment of cash dividends	(12,681)	(10,161)
Net cash provided by financing activities	<u>155,549</u>	<u>391,233</u>
Net (decrease) increase in cash and cash equivalents	(281,952)	137,009
Cash and cash equivalents at beginning of period	<u>1,050,610</u>	<u>759,465</u>
Cash and cash equivalents at end of period	<u>\$ 768,658</u>	<u>\$ 896,474</u>

*See accompanying notes to the unaudited consolidated interim financial statements.*

**PREFERRED BANK**  
**Consolidated Statements of Cash Flows - continued**  
(In thousands)  
(Unaudited)

	Six months ended June 30,	
	2022	2021
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$ 11,090	\$ 14,257
Income taxes	12,420	18,052
Noncash activities:		
Common stock dividends declared but not paid	\$ 6,286	\$ 5,685
Repossession assets in settlement of loans	3,465	-
Operating lease liabilities arising from right-of-use assets	127	-
Transfer of loans held for investment to loans held for sale	-	25,321
Real estate acquired in settlement of loans	3,750	-

*See accompanying notes to the unaudited consolidated interim financial statements.*

**PREFERRED BANK**  
**Notes to Consolidated Interim Financial Statements**  
**(Unaudited)**

**1. Business**

Preferred Bank commenced operations in 1991 as a California state-chartered bank and offers a wide range of financial services. As of June 30, 2022, the Bank operates through twelve full-service branch banking offices in Los Angeles, Orange, and San Francisco Counties in California, one full-service branch in Queens County, New York, and a loan production office (“LPO”) in the Houston suburb of Sugar Land, Texas. In September 2021, we opened a satellite office in Manhattan, New York. As of June 30, 2022, approximately 88% of the total dollar amount of the Bank’s gross loans were secured by real estate located in California and the Northeast Tri-State area (New York, New Jersey and Connecticut). The Bank is a member of the Federal Home Loan Bank system (“FHLB”) and the Bank’s deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”).

***COVID-19 and Recent Events***

The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains, affected equity market valuations, and created significant volatility and disruption in financial markets, although economic growth and employment levels had largely rebounded by the end of 2021. Similarly, the initial imposition of temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities have been relaxed or rescinded as the COVID-19 pandemic has become more endemic.

The Bank continues to monitor and adhere to all federal, state, county and city mandates as it relates to the ongoing COVID-19 pandemic. We have resumed branch operating hours closer to those in effect pre-pandemic and beginning mid-June 2021, we brought back our employees to our offices full time. The Bank has taken various actions to support our customers and the communities we collectively serve, including modifying outstanding loans and waiving certain deposit service charges. Loans that were modified via principal and/or interest deferrals were done so in accordance with Section 4013 of the CARES Act and the Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus and have not been categorized as troubled debt restructurings. We took part in the Paycheck Protection Program (“PPP”) created by the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), which officially ended on May 31, 2021. The Federal Reserve established the Main Street Lending Program to support lending to small and medium-sized for-profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic. The program operated through the five facilities and we participated in the Main Street New Loan Facility (“MSNLF”) in the third quarter of 2020. The MSLP terminated on January 8, 2021.

**2. Principles of Consolidation and Basis of Presentation**

The accompanying unaudited consolidated interim financial statements include the accounts of Preferred Bank and its wholly-owned, inactive subsidiary, PB Investment and Consulting, Inc. (herein referred to as the “Bank”, “we”, “us” or “our”). All intercompany transactions and accounts have been eliminated in consolidation.

The unaudited consolidated interim financial statements of the Bank have been prepared in conformity with generally accepted accounting principles generally accepted in the United States of America (“GAAP”). In the opinion of management, all adjustments, which consist of normally recurring adjustments necessary for a fair statement of the interim period results, have been made.

Through its branch network, the Bank provides a broad range of financial services to individuals and companies primarily located in Southern California, the Bay Area of California and the Greater New York City area. These services include demand, time and savings deposits and real estate, business and consumer lending. While the Bank’s chief decision makers monitor the revenue streams of various products and services, operations are managed and financial performance is evaluated on a bank-wide basis. Accordingly, the Bank considers all operations aggregated in one reportable operating segment.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. The results of operations for the three and six months ended June 30, 2022 are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2022. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the registrant's Annual Report on Form 10-K for the year ended December 31, 2021, which was filed with the FDIC on March 14, 2022. Subsequent events have been evaluated through the date of the issuance of the unaudited Consolidated Financial Statements. No significant subsequent events have occurred through this date requiring adjustment to the financial statements or disclosures.

### **3. Recent Accounting Pronouncements**

#### ***Recently Issued Accounting Pronouncements***

Following are the recently issued updates to the codification of U.S. Accounting Standards ("ASUs"), which are the most relevant to the Bank.

ASU 2020-04, *Reference Rate Reform (Topic 848), Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. In January 2021, the FASB clarified the scope of that guidance with the issuance of ASU 2021-01, "Reference Rate Reform: Scope." This ASU provides optional guidance for a limited period of time to ease the burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. This guidance applies to companies meeting certain criteria that have contracts, hedging relationships and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. This standard is effective for us immediately and may be applied prospectively to contract modifications made and hedging relationships entered into or evaluated on or before December 31, 2022. The adoption of this ASU did not have an impact on the Bank's financial statements. The Bank considers SOFR to be its likely preferred reference as an alternative to LIBOR. New originations by the Bank are being made using SOFR in addition to Prime Rate. The Bank may also consider the use of other alternative reference rates based on marketplace demands and the needs of its customers.

ASU 2022-02, *Financial Instruments—Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures*. In March 2022, the FASB issued ASU 2022-02 to address areas identified by the FASB as part of its post-implementation review of the credit losses standard (ASU 2016-13) that introduced the CECL model. The amendments eliminate the accounting guidance for troubled debt restructurings by creditors that have adopted the CECL model and enhance the disclosure requirements for loan refinancings and restructurings made with borrowers experiencing financial difficulty. In addition, the amendments require a public business entity to disclose current-period gross write-offs for financing receivables and net investment in leases by year of origination in the vintage disclosures. ASU 2022-02 is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted if an entity has adopted ASU 2016-13. ASU 2022-02 is not expected to have a material effect on the Bank's consolidated financial statements.

### **4. Earnings Per Share**

Earnings per share (EPS) are computed on a basic and diluted basis. Basic EPS is computed by dividing net income adjusted by presumed dividend payments and earnings on unvested restricted stock by the weighted average number of common shares outstanding. Losses are not allocated to participating securities. Unvested shares of restricted stock are excluded from basic shares outstanding. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that shares in the earnings of the Bank.

The following tables set forth earnings per share calculations:

	<b>Income (Numerator)</b>	<b>Weighted Average Shares (Denominator)</b>	<b>Per Share Amount</b>
<b><u>Three months ended June 30, 2022</u></b>			
Net Income	\$ 28,069	14,792,298	
Less: Income & dividend allocated to participating securities	-	-	
<b>Basic EPS – income available to common shareholders</b>	<b>28,069</b>	<b>14,792,298</b>	<b>\$ 1.90</b>
Effect of dilutive securities	-	214,503	
<b>Diluted EPS – income available to common shareholders</b>	<b>\$ 28,069</b>	<b>15,006,801</b>	<b>\$ 1.87</b>
<b><u>Three months ended June 30, 2021</u></b>			
Net Income	\$ 21,480	14,954,688	
Less: Income & dividend allocated to participating securities	(3)	-	
<b>Basic EPS – income available to common shareholders</b>	<b>21,477</b>	<b>14,954,688</b>	<b>\$ 1.44</b>
Effect of dilutive securities	-	-	
<b>Diluted EPS – income available to common shareholders</b>	<b>\$ 21,477</b>	<b>14,954,688</b>	<b>\$ 1.44</b>

There were no anti-dilutive shares excluded from the computation of diluted earnings per share for the three months ended June 30, 2022 and 2021, respectively.

	<b>Income (Numerator)</b>	<b>Weighted Average Shares (Denominator)</b>	<b>Per Share Amount</b>
<b><u>Six months ended June 30, 2022</u></b>			
Net Income	\$ 54,096	14,778,892	
Less: Income & dividend allocated to participating securities	(2)	-	
<b>Basic EPS – income available to common shareholders</b>	<b>54,094</b>	<b>14,778,892</b>	<b>\$ 3.66</b>
Effect of dilutive securities	-	212,097	
<b>Diluted EPS – income available to common shareholders</b>	<b>\$ 54,094</b>	<b>14,990,989</b>	<b>\$ 3.61</b>
<b><u>Six months ended June 30, 2021</u></b>			
Net Income	\$ 42,674	14,952,366	
Less: Income & dividend allocated to participating securities	(5)	-	
<b>Basic EPS – income available to common shareholders</b>	<b>42,669</b>	<b>14,952,366</b>	<b>\$ 2.85</b>
Effect of dilutive securities	-	-	
<b>Diluted EPS – income available to common shareholders</b>	<b>\$ 42,669</b>	<b>14,952,366</b>	<b>\$ 2.85</b>

There were no anti-dilutive shares excluded from the computation of diluted earnings per share for the six months ended June 30, 2022 and 2021, respectively.

## 5. Share-based Compensation

The Bank remunerates employees and directors through, among other means, the 2014 Equity Incentive Plan (the “2014 Plan”), which is discussed below.

When stock options are exercised under the 2014 Plan, the Bank’s policy is to issue new shares of stock. Under the 2014 Plan, there were no options outstanding as of June 30, 2022 and 2021 and no options were exercised during the three and six months ended June 30, 2022 and 2021. During the three and six months ended June 30, 2022 and 2021, no money was received from option exercises under the 2014 Plan.

## 2014 Equity Incentive Plan

The 2014 Plan provides for granting of nonstatutory stock options, incentive stock options, RSAs and RSUs to employees, officers, and directors of the Bank. Stock options granted under the 2014 Plan have an exercise price equal to the fair value of the underlying common stock on the date of grant. Stock options and share awards granted under the 2014 Plan are generally expected to vest in installments between 20-25% each year, become fully vested after four to five years, and expire four to six years from the date of grant. All option and share awards provide for accelerated vesting if there is a change in control (as defined in the 2014 Plan). There are 2,500,000 shares authorized under this plan. As of June 30, 2022, there have been no stock options granted under the 2014 Plan.

### Restricted Stock Awards and Units

The 2014 Plan provides for the granting of RSAs and RSUs to employees, officers, and directors of the Bank.

The RSAs and RSUs granted to our employees, officers and directors under the 2014 Plan have an immediate-to-four year vesting period and the vested number of shares are distributed at the end of the vesting period. Unlike RSAs, RSUs do not entitle the recipients to receive cash dividends.

Performance-based RSUs are granted to our Chief Executive Officer at the target amount of awards, payable at the end of the three-year performance period. Based on achievement of pre-determined financial goals, the number of shares that vest can be adjusted to a maximum of 175% of the target.

The compensation costs of both time-based and performance-based awards are estimated based on awards ultimately expected to vest and recognized on a straight-line basis from the grant date until the vesting date of each grant. The total unrecognized compensation expense for outstanding RSAs and RSUs as of June 30, 2022 were zero and \$7.4 million, respectively, and will be recognized over an average of zero and 1.8 years, respectively.

The total fair value of vested RSAs and RSUs during the three months ended June 30, 2022 and 2021 was \$64,000 and \$79,000, respectively. The total fair value of vested RSAs and RSUs during the six months ended June 30, 2022 and 2021 was \$11.4 million and \$1.2 million, respectively.

During the three months ended June 30, 2022, the Bank granted 9,100 RSAs and 200 RSUs and recognized \$1.4 million of compensation expense related to all RSAs and RSUs. During the three months ended June 30, 2021, the Bank granted 9,600 RSAs and 2,859 RSUs and recognized \$1.4 million of compensation expense related to all RSAs and RSUs.

During the six months ended June 30, 2022, the Bank granted 26,110 RSAs and 97,025 RSUs and recognized \$2.7 million of compensation expense related to all RSAs and RSUs. During the six months ended June 30, 2021, the Bank granted 33,450 RSAs and 118,129 RSUs and recognized \$2.7 million of compensation expense related to all RSAs and RSUs.

The following is a summary of the transactions for non-vested RSAs under the 2014 Plan for the six months ended June 30, 2022:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-Vested RSAs as of January 1, 2022	1,800	\$ 55.58
RSAs granted	26,110	70.57
Vested	(27,910)	69.61
Non-Vested RSAs as of June 30, 2022	-	\$ -

The following is a summary of the transactions for non-vested RSUs under the 2014 Plan for the six months ended June 30, 2022:

	Performance-based		Time-based	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Non-Vested RSUs as of January 1, 2022	96,063	\$ 53.56	277,279	\$ 53.94
RSUs granted	22,875	62.60	74,150	71.79
Forfeited or expired	-	-	(1,650)	39.04
Vested	(38,500)	49.25	(93,187)	49.10
Non-Vested RSUs as of June 30, 2022	80,438	\$ 60.10	256,592	\$ 60.95

## 6. Off-Balance Sheet Risks

The Bank enters into a variety of financial transactions with its customers in the normal course of business. Many of these products do not necessarily entail present or future funded asset or liability positions but are instead in the nature of executor contracts.

Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some commitments expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Financial instrument transactions are subject to the Bank's normal credit standards, financial controls and risk-limiting and monitoring procedures. Collateral requirements are based on a case-by-case evaluation of each customer and product. The most significant categories of collateral include real estate properties underlying mortgage loans, liens on equipment and inventory and personal property and cash on deposit with the Bank.

The Bank's exposure to credit risk under commitments to extend credit, standby letters of credit, and financial guarantees written is limited to the contractual amount of those instruments.

The following table sets forth the Bank's commitments to fund loans and other financial instruments as of June 30, 2022 and December 31, 2021:

	June 30, 2022	December 31, 2021
	<i>(In thousands)</i>	
Commitments to extend credit	\$ 1,176,209	\$ 1,081,963
Commercial letters of credit	9,452	8,759
Standby letters of credit	260,607	237,338
Total	<u>\$ 1,446,268</u>	<u>\$ 1,328,060</u>

The majority of loan commitments have terms up to one year and variable rates of interest. Standby letters of credit have terms up to one year. Most standby letters of credit expire unused.

The Bank performs an analysis to estimate the credit losses for off-balance sheet commitments, including letters of credit, acceptances outstanding, and committed loan amounts, on a quarterly basis. The reserve is calculated by applying the historical loss factor for the quarter over the total outstanding letters of credit which is also applied to pass loans for allowance for credit losses on loans provision purposes. Under the current expected credit losses ("CECL") methodology, the look back period over the last 10 years period diluted the more recent loss experience so a rolling 4-year loss rate is applied until the historical loss rate equalizes.

The allowance for credit losses on off-balance sheet commitments was \$1.2 million at June 30, 2022 and December 31, 2021 and is included in other liabilities on the statement of financial condition. Provision for credit losses on off-balance sheet commitments is included in other noninterest expense on the income statement. There was no provision for credit losses on off-balance sheet commitments for the three and six months ended June 30, 2022 and 2021.

## 7. Cash Dividend

On June 22, 2022, the Bank declared a cash dividend of \$0.43 per share on 14,617,795 shares outstanding as of July 7, 2022, for distribution to holders of common stock on July 21, 2022. Total cash dividends of \$6.4 million and \$12.7 million were paid during the three and six months ended June 30, 2022. Total cash dividends of \$5.7 million and \$10.2 million were paid during the six months ended June 30, 2021.

## 8. Investment Securities

The Bank classifies its debt investment securities in two categories: held-to-maturity or available-for-sale. Unrealized holding gains or losses, net of the related tax effect, on available-for-sale securities are excluded from income and are reported as a separate component of shareholders' equity as accumulated other comprehensive income net of applicable taxes until realized. Recognized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis. These securities are adjusted for the amortization or accretion of premiums or discounts. The Bank does not own any debt securities classified as trading or equity securities.

The carrying value of our securities classified as held-to-maturity was \$12.8 million at June 30, 2022 and \$14.0 million at December 31, 2021. The table below shows the amortized cost, gross unrecognized gains and losses and estimated fair value of securities held-to-maturity as of June 30, 2022 and December 31, 2021:

	June 30, 2022			
	Amortized cost	Gross unrecognized gains	Gross unrecognized losses	Estimated fair value
	(In thousands)			
Mortgage-backed securities	\$ 12,784	\$ -	\$ (1,128)	\$ 11,656

  

	December 31, 2021			
	Amortized cost	Gross unrecognized gains	Gross unrecognized losses	Estimated fair value
	(In thousands)			
Mortgage-backed securities	\$ 13,962	\$ 37	\$ (71)	\$ 13,928

The following tables summarize unrecognized losses on our held-to-maturity investment securities, aggregated by the length of time the securities have been in a continuous unrecognized loss position, at June 30, 2022 and December 31, 2021:

	June 30, 2022					
	Less than 12 months		12 months or greater		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
	(In thousands)					
<b>Held to maturity:</b>						
U.S. Agency mortgage-backed securities	11,656	(1,128)	-	-	11,656	(1,128)
Total securities available-for-sale	\$ 11,656	\$ (1,128)	\$ -	\$ -	\$ 11,656	\$ (1,128)



	December 31, 2021					
	Less than 12 months		12 months or greater		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
	(In thousands)					
<b>Held to maturity:</b>						
U.S. Agency mortgage-backed securities	9,280	(71)	-	-	9,280	(71)
Total securities available-for-sale	<u>\$ 9,280</u>	<u>\$ (71)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,280</u>	<u>\$ (71)</u>

The tables below show the amortized cost, gross unrealized gains and losses, and estimated fair value of securities classified as available-for-sale as of June 30, 2022 and December 31, 2021:

	June 30, 2022			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
	(In thousands)			
Asset-backed securities	\$ 3,278	\$ 25	\$ (17)	\$ 3,286
Corporate notes	144,186	99	(6,918)	137,367
U.S. Agency mortgage-backed securities	12,951	12	(461)	12,502
Collateralized mortgage obligations	178,314	-	(10,380)	167,934
Municipal securities	75,246	79	(9,082)	66,243
U.S. Agency principal-only strip securities	481	-	(27)	454
SBA securities	114	-	(1)	113
U.S. Treasury Bill	14,934	-	(2,236)	12,698
Total securities available-for-sale	<u>\$ 429,504</u>	<u>\$ 215</u>	<u>\$ (29,122)</u>	<u>\$ 400,597</u>

	December 31, 2021			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
	(In thousands)			
Asset-backed securities	\$ 3,362	\$ 19	\$ (19)	\$ 3,362
Corporate notes	142,279	5,386	(362)	147,303
U.S. Agency mortgage-backed securities	14,991	122	(222)	14,891
Collateralized mortgage obligations	190,491	430	(234)	190,687
Municipal securities	78,288	2,509	(132)	80,665
U.S. Agency principal-only strip securities	553	-	-	553
SBA securities	170	-	(1)	169
U.S. Treasury Bill	14,931	-	(650)	14,281
Total securities available-for-sale	<u>\$ 445,065</u>	<u>\$ 8,466</u>	<u>\$ (1,620)</u>	<u>\$ 451,911</u>

The following tables show the gross unrealized losses and estimated fair value of our available-for-sale investments aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position at June 30, 2022 and December 31, 2021:

	June 30, 2022					
	Less than 12 months		12 months or greater		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
	(In thousands)					
<b>Available for sale:</b>						
Asset-backed securities	\$ -	\$ -	\$ 1,159	\$ (17)	\$ 1,159	\$ (17)
Corporate notes	107,841	(6,563)	2,538	(355)	110,379	(6,918)
U.S. Agency mortgage-backed securities	4,687	(153)	6,658	(308)	11,345	(461)
Collateralized mortgage obligations	167,880	(10,380)	-	-	167,880	(10,380)
Municipal securities	59,817	(9,082)	-	-	59,817	(9,082)
U.S. Agency principal-only strip securities	454	(27)	-	-	454	(27)
SBA securities	-	-	113	(1)	113	(1)
U.S. Treasury Bill	-	-	12,698	(2,236)	12,698	(2,236)
Total securities available-for-sale	<u>\$ 340,679</u>	<u>\$ (26,205)</u>	<u>\$ 23,166</u>	<u>\$ (2,917)</u>	<u>\$ 363,845</u>	<u>\$ (29,122)</u>

	December 31, 2021					
	Less than 12 months		12 months or greater		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
	(In thousands)					
<b>Available for sale:</b>						
Asset-backed securities	\$ -	\$ -	\$ 1,244	\$ (19)	\$ 1,244	\$ (19)
Corporate notes	29,882	(254)	2,781	(108)	32,663	(362)
U.S. Agency mortgage-backed securities	8,318	(213)	465	(9)	8,783	(222)
Collateralized mortgage obligations	140,219	(234)	-	-	140,219	(234)
Municipal securities	9,794	(132)	-	-	9,794	(132)
SBA securities	-	-	169	(1)	169	(1)
U.S. Treasury Bill	-	-	14,281	(650)	14,281	(650)
Total securities available-for-sale	<u>\$ 188,213</u>	<u>\$ (833)</u>	<u>\$ 18,940</u>	<u>\$ (787)</u>	<u>\$ 207,153</u>	<u>\$ (1,620)</u>

In accordance with Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Bank performs a thorough annual review of each of the investment securities in its portfolio (other than US Government and Agency securities) to determine, among other things, the current financial status of the issuer as well as the issuer's ability to repay the debt. This analysis is performed in addition to the quarterly review that is performed on all investment securities which are in an unrealized loss position.

We do not intend to sell these securities until recovery and have determined that it is not more likely than not that we will be required to sell the securities prior to recovery of their amortized cost basis.

At June 30, 2022, there were a total of 123 investment securities that were in an unrealized loss position for less than 12 months and 11 investment securities that were in an unrealized loss position for 12 months or longer. Temporary impairments primarily related to corporate notes (which are all considered investment grade by Moody's, Standard & Poor's, Kroll Bond Rating Agency or Fitch rating agencies), mortgage-backed securities (which are generally guaranteed by the U.S. government and are highly rated by rating agencies and have a long history of no credit losses), and municipal securities are primarily attributable to declining market prices caused by dramatically rising interest rates over the past four months and subsequent to the date that these securities were purchased. None of the securities in the Bank's investment portfolio rely on an insurance wrap as a credit enhancement. Management believes that it is more likely than not that the Bank will receive all amounts due under the contractual terms of these securities. If economic conditions deteriorate, or if the financial condition of specific issuers within these portfolios deteriorates, then the Bank could record an allowance for credit losses for AFS debt securities under the ASC 326-30. The new standard ASC 326-20 requires the Bank to estimate lifetime credit loss allowance for the HTM debt securities. However, the Bank holds HTM debt securities that are guaranteed by the U.S. government which are highly rated by rating agencies and have a long history of no credit losses so no expected credit losses will be recorded. There were no debt securities considered past due at June 30, 2022. There were no purchases of debt securities with credit deterioration during the three months ended June 30, 2022.

Cash proceeds from calls or maturities of securities available-for-sale totaled \$1.8 million and \$7.8 million for the three and six months ended June 30, 2022, respectively. Cash proceeds from calls or maturities of securities available-for-sale

totaled \$6.0 million and \$10.0 million for the three and six months ended June 30, 2021, respectively. There were no net realized gains or losses for sales and calls of securities for the three and six months ended June 30, 2022 and 2021.

The amortized cost and estimated fair value of securities at June 30, 2022, by contractual maturity, are shown below. Mortgage-backed securities are classified in accordance with their estimated average life. Expected maturities differ from contractual maturities mainly due to prepayment rates; changes in prepayment rates will affect a security's average life.

	<b>Available-for-Sale</b>		<b>Held-to-maturity</b>	
	<b>Amortized Cost</b>	<b>Estimated fair value</b>	<b>Amortized Cost</b>	<b>Estimated fair value</b>
	<i>(In thousands)</i>		<i>(In thousands)</i>	
Due in one year or less	\$ -	\$ -	\$ -	\$ -
Due after one year through five years	37,056	36,482	-	-
Due after five years through ten years	133,237	124,678	1,025	982
Due after ten years	259,211	239,437	11,759	10,674
Total	<u>\$ 429,504</u>	<u>\$ 400,597</u>	<u>\$ 12,784</u>	<u>\$ 11,656</u>

## 9. Loans and Allowance for Credit Losses on Loans

The Bank's loan portfolio includes originated loans as well as purchased loans. The loans portfolio as of June 30, 2022 and December 31, 2021 are summarized as follows:

	<b>June 30, 2022</b>	<b>December 31, 2021</b>
	<i>(In thousands)</i>	
Real estate mortgage	\$ 3,164,896	\$ 2,803,349
Real estate construction	371,637	333,324
Commercial & industrial	1,336,631	1,234,425
SBA (PPP)	22,186	42,467
Trade finance	24,663	11,309
Consumer & other	128	118
Gross loans	<u>4,920,141</u>	<u>4,424,992</u>
Less:		
Allowance for credit losses on loans	(61,396)	(59,969)
Deferred loan and fees, net	<u>(9,525)</u>	<u>(6,316)</u>
Total loans, net	<u>\$ 4,849,220</u>	<u>\$ 4,358,707</u>

We evaluate our allowance for credit losses quarterly. The allowance for credit losses ("ACL") is based upon management's assessment of various factors affecting the collectability of the loans using the relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors.

The Bank adopted the new accounting standard under the Current Expected Credit Losses (CECL) on January 1, 2020. The methodology adopted was dependent largely on the availability of historical loan data based on loan level risk approach using Probability of Default / Loss Given Default (PD/LGD). PD is the probability that a borrower will default on its obligation. LGD is the amount of money a bank loses when a loan defaults net of any recovery expressed as a percentage of the outstanding loan amount at the time of default. We selected a software solution to help apply transition matrices to develop the PD / LGD approach. This method assesses historical loss data to estimate expected credit losses over the historical, current,

and forecast periods that represents the life of loans under CECL. The considerations to establish a look back period are influenced by data availability, historical economic cycles, changes to lending practices, improvement in credit risk management and oversight control over the years. Based on our assessment, we have decided to use a look back period beginning from January, 2010. For the forecasted periods, management has considered a more near-term outlook of twelve months to be reasonable and supportable based on management's understanding of the current loan portfolio and management's best judgement to forecast credit losses. Management has also considered a reversion period equal to half of the forecast period or equivalent to six months of the reasonable and supportable forecast. Accrued interest is not considered in computed expected credit losses.

The loan portfolio is segmented into pools with similar characteristics, primarily based on loan product type (collateral driven). The Bank examined the loan portfolio and the current loan segmentations reasonably reflect the homogenous risk characteristics related to each loan pool. The loan portfolio is segmented into six main categories: commercial, international trade finance, construction, real estate, residential mortgage and cash secured. Within these categories, we further segment into 14 collective pools with similar risk characteristics. Management has examined the 14 current loan pools and concluded the segmentations reasonably reflect homogenous risk characteristics related to each loan pool. The Bank remains focused on commercial loan products which have comprised the majority of the loan portfolio. The loan products have not changed over the years before or after the last economic cycle. The 14 existing loan pools are considered appropriate for use to estimate ACL. The bank has originated a pool loans under the PPP program to provide temporary economic relief to small businesses that are 0% risk weighted as they are fully guaranteed by the SBA.

Loans are individually evaluated for credit losses when they no longer exhibit similar risk characteristics with other loans in the portfolio. We individually review and analyze non-accrual loans, classified loans, and troubled debt restructured ("TDR") loans. Collateral dependent loans are loans for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower, based on management's assessment, is experiencing financial difficulty as of the reporting date. Collateral dependent loans are typically analyzed by comparing the loan amount to the fair value of collateral less cost to sell, with a prompt charge-off taken for the 'shortfall' amount once the value is confirmed. Other methods can be used; i.e. loan sale market price or present value of expected future cash flows discounted at the loan's effective interest rate.

The Bank also makes adjustments, if warranted, in both quantitative and qualitative modeling to estimate the allowance. Such adjustments are intended to account for conditions that management believes directly impact loss potential in the portfolio that is not currently being captured in the model. To the extent possible, management accounts for the impact of quantitative factors on a pool by pool basis, and qualitative factors on a portfolio basis. Qualitative factors consist of nine factors including recent trends and economic conditions. We apply environmental and general economic factors to our allowance methodology including: credit concentrations; delinquency trends; national and local economic and business conditions; the quality of lending management and staff; lending policies and procedures; loss and recovery trends; nature and volume of the portfolio; changes in the value of underlying collateral for collateral dependent loans; the quality of loan reviews; and other external factors including competition, legal, and regulatory factors. The Bank aggregates the sums of the estimates of probable loss for each category with the specific individually evaluated reserves to arrive at the total estimated allowance for credit losses.

The Bank had \$10.6 million of non-accrual loans at June 30, 2022 compared to \$14.8 million at December 31, 2021. These loans had interest due, but not recognized, of approximately \$416,000 and \$2.1 million at June 30, 2022 and December 31, 2021, respectively. The Bank had one loan of \$1.0 million that was past due 90 or more days and still accruing interest loan as of June 30, 2022 and no such loans as of December 31, 2021.

The following tables show the Bank's past due and non-accrual loans by class as of June 30, 2022 and December 31, 2021:

June 30, 2022:	Accruing Loans						Non-accrual Loans	Total Loans								
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total										
Loan Class	(In thousands)															
Real estate mortgage																
Residential	\$	6,364	\$	-	\$	1,020	\$	7,384	\$	571,880	\$	579,264	\$	2,148	\$	581,412
Commercial		-		-		-		-		2,583,484		2,583,484		-		2,583,484
Total real estate mortgage		6,364		-		1,020		7,384		3,155,364		3,162,748		2,148		3,164,896
Real estate construction																
Residential		-		-		-		-		168,420		168,420		-		168,420
Commercial		-		-		-		-		194,740		194,740		8,477		203,217
Total real estate construction		-		-		-		-		363,160		363,160		8,477		371,637
Commercial and Industrial		-		-		-		-		1,336,631		1,336,631		-		1,336,631
SBA		794		-		-		794		21,392		22,186		-		22,186
Trade Finance		-		-		-		-		24,663		24,663		-		24,663
Consumer & other		-		-		-		-		128		128		-		128
<b>Total as of June 30, 2022:</b>	\$	7,158	\$	-	\$	1,020	\$	8,178	\$	4,901,338	\$	4,909,516	\$	10,625	\$	4,920,141

December 31, 2021:	Accruing Loans						Non-accrual Loans	Total Loans							
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total									
Loan Class	(In thousands)														
Real estate mortgage															
Residential	\$	-	\$	-	\$	-	\$	538,006	\$	538,006	\$	5,911	\$	543,917	
Commercial		-		-		-		2,257,313		2,257,313		2,119		2,259,432	
Total real estate mortgage		-		-		-		2,795,319		2,795,319		8,030		2,803,349	
Real estate construction															
Residential		-		-		-		130,842		130,842		-		130,842	
Commercial		-		-		-		202,482		202,482		-		202,482	
Total real estate construction		-		-		-		333,324		333,324		-		333,324	
Commercial and Industrial		3		-		-	3	1,227,628		1,227,631		6,794		1,234,425	
SBA		-		-		-		42,467		42,467		-		42,467	
Trade Finance		-		-		-		11,309		11,309		-		11,309	
Consumer & other		-		-		-		118		118		-		118	
Total as of December 31, 2021:	\$	3	\$	-	\$	-	3	\$	4,410,165	\$	4,410,168	\$	14,824	\$	4,424,992

The following tables depict the Bank's non-accrual loans with and without an allowance for credit losses and related interest income recognized by class as of June 30, 2022 and December 31, 2021:

	Nonaccrual Loans			Loans 90+ Days	Interest Income Recognized	
	without ACL	with ACL	Total	Past Due and Accruing Interest	Three months ended 6/30/22	Six months ended 6/30/22
	(in thousands)					
June 30, 2022						
Real estate mortgage:						
Residential	\$ 2,148	\$ -	\$ 2,148	\$ 1,020	\$ -	\$ -
Total R/E mortgage	2,148	-	2,148	1,020	-	-
Real estate construction:						
Commercial	8,477	-	8,477	-	164	164
Total R/E construction	8,477	-	8,477	-	164	164
Total	\$ 10,625	\$ -	\$ 10,625	\$ 1,020	\$ 164	\$ 164

	Nonaccrual Loans			Loans 90+ Days	Interest Income
	without	with	Total	Past Due and	Recognized
	ACL	ACL		Accruing Interest	Twelve months
					ended 12/31/21
<i>(in thousands)</i>					
<b>December 31, 2021</b>					
Real estate mortgage:					
Residential	\$ 5,911	\$ -	\$ 5,911	\$ -	\$ 12
Commercial	2,119	-	2,119	-	95
Total R/E mortgage	8,030	-	8,030	-	107
Commercial & industrial	2,000	4,794	6,794	-	143
Total	\$ 10,030	\$ 4,794	\$ 14,824	\$ -	\$ 250

The following table represents the amortized cost basis of collateral-dependent loans by class of loans as of June 30, 2022.

	Real Estate	Total
Real estate mortgage:		
Residential	\$ 2,148	\$ 2,148
Real Estate-Construction:		
Commercial	8,477	8,477
<b>TOTAL</b>	<b>\$ 10,625</b>	<b>\$ 10,625</b>

A troubled debt restructuring (“TDR”) is a formal modification of the terms of a loan when the lender, for economic or legal reasons related to the borrower’s financial condition, grants a concession to the borrower. The concessions may be granted in various forms, including change in the stated interest rate, reduction in the loan balance or accrued interest, or extension of the maturity date with a stated interest rate lower than the current market rate.

The Bank has implemented various loan modification programs to provide its borrowers relief from the economic impacts of the COVID-19 pandemic. As provided under Section 4013 of the CARES Act, as amended by the Consolidated Appropriations Act, 2021 (“CAA”), the Bank has elected not to apply TDR classification to any COVID-19 pandemic related loan modifications that were executed after March 1, 2020 and the earlier of (A) 60 days after the national emergency termination date concerning the COVID-19 pandemic outbreak declared by the President on March 13, 2020 under the National Emergencies Act, or (B) January 1, 2022 to borrowers who were current as of December 31, 2019. For loans that were modified in response to the COVID-19 pandemic that do not meet the CARES Act criteria (e.g., current payment status as of December 31, 2019), the Bank has applied the guidance included in the “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customer Affected by the Coronavirus (Revised)” (the “Interagency Statement”) issued by the federal banking regulators on April 7, 2020. The Interagency Statement states that short-term loan modifications (i.e. six months or less) are not TDRs if they were made on a good faith basis in response to the COVID-19 pandemic to borrowers who were current as of the implementation date of a loan modification program. The aging on the delinquency of the loans modified under the CARES Act, as amended by the CAA, and the Interagency Statement is frozen at the time of the modification. Interest income continues to be recognized over the accommodation period.

The majority of the COVID-19 pandemic-related loan modifications primarily consisted of payment deferrals three to six months or less in duration, in the form of principal payment deferrals or principal and interest payment deferrals. Other forbearance programs consisted of interest rate concessions. The deferred payments are either repaid at contractual maturity, or over the remaining contractual term of the loan.

We modified approximately 308 loans totaling \$588.0 million net of the paid-off amount under the COVID-19 pandemic-related guidance by the CARES Act and the Interagency Statement and all of these loans have resumed to full payment status since September 30, 2021.

TDRs may be designated as performing or non-performing. A TDR may be designated as performing if the loan has demonstrated sustained performance under the modified terms. The period of sustained performance may include the periods prior to modification if prior performance met or exceeded the modified terms. For nonperforming restructured loans, the loan will remain on non-accrual status until the borrower demonstrates a sustained period of performance, generally six consecutive months of payments. At June 30, 2022, the Bank had two performing restructured loans totaling \$2.0 million and a non-performing restructured loan of \$1.2 million. At December 31, 2021, the Bank had three performing restructured loans totaling \$25.2 million and a non-performing restructured loan of \$4.9 million classified as TDR. There were no balance reductions or rate concessions associated with the renewals designated as TDRs during the three and six months ended June 30, 2022 and 2021.

The following tables detail activity in the allowance for credit losses on loans by portfolio segment for the three and six months ended June 30, 2022 and 2021. Allocation of a portion of the allowance to one particular portfolio segment does not indicate that it is no longer available to absorb losses in other portfolio segments.

	Real Estate-Mortgage		Real Estate-Construction		Commercial			Trade	Consumer			
	Residential	Commercial	Residential	Commercial	& Industrial	SBA		Finance	& Other	Unallocated	Total	
<b>Three months ended June 30, 2022</b>												
Balance as of April 1, 2022	\$ 2,438	\$ 24,820	\$ 629	\$ 998	\$ 29,120	\$ -	\$ 81	\$ 3	\$ 407	\$ 58,496		
Provision (benefit) for credit losses	(109)	3,463	163	(16)	(641)	-	29	-	11	2,900		
Loans charged off	-	-	-	-	-	-	-	-	-	-		
Recoveries	-	-	-	-	-	-	-	-	-	-		
Net (charge offs) recoveries	-	-	-	-	-	-	-	-	-	-		
Balance at June 30, 2022	\$ 2,329	\$ 28,283	\$ 792	\$ 982	\$ 28,479	\$ -	\$ 110	\$ 3	\$ 418	\$ 61,396		
<b>Six months ended June 30, 2022</b>												
Balance as of January 1, 2022	\$ 2,667	\$ 23,371	\$ 548	\$ 851	\$ 31,853	\$ -	\$ 46	\$ 3	\$ 630	\$ 59,969		
Provision (benefit) for credit losses	(338)	4,913	244	131	(2,152)	-	64	-	(212)	2,650		
Loans and leases charged off	-	(1)	-	-	(1,222)	-	-	-	-	(1,223)		
Recoveries	-	-	-	-	-	-	-	-	-	-		
Net (charge offs) recoveries	-	(1)	-	-	(1,222)	-	-	-	-	(1,223)		
Balance at June 30, 2022	\$ 2,329	\$ 28,283	\$ 792	\$ 982	\$ 28,479	\$ -	\$ 110	\$ 3	\$ 418	\$ 61,396		
<b>Three months ended June 30, 2021</b>												
Balance as of April 1, 2021	\$ 5,867	\$ 18,650	\$ 447	\$ 836	\$ 38,517	\$ -	\$ 159	\$ 5	\$ 402	\$ 64,883		
Provision (benefit) for credit losses	(555)	742	17	19	(518)	-	(77)	(1)	373	-		
Loans charged off	(817)	-	-	-	(431)	-	-	-	-	(1,248)		
Recoveries	-	-	-	-	-	-	-	-	-	-		
Net (charge offs) recoveries	(817)	-	-	-	(431)	-	-	-	-	(1,248)		
Balance at June 30, 2021	\$ 4,495	\$ 19,392	\$ 464	\$ 855	\$ 37,568	\$ -	\$ 82	\$ 4	\$ 775	\$ 63,635		
<b>Six months ended June 30, 2021</b>												
Balance as of January 1, 2021	\$ 5,892	\$ 15,414	\$ 568	\$ 932	\$ 39,721	\$ -	\$ 81	\$ 1	\$ 817	\$ 63,426		
Provision (benefit) for credit losses	(580)	3,978	(104)	(77)	(1,779)	-	1	3	(42)	1,400		
Loans and leases charged off	(817)	-	-	-	(431)	-	-	-	-	(1,248)		
Recoveries	-	-	-	-	57	-	-	-	-	57		
Net (charge offs) recoveries	(817)	-	-	-	(374)	-	-	-	-	(1,191)		
Balance at June 30, 2021	\$ 4,495	\$ 19,392	\$ 464	\$ 855	\$ 37,568	\$ -	\$ 82	\$ 4	\$ 775	\$ 63,635		

As required by federal regulations, we classify our assets on a regular basis. In order to monitor the quality of our lending portfolio and quantify the risk therein, we maintain a loan grading system consisting of eight different categories (Grades 1-8). The grading system is used to determine, in part, the allowance for credit losses on loans. The first four grades in the system are considered pass, whereas the fifth grade is a transition grade known as “special mention.” The other three grades (6-8) range from a “substandard” to “doubtful” to a “loss” category. Loans graded as “loss” are charged-off in the period so rated. We use grades 6 and 7 of our loan grading system to identify potential problem assets for individual analysis. The grade on each individual loan rated in the first four grades is reviewed on a regular basis by the loan officer responsible for monitoring the credit whereas the grade for loans rated special mention, substandard, or doubtful are reviewed at least quarterly for appropriateness. Credit Administration reviews a sample of loans assigned a grade in the first four grades and all loans assigned a grade of 5 or above each quarter for appropriateness. Additionally, loan grades are subject to further review by our Chief Credit Officer, Audit Committee (via contracted external loan reviews), Director’s Loan Committee, and our Board of

Directors (our “Board”). In reviewing loans and evaluating the adequacy of the allowance, there are several risk characteristics considered. Those most relevant to the major portfolio segments includes vacancy and lease rates on commercial real estate, state of the general housing market, home prices, commercial real estate values and the impact of economic conditions and employment levels on the various businesses in our market area.

The following table presents risk grades and classified loans by recorded investment in class of loan by origination year as of June 30, 2022. Classified loans include loans in risk grades 6 and 7, which correlate to substandard and doubtful for risk classification purposes.

	Term Loans by Origination Year							Revolving Loans	Total
	2022	2021	2020	2019	2018	Prior	Total		
Real estate mortgage									
Pass	\$ 555,133	\$ 574,537	\$ 332,709	\$ 245,260	\$ 143,260	\$ 564,630	\$ 2,415,529	\$ 675,076	\$ 3,090,605
Special mention	-	24,742	-	5,805	962	38,446	69,955	-	69,955
Substandard	-	-	-	-	697	2,471	3,168	1,168	4,336
Doubtful	-	-	-	-	-	-	-	-	-
Real estate construction									
Pass	-	-	-	-	-	-	-	363,160	363,160
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	8,477	8,477
Doubtful	-	-	-	-	-	-	-	-	-
Commercial & industrial									
Pass	88,176	38,017	53,505	56,670	17,010	44,391	297,769	1,025,794	1,323,563
Special mention	-	-	-	-	-	1,085	1,085	7,657	8,742
Substandard	-	-	-	-	-	4,326	4,326	-	4,326
Doubtful	-	-	-	-	-	-	-	-	-
SBA (PPP)									
Pass	-	19,140	3,015	-	-	-	22,155	-	22,155
Special mention	-	-	31	-	-	-	31	-	31
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Trade finance									
Pass	-	-	-	-	-	-	-	24,663	24,663
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Consumer & other									
Pass	-	-	-	-	-	128	128	-	128
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 643,309</b>	<b>\$ 656,436</b>	<b>\$ 389,260</b>	<b>\$ 307,735</b>	<b>\$ 161,929</b>	<b>\$ 655,477</b>	<b>\$ 2,814,146</b>	<b>\$ 2,105,995</b>	<b>\$ 4,920,141</b>



The following table presents risk grades and classified loans by recorded investment in class of loan by origination year as of December 31, 2021. Classified loans include loans in risk grades 6 and 7, which correlate to substandard and doubtful for risk classification purpose

	Term Loans by Origination Year							Revolving Loans	Total
	2021	2020	2019	2018	2017	Prior	Total		
Real estate mortgage									
Pass	\$ 613,516	\$ 416,597	\$ 312,079	\$ 162,244	\$ 276,613	\$ 391,222	\$ 2,172,271	\$ 570,196	\$ 2,742,467
Special mention	-	-	4,955	-	-	23,228	28,183	487	28,670
Substandard	-	-	-	25,816	4,909	305	31,030	1,182	32,212
Doubtful	-	-	-	-	-	-	-	-	-
Real estate construction									
Pass	-	-	-	-	-	-	-	333,324	333,324
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Commercial & industrial									
Pass	44,429	64,940	77,834	17,594	15,697	28,388	248,882	930,527	1,179,409
Special mention	-	-	-	-	-	2,181	2,181	39,441	41,622
Substandard	-	-	-	-	-	3,550	3,550	9,844	13,394
Doubtful	-	-	-	-	-	-	-	-	-
SBA									
Pass	34,464	8,003	-	-	-	-	42,467	-	42,467
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Trade finance									
Pass	-	-	-	-	-	-	-	11,309	11,309
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
Consumer & other									
Pass	-	-	-	-	-	-	-	118	118
Special mention	-	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-	-
<b>Total</b>	<b>\$ 692,409</b>	<b>\$ 489,540</b>	<b>\$ 394,868</b>	<b>\$ 205,654</b>	<b>\$ 297,219</b>	<b>\$ 448,874</b>	<b>\$ 2,528,564</b>	<b>\$ 1,896,428</b>	<b>\$ 4,424,992</b>

## 10. Fair Value Measurements

FASB ASC Topic 825, Financial Instruments requires that an entity disclose the fair value of all financial instruments, as defined, regardless of whether recognized in the financial statements of the reporting entity. For purposes of determining fair value under the Financial Instruments Topic of FASB ASC, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The Bank determines fair values of financial instruments based on the following hierarchy:

- Level 1 – Quoted prices in active markets for identical assets or liabilities. Certain financial assets and liabilities for which carrying amount equals fair value are considered to be Level 1.
- Level 2 – Observable prices in active markets for similar assets or liabilities; prices for identical or similar assets or liabilities in markets that are not active; directly observable market inputs for substantially the full term of the asset and liability; market inputs that are not directly observable but are derived from or corroborated by observable market data.
- Level 3 – Unobservable inputs based on the Bank's own judgments about the assumptions that a market participant would use.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments.

(a) *Cash Due from Banks, Federal Funds Sold and Securities Purchased under Resale Agreements*

For cash and short-term instruments whose original or purchased maturity is less than 90 days, the carrying amount was assumed to be a reasonable estimate of fair value.

(b) *Securities held-to-maturity and securities available-for-sale*

For securities held-to maturity and securities available-for-sale, fair values were based on quoted market prices obtained from market quotes, a Level 1 measurement. If a quoted market price was not available, fair value was estimated using quoted market prices for similar securities or if no quotes on similar securities were available, a Level 2 measurement, or a discounted cash flow analysis was used based on a market discount rate and adjusted for prepayments and defaults, a Level 3 measurement.

(c) *Federal Home Loan Bank Stock*

It is not practical to determine the fair value of FHLB stock due to the restrictions placed on its transferability.

(d) *Loans*

Loans are not measured at fair value on a recurring basis. Therefore, the following valuation discussion relates to estimating the fair value disclosures under ASC 825, Fair Value Measurements and Disclosures. Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type and further segmented into fixed and adjustable rate interest terms. The fair value estimates does take into consideration an exit price concept as contemplated in ASC 825. The fair value is determined using a discounted cash flow analysis approach, using prepayment and charge-off adjusted cash flow projections at a loan level. The projected cash flows were discounted to fair value using discount rates that were estimated using a build-up method reflecting a hypothetical market participant's funding and serving costs, and a charge for variability/liquidity. As these loans reprice frequently at market rates and the credit risk is not considered to be greater than normal, the market value is typically close to the carrying amount of these loans.

Loans measured for impairment based on the fair value of the underlying collateral are considered recorded at fair value on a non-recurring basis. Impaired loans include all of the Bank's non-accrual loans and certain restructured loans, all of which are reviewed individually for the amount of impairment, if any. The fair value of each loan's collateral is generally based on estimated market prices from an independently prepared appraisal, which is then adjusted for the cost related to liquidating such collateral; such valuation inputs result in a non-recurring fair value measurement that is categorized as a Level 2 measurement. When adjustments are made to an appraised value to reflect various factors such as the age of the appraisal or known changes in the market or the collateral or if an appraisal value is based on a discount cash flow rather than a market comparable, such valuation inputs are considered unobservable and the fair value measurement is categorized as a Level 3 measurement. In addition, unsecured impaired loans are measured at fair value based generally on unobservable inputs, such as the strength of a guarantor, discounted cash flow models and management's judgment; the fair value measurement of these loans is also categorized as a Level 3 measurement. Fair values were estimated for portfolios of loans with similar financial characteristics. Each loan category was further segmented into fixed and adjustable rate interest terms and by performing and non-performing categories.

(e) *Accrued Interest Receivable and Accrued Interest Payable*

The carrying amounts of accrued interest receivable and accrued interest payable approximate its fair value due to their short-term nature.

(f) *Deposits*

The fair value of demand deposits, saving accounts, and certain money market deposits were assumed to be the amount payable on demand at the reporting date. The fair value of interest-bearing deposits and fixed maturity certificates of deposit was estimated based on discounted cash flow analysis. The discount rate used for fair valuation is based on interest rates currently offered on deposits with similar remaining maturities. This is a Level 2 measurement.

(g) *FHLB Borrowings*

The fair value of FHLB borrowings was based on discounted cash flow analysis. The discount rate used for fair valuation is based on rates currently offered for borrowings with similar remaining maturities, a Level 2 measurement.

(h) *Commitment to Extend Credit and Letters of Credit*

The majority of our commitments to extend credit carry market interest rates if converted to loans. Because these commitments are generally unassignable by either the borrower or us, they only have value to the borrower and us. The estimated fair value is not material. The fair value of letters of credit was based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

(i) *Subordinated Debt Issuance*

The fair value of subordinated debt is estimated by discounting the cash flows through the maturity date based on observable market rates which the Bank would pay for new issuances, a Level 2 measurement.

The carrying amounts and estimated fair values of financial instruments as of June 30, 2022 and December 31, 2021 are summarized in the tables below:

<b>June 30, 2022</b>					
	<b>Carrying amount</b>	<b>Estimated fair value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<i>(In thousands)</i>					
<b>Assets:</b>					
Cash and cash equivalents	\$ 768,658	\$ 768,658	\$ 768,658	\$ -	\$ -
Securities held-to-maturity	12,784	11,656	-	11,656	-
Securities available-for-sale	400,597	400,597	-	390,573	10,024
Loans, net of ACL and net deferred loan fees	4,849,220	4,734,916	-	-	4,734,916
Accrued interest receivable	16,241	16,241	-	2,214	14,027
Federal Home Loan Bank stock	15,000	N/A	N/A	N/A	N/A
<b>Liabilities:</b>					
Demand deposits and savings:					
Noninterest-bearing	\$ 1,385,934	\$ 1,385,934	\$ -	\$ 1,385,934	\$ -
Interest-bearing	2,279,285	2,279,285	-	2,279,285	-
Time deposits	1,742,733	1,719,442	-	1,719,442	-
Subordinated debt issuance	147,877	156,536	-	156,536	-
Accrued interest payable	752	752	-	752	-

**December 31, 2021**

	<b>Carrying amount</b>	<b>Estimated fair value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets:</b>					
Cash and cash equivalents	\$ 1,050,610	\$ 1,050,610	\$ 1,050,610	\$ -	\$ -
Securities held-to-maturity	13,962	13,928	-	13,928	-
Securities available-for-sale	451,911	451,911	-	441,530	10,381
Loans, net of allowance and net deferred loan fees	4,358,707	4,364,298	-	-	4,364,298
Accrued interest receivable	14,646	14,646	-	2,124	12,522
Federal Home Loan Bank stock	15,000	N/A	N/A	N/A	N/A
<b>Liabilities:</b>					
Demand deposits and savings:					
Noninterest-bearing	\$ 1,305,692	\$ 1,305,692	\$ -	\$ 1,305,692	\$ -
Interest-bearing	2,070,658	2,070,658	-	2,070,658	-
Time deposits	1,849,161	1,847,598	-	1,847,598	-
Subordinated debt issuance	147,758	167,616	-	167,616	-
Accrued interest payable	715	715	-	715	-

The fair value estimates do not reflect any premium or discount that could result from offering the instruments for sale. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in amounts disclosed. The fair value estimates are dependent upon subjective estimates of market conditions and perceived risks of financial instruments at a point in time and involve significant uncertainties resulting in variability in estimates with changes in assumptions.

The Bank determined the fair values of its financial instruments based on the fair value hierarchy established in ASC 820. ASC 820 defines fair value, establishes a three-level fair value hierarchy based on the quality of inputs used to measure fair value and expands disclosures about fair value measurements.

- *Asset-backed securities* – The Bank measures fair value of asset-backed securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.
- *Corporate notes* – The Bank measures fair value of corporate notes by using quoted market prices for similar securities or dealer quotes, a level 2 measurement except one corporate note with fair value measurement using significant unobservable inputs, a level 3.
- *U.S. Agency mortgage-backed securities* – The Bank measures fair value of mortgage-backed securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.
- *Collateralized mortgage obligations* – The Bank measures fair value of collateralized mortgage obligations by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.
- *Municipal securities* – The Bank measures fair value of state and municipal securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.
- *U.S. Agency principal-only strip securities* – The Bank measures fair value of principal-only strip securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.
- *SBA securities* – The Bank measures fair value of small business administration (SBA) securities by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.
- *U.S. Treasury Bill* – The Bank measures fair value of U.S. Treasury Bill by using quoted market prices for similar securities or dealer quotes, a Level 2 measurement.

The following tables present the Bank's hierarchy for its assets and liabilities measured at fair value on a recurring basis at June 30, 2022 and December 31, 2021.

Assets	Fair Value Measurements Using			Balance at June 30, 2022
	Quoted Prices in	Significant	Significant	
	Active Markets	Observable	Unobservable	
	for Identical	Inputs	Inputs	
	Assets	Inputs	Inputs	
	(Level 1)	(Level 2)	(Level 3)	
(In thousands)				
Securities, available-for-sale:				
Asset-backed securities	-	3,286	-	3,286
Corporate notes	-	127,343	10,024	137,367
U.S. Agency mortgage-backed securities	-	12,502	-	12,502
Collateralized mortgage obligations	-	167,934	-	167,934
Municipal securities	-	66,243	-	66,243
U.S. Agency principal-only strips	-	454	-	454
SBA Securities	-	113	-	113
U.S. Treasury Bill	-	12,698	-	12,698
Total	\$ -	\$ 390,573	\$ 10,024	\$ 400,597

Assets	Fair Value Measurements Using			Balance at December 31, 2021
	Quoted Prices in	Significant	Significant	
	Active Markets	Observable	Unobservable	
	for Identical Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)	
<i>(In thousands)</i>				
<b>Securities, available-for-sale:</b>				
Asset-backed securities	-	3,362	-	3,362
Corporate notes	-	136,922	10,381	147,303
U.S. Agency mortgage-backed securities	-	14,891	-	14,891
Collateralized mortgage obligations	-	190,687	-	190,687
Municipal securities	-	80,665	-	80,665
U.S. Agency principal-only strips	-	553	-	553
SBA Securities	-	169	-	169
U.S. Treasury Bill	-	14,281	-	14,281
Total	\$ -	\$ 441,530	\$ 10,381	\$ 451,911

There were no transfers in or out of Level 1, Level 2 or Level 3 fair value measurements during the three and six months ended June 30, 2022 and 2021.

There was one \$10.0 million and one \$10.4 million corporate note measured at fair value on a recurring basis using significant unobservable (Level 3) inputs as of June 30, 2022 and December 31, 2021, respectively.

Collateral-dependent loans – On a non-recurring basis, the Bank measures the fair value of collateral-dependent loans based on fair value of the collateral value which is derived from appraisals that take into consideration prices in observable transactions involving similar assets in similar locations in accordance with Receivables Topic of FASB ASC. Collateral value determined based on recent independent appraisals are considered a level 2 measurement. Collateral values based on unobservable inputs that are supported by little or no market data and less current appraisals are considered a level 3 measurement.

Other real estate owned and repossessed assets – Real estate and repossessed assets acquired in the settlement of loans

is initially recorded at fair value, less estimated costs to sell. The Bank records other real estate owned at fair value on a non-recurring basis. As from time to time, nonrecurring fair value adjustments to other real estate owned are recorded based on current appraisal value of the property, a Level 2 measurement, or management's judgment and estimation based on reported appraisal value, a Level 3 measurement. There was \$21.4 million and zero of other real estate owned and repossessed assets measured at estimated fair value on a non-recurring basis at June 30, 2022 and December 31, 2021, respectively. There were no gains or losses resulting from the measurement of other real estate owned or repossessed assets measured on a non-recurring basis for the three and six months ending June 30, 2022 and 2021.

## **11. Affordable Housing Partnerships**

In order to provide financing for properties for low-to-moderate income renters in our assessment areas and to lower our effective tax rate, the Bank has invested in limited partnerships that are formed to develop and operate high-quality affordable housing for lower income tenants within the United States. These partnerships must meet the regulatory requirements for affordable housing for a minimum 15-year compliance period to fully utilize the tax credits. The Bank is not the primary beneficiary and therefore does not consolidate these partnerships. If the partnerships cease to qualify for tax credits during the compliance period, the credits may be denied for any period in which the projects are not in compliance, and credits previously taken may be partially subject to recapture with interest.

The Bank amortizes investments in affordable housing partnerships in proportion to tax credits and benefits realized. As of June 30, 2022, the Bank had eight investments, with a net carrying value of \$54.9 million. Commitments to fund investment in affordable housing partnerships as of June 30, 2022 totaled \$20.0 million. As of December 31, 2021, the Bank had eight investments with a net carrying value of \$59.0 million and a further commitment to fund \$22.6 million.

## **12. Income Taxes**

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enacted date.

We record net tax assets to the extent we believe these assets will more likely than not be realized. In making such determination, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial performance. A valuation allowance is provided when it is more likely than not that some portion of deferred tax assets will not be realized. As of June 30, 2022 and December 31, 2021, the Bank determined that a valuation allowance for deferred tax assets was not required.

Income tax expense was \$10.9 million and \$21.3 million for the three and six months ended June 30, 2022 representing an effective tax rate of 28.00% and 28.23%, respectively. Income tax expense was \$8.6 million and \$17.0 million for the three and six months ended June 30, 2021 representing an effective tax rate of 28.50% and 28.50%, respectively. Our effective tax rate differs from the statutory rate primarily as a result of state taxes, income from bank owned life-insurance, low income housing tax credits and excess tax benefits from share-based compensation.

As of June 30, 2022 and December 31, 2021, there were no uncertain tax positions. The Bank does not expect the amount of unrecognized tax benefit to change significantly within the next twelve months.

## **13. Long-Term Debt**

During 2016, the Bank completed a private placement of \$100.0 million in principal amount of fixed-to-floating rate subordinated notes to certain qualified investors. The proceeds from the placement of the notes were for general corporate purposes, capital management, and to support future growth. The subordinated notes had a maturity date of June 15, 2026 and had interest, payable semi-annually, at the rate of 6.0% per annum until June 15, 2021. On that date, the interest rate would have been adjusted to float at a rate equal to the three-month LIBOR rate plus 467.3 basis points (4.673%) until maturity. The notes included a right of prepayment, on or after June 15, 2021 and, in certain limited circumstances, before that date. On June

18, 2021, the Bank repaid all \$100.0 million in principal amount of subordinated notes including accrued and unpaid interest. The Bank incurred a net charge of \$614,000 to interest expense related to the unamortized issuance costs and premium on the subordinated notes.

On June 16, 2021, the Bank completed a public offering of \$150.0 million in aggregate principal amount of 3.375% fixed-to-floating rate subordinated notes due June 15, 2031. A majority of the proceeds from the placement of the notes were used to repay the subordinated notes due 2026. The subordinated notes mature on June 15, 2031 and bear interest at a fixed rate per annum of 3.375%, payable semi-annually in arrears until June 15, 2026. On that date, the subordinated notes will bear interest at a floating rate per annum equal to a benchmark rate, which is expected to be the Three-Month Term SOFR, plus 278 basis points (2.78%), payable quarterly in arrears; provided, however, in the event that the then-current benchmark rate is less than zero, then the benchmark rate will be deemed zero. The Bank may, at its option, redeem the subordinated notes in whole or in part beginning on June 15, 2026 and, in other certain limited circumstances. The subordinated notes have been structured to qualify as Tier 2 capital for regulatory purposes. Debt issuance costs incurred in conjunction with the offering were \$2.4 million.

Debt issuance costs are reported as a direct deduction from the face of the note. The premium and related debt issuance costs are being amortized into interest expense over a 10-year period. A summary of outstanding long-term debt at June 30, 2022 is as follows:

	As of June 30, 2022	As of December 31, 2021	Interest rate	Maturity date	Earliest call date
	<i>(in thousands)</i>				
Subordinated notes payable (\$150,000 face amount)	\$ 147,877	\$ 147,758	3.375%	June 15, 2031	June 15, 2026

#### 14. Leases

The Bank is obligated under non-cancellable operating leases for our corporate office/main branch, 11 other branch offices, one administrative office, one loan production office and one satellite office. Our leases have remaining terms of 1 to 9 years, with a weighted average remaining lease term of 6.6 years as of June 30, 2022. The majority of our leases provide for increases in future minimum annual rental payments as defined in the lease agreements. We have one variable lease where the increase in lease liability is tied to the Consumer Price Index capped at 3% and no options to extend were incorporated into our lease liability calculations.

At June 30, 2022, operating lease right-of-use (“ROU”) assets and related liabilities were \$21.0 million and \$21.1 million, respectively. For the three and six months ended June 30, 2022, the recorded operating lease expense was \$646,000 and \$1.2 million, respectively. For the three and six months ended June 30, 2021, the recorded operating lease expense was \$687,000 and \$1.3 million. For the three and six months ended June 30, 2022, cash payments for operating leases were \$1.0 million and \$2.0 million, respectively. For the three and six months ended June 30, 2021, cash payments for operating leases were \$960,000 and \$1.9 million, respectively.

Operating lease ROU assets represent the Bank’s right to use the underlying asset during the lease term and operating lease liabilities represent the Bank’s obligation to make lease payments arising from the lease. ROU assets and operating lease liabilities are recognized at lease commencement based on the present value of the remaining lease payments using the Bank’s incremental borrowing rate at the lease commencement date. Operating lease expense, which is comprised of amortization of the ROU asset and the implicit interest accreted on the operating lease liability, is recognized on a straight-line basis over the lease term and is recorded in occupancy expense in the Consolidated Income Statement. The Bank uses its incremental borrowing rate to present value lease payments in order to recognize a ROU asset and the related lease liability. The Bank calculates its incremental borrowing rate by adding a spread to the FHLB borrowing interest rate at a given period.

The table below shows contractually obligated lease payments under current leases and a reconciliation to the lease liability reported on the consolidated statement of financial condition as of June 30, 2022.

*(Dollars in thousands)*

2022	\$	1,984
2023		3,819
2024		3,774
2025		2,753
2026		2,139
Thereafter		6,918
Total future lease payments	\$	21,387
Discount to present value		(272)
Total lease liability	\$	<u>21,115</u>

**15. Subsequent Event**

As of August 1, 2022, the Bank completed its \$32 million stock repurchase program. The total shares repurchased was 464,438.



## **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion provides information about our results of operations, financial condition, liquidity, and capital resources. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations since the date of our last periodic report. This discussion and analysis should be read in conjunction with our unaudited interim financial statements and the accompanying notes presented elsewhere herein.

### **Overview**

We are one of the larger independent commercial banks headquartered in California focusing primarily on the California market, with a historical niche in the Chinese-American market. We consider the Chinese-American market to encompass individuals born in the United States of Chinese ancestry, ethnic Chinese who have immigrated to the United States and ethnic Chinese who live abroad but conduct business in the United States. Although founded as a Bank that primarily serves the Chinese-American community, Preferred Bank has grown into an institution whereby the majority of our current business activities come from the mainstream (non-Chinese American) markets of Southern and Northern California. Our Flushing, New York office, however, still primarily serves the Chinese-American segment of that market. We commenced operations in December 1991 as a California state-chartered bank in Los Angeles, California. Our deposits are insured by the FDIC. We are a member of the FHLB.

We provide personalized deposit services as well as real estate finance, commercial loans and trade finance to small and mid-sized businesses and their owners, entrepreneurs, real estate developers and investors, professionals and high net worth individuals. We are generally focused on businesses as opposed to retail customers and thus we have a smaller number of customer relationships for whom we provide a high level of service and personal attention.

We derive our income primarily from interest received on our loan and investment securities portfolios and our excess cash, and fee income we receive in connection with servicing our loan and deposit customers. Our major operating expenses are the interest we pay on deposits and borrowings, and the salaries and related benefits we pay our management and staff.

The Bank conducts its banking business from its main office in Los Angeles, California, and through eleven other full-service branch offices in the California cities of Alhambra, Century City, City of Industry, Torrance, Arcadia, Irvine, Diamond Bar, Pico Rivera, Tarzana, and San Francisco (2 branches), and one branch in Flushing, New York all of which we lease, except the Irvine branch which we own. Additionally, the Bank opened a loan production office in the Houston suburb of Sugar Land, Texas in April 2021. The Bank also opened a satellite office in Manhattan in September of 2021. This office is only for meeting and communications, no business is transacted there. We market our services and conduct our business primarily in Los Angeles, Orange, Ventura, Riverside, San Bernardino, and San Francisco counties within California, and the Tri-State area of New York, New Jersey and Connecticut.

The following table presents selected performance indicators and metrics for the periods indicated:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2022	2021	2022	2021
<i>(Dollars in thousands, except per share amounts)</i>				
<b>Selected Financial Ratios:</b>				
Return on average assets (annualized)	1.84%	1.58%	1.79%	1.61%
Return on average shareholders' equity (annualized)	18.57%	15.56%	18.13%	15.76%
Net interest margin	3.77%	3.25%	3.60%	3.43%
Efficiency ratio	29.04%	33.25%	29.91%	33.39%
Net charge-offs to average loans	0.00%	0.12%	0.05%	0.06%
	June 30,	December 31,	June 30,	
	2022	2021	2021	
<b>Selected Asset Quality Ratios:</b>				
Non-performing loans to total loans	0.24%	0.34%	0.51%	
Non-performing asset to total assets	0.53%	0.25%	0.39%	
Allowance for credit losses to total loans	1.25%	1.36%	1.49%	
Allowance for credit losses to non-performing loans	5.27x	4.05x	2.91x	
<b>Liquidity and Capital Ratios:</b>				
Tier 1 leverage capital ratio	9.92%	9.54%	10.07%	
Common equity tier 1 risk-based capital ratio	10.61%	11.26%	11.28%	
Tier 1 risk-based capital ratio	10.61%	11.26%	11.28%	
Total risk-based capital ratio	14.28%	15.37%	15.61%	

At June 30, 2022, assets totaled \$6.23 billion, an increase of \$186.7 million, or 3.1% from \$6.05 billion at December 31, 2021. Our loan portfolio increased \$495.1 million to \$4.92 billion at June 30, 2022, from \$4.42 billion at December 31, 2021. At June 30, 2022, deposits totaled \$5.41 billion, an increase of \$182.4 million, or 3.5% from \$5.23 billion at December 31, 2021. We recorded net income per share on a diluted basis of \$1.87 and \$3.61 for the three and six months ended June 30, 2022, respectively, as compared to net income per share on a diluted basis of \$1.44 and \$2.85 for the three and six months ended June 30, 2021. Our net interest income before (reversal of) provision for credit losses for the three and six months period increased compared to the same three and six months period a year ago, primarily due to increases in average interest-earning assets outpacing the increase in average interest-bearing liabilities, coupled with higher yields on interest-earning assets and lower cost of interest-bearing liabilities. For the second quarter of 2022, return on average assets was 1.84%, compared to 1.58% from the same period in 2021, while return on average equity was 18.57%, compared to 15.56% for the second quarter of 2021. For the six months ended June 30, 2022, return on average assets was 1.79% compared to 1.61% in the same period in 2021 and return on average equity was 18.13% compared to 15.76% from the same period in 2021.

Non-performing assets were \$33.1 million and \$14.8 million as of June 30, 2022 and December 31, 2021, respectively. The increase in non-performing assets is primarily due to 1) taking ownership of assets of one commercial and industrial relationship totaling \$3.5 million and a property of a residential real estate loan totaling \$3.8 million as well as first and second lien payoffs of \$14.2 million, 2) reduced by a \$2.0 million payoff related to one commercial and industrial relationship and paydown of \$2.0 million related to one commercial real estate loan, and 3) charge-offs of \$1.2 million related to the one commercial and industrial loan.

## ***COVID-19***

The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains, affected the valuations of debt securities, and created significant volatility and disruption in financial markets, although economic growth and employment levels had largely rebounded by the end of 2021. Similarly, the initial imposition of temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities have been relaxed or rescinded as the COVID-19 pandemic has become more endemic.

We have since resumed branch operating hours closer to those in effect pre-pandemic and beginning mid-June 2021, we brought our employees back to our offices full time. We continue to monitor all federal, state, county and city mandates relative to masks, vaccinations and other safety protocols to ensure the safety of our employees and clients.

For our customers, we established and participated in a variety of relief programs which include loan payment deferrals, fee waivers and the suspension of foreclosure and repossessions for those whose ability to pay was affected by the pandemic. In addition to these measures, we worked with our customers to originate business loans made available through the Small Business Administration Paycheck Protection Program. Since granting loan deferrals, all of these loans have resumed to full payment status as of June 30, 2022. The Bank is also working to assist its customers that received Paycheck Protection Program loans complete the forgiveness process with the Small Business Administration.

### ***The CARES Act***

The CARES Act was passed by Congress and signed into law on March 27, 2020 to address the economic impact to individuals and businesses as a result of the COVID-19 pandemic. As part of the CARES Act, various initiatives to protect individuals, businesses and local economies were established in an effort to lessen the impact of the COVID-19 pandemic on consumers and businesses. These initiatives included extended unemployment benefits, mortgage forbearance, the Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”) and the Main Street Lending Program. The PPP loans are forgivable, in whole or in part, if the proceeds are used for payroll and other permitted purposes in accordance with the requirements of the PPP. These loans carry a fixed rate of 1.00% and a term of 2 years or 5 years, if not forgiven, in whole or in part. The loans also require deferral of principal and interest payment. The loans are 100% guaranteed by the SBA. The SBA pays the originating bank a processing fee ranging from 1% to 5%, based on the size of the loan and these fees are deferred and amortized into interest income over the contractual period of 24 months or 60 months, as applicable. Upon SBA forgiveness, unamortized fees are then recognized into interest income. Participation in the PPP impacted the Bank’s asset mix and net interest income in 2020 and 2021 and will continue to impact both asset mix and net interest income until these loans are forgiven or paid off. In addition, the FRB implemented a liquidity facility available to financial institutions participating in the PPP (“PPPLF”). In conjunction with the PPP, the PPPLF allowed the Federal Reserve Banks to lend to member banks on a non-recourse basis with PPP loans as collateral. On June 22, 2020, the FDIC issued a final rule to remove the effect of participation in the PPP and borrowings under the PPPLF from the various risk measures used to calculate an insured depository institution’s assessment rate. As part of our commitment to support our customers, the Bank participated in the PPP and PPPLF.

On December 27, 2020, the President signed another COVID-19 relief bill, the Economic Aid Act that extended and modified several provisions of the PPP. The Economic Aid Act included an additional allocation of \$284 billion to the PPP. The SBA subsequently reactivated the PPP on January 11, 2021. The Bank originated additional PPP loans through the PPP, which extended through June 30, 2021, and officially ended on May 31, 2021.

The CARES Act requires mortgage servicers to grant, on a borrower’s request, forbearance for up to 180 days (which can be extended for an additional 180 days) on a federally-backed single-family mortgage loan or forbearance up to 30 days (which can be extended for two additional 30-day periods) on a federally-backed multifamily mortgage loan when the borrowers experience financial hardship due to the COVID-19 pandemic.

### ***Non-TDR Loan Modifications due to COVID-19***

On March 22, 2020, the federal banking agencies issued an “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus” which statement was revised on April 7, 2020. This guidance encourages financial institutions to work prudently with borrowers that are or that may be unable to meet their contractual obligations because of the effects of COVID-19. The guidance goes on to explain that in consultation with the FASB staff the federal banking agencies concluded that short-term modifications (e.g. six months) made on a good faith basis to borrowers who were current as of the implementation date of a modification program are not Troubled Debt Restructurings (“TDRs”). Section 4013 of the CARES Act, as amended by the Consolidated Appropriations Act, 2021 (“CAA”), permits a financial institution to elect

to temporarily suspend TDR accounting under ASC Subtopic 310-40 in certain circumstances. The Bank has elected not to apply TDR classification to any COVID-19 pandemic related loan modifications that were executed after March 1, 2020 and earlier of (A) 60 days after the national emergency termination date concerning the COVID-19 pandemic outbreak declared by the President on March 13, 2020 under the National Emergencies Act, or (B) January 1, 2022 to borrowers who were current as of December 31, 2019. Given that nonaccrual loans are more heavily risk-weighted for capital purposes, this TDR relief allows a capital benefit in the form of reduced risk weighted assets since the aging of such loans was frozen at the time of modification. The Bank grants loan modifications to our customers in the form of maturity extensions, payment deferrals and forbearance. For a summary of the loans that we have modified in response to the COVID-19 pandemic, please refer to “Notes to Consolidated Interim Financial Statements” — “Note 9— Loans and Allowance for Credit Losses on Loans” in this Quarterly Report on Form 10-Q.

### ***Federal Reserve Bank Actions***

During the first quarter of 2022, the Federal Reserve Bank (“FRB”) has taken a range of actions in response to inflation and other economic pressures. In March 2022, the FRB increased its benchmark interest rate 25 bps. This was the first rate hike by the FRB in more than three years. The FRB then increased its benchmark interest rate another 25 bps in May 2022, and 75 bps in both June and July 2022. These increases in the benchmark rate will likely reduce economic growth. However, the Bank’s balance sheet position should benefit from rising interest rates as a large portion of the Bank’s interest-earning assets are variable rate.

### ***Economy***

The economic shutdown(s) resulting from the pandemic have resulted in unprecedented uncertainties for our economy and the banking industry. Our operating results indicated that our underlying economic fundamentals in our footprint were healthy and we believe that we are well positioned to continue to create significant increases in the prices of commodities, food and energy as disrupted supply chains coupled with a large money supply has created a significant mismatch. The Federal Reserve Open Market Committee (“FOMC”) has embarked on a path of hiking interest rates in order to stem the demand side of this economic equation. It is hoped that this will bring down prices without created a recession.

### **Critical Accounting Policies**

Our accounting policies are integral to understanding the financial results reported. Our most complex accounting policies require management’s judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and consistently applied from period to period. In addition, these policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief description of our current accounting policies involving significant management valuation judgments.

#### ***Allowance for Credit Losses***

The Bank adopted ASU 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments on January 1, 2020, which introduced a new CECL model. The allowance for credit losses (“ACL”) on loans represents our best estimate of expected credit losses inherent in the existing loan portfolio. The allowance for credit losses on loans is increased by the provision for credit losses charged to expense and reduced by loans and leases charged off, net of recoveries.

We evaluate our allowance for credit losses quarterly. We believe that the allowance for credit losses is a “critical accounting estimate” because it is based upon management’s assessment of various factors affecting the collectability of the loans using the relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors.

We segment the loan portfolio into six main categories: commercial, international trade finance, construction, real estate, residential mortgage, and cash secured. Within those categories, we further segment into collective pools with similar risk characteristics. The segmentation reflects management’s view of risks inherent in the portfolio based on historical loan experiences.

Loans are individually evaluated for credit losses when they no longer exhibit similar risk characteristics with other loans in the portfolio. We individually review and analyze non-accrual loans, classified loans, and TDR loans. Collateral dependent loans are loans for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower, based on management's assessment, is experiencing financial difficulty as of the reporting date. Collateral dependent loans are typically analyzed by comparing the loan amount to the fair value of collateral less cost to sell, with a prompt charge-off taken for the 'shortfall' amount once the value is confirmed. Other methods can be used including, for example loan sale market price or present value of expected future cash flows discounted at the loan's effective interest rate.

We also make adjustments, if warranted, in our allowance methodology in both quantitative and qualitative modeling to estimate the allowance. Such adjustments are intended to account for conditions that management believes directly impact loss potential in the portfolio that is not currently being captured in the model. To the extent possible, management accounts for the impact of quantitative factors on a pool by pool basis, and qualitative factors on a portfolio basis. Qualitative factors consisted of nine factors including recent trends and economic conditions. We apply environmental and general economic factors to our allowance methodology including: credit concentrations; delinquency trends; national and local economic and business conditions; the quality of lending management and staff; lending policies and procedures; loss and recovery trends; nature and volume of the portfolio; changes in the value of underlying collateral for collateral dependent loans; the quality of loan reviews; and other external factors including competition, legal, and regulatory factors. We aggregate the sums of the estimates of probable loss for each category with the specific individually evaluated reserves to arrive at the total estimated allowance for credit losses.

The allowance adequacy analysis requires a significant amount of judgment and subjectivity by management especially in regards to the qualitative portion of the analysis. We do not provide any assurance that further economic difficulties or other circumstances which would adversely affect our borrowers and their ability to repay outstanding loans will not occur. These difficulties or other circumstances could result in increased losses in our loan portfolio, which could result in actual losses that exceed loss reserves previously established.

The Bank performs an analysis to estimate the credit losses for off-balance sheet commitments, including letters of credit, acceptances outstanding, and committed loan amounts, on a quarterly basis. The reserve is calculated by applying the historical loss factor for the quarter over the total outstanding letters of credit which is also applied to pass loans for allowance for credit losses on loans provision purposes. Under the CECL methodology, the look back period beginning from January 2010 diluted the more recent loss experience so a rolling 4-year loss rate is applied until the historical loss rate equalizes.

On a quarterly basis, management performs a qualitative evaluation for available-for-sale ("AFS") debt securities in an unrealized loss position to determine if the impairment of an investment's value is related to credit or all other factors under the guidance of ASC 326-30. In determining whether a security's decline in fair value is credit related, management considers a number of factors including, but not limited to: (i) the extent to which the fair value of the investment is less than its amortized cost; (ii) the financial condition and near-term prospects of the issuer; (iii) downgrades in credit ratings; (iv) payment structure of the security; (v) the ability of the issuer of the security to make scheduled principal and interest payments and (vi) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads. Per the new guidance, the credit impairment is limited by the amount of the unrealized loss through the allowance for credit losses and the reversals of credit losses are recognized immediately through earnings. The Bank measures credit losses on AFS debt securities at the individual security level for purposes of measuring credit losses.

ASC 326-20 requires an estimate of lifetime credit loss allowance for the held-to-maturities ("HTM") debt securities. The Bank holds the HTM debt securities that are issued by the government agencies which are highly rated by the agencies and have a long history of no credit losses so no ACL on these securities are recorded.

## Results of Operations

The following tables summarize key financial results for the periods indicated:

	Three months ended June 30,		Six months ended June 30,	
	2022	2021	2022	2021
<i>(Dollars in thousands, except per share amounts)</i>				
Net income	\$ 28,069	\$ 21,480	\$ 54,096	\$ 42,674
Net income available to common shareholders, basic	28,069	21,477	54,094	42,669
Net income available to common shareholders per share, basic	1.90	1.44	3.66	2.85
Net income available to common shareholders, diluted	28,069	21,477	54,094	42,669
Net income available to common shareholders per share, diluted	1.87	1.44	3.61	2.85
Return on average assets (annualized)	1.84%	1.58%	1.79%	1.61%
Return on average shareholders' equity (annualized)	18.57%	15.56%	18.13%	15.76%

	Three months ended June 30,			Six months ended June 30,		
	2022	2021	Increase (Decrease)	2022	2021	Increase (Decrease)
<b>Statement of Operations Data:</b>						
Interest income	\$ 62,559	\$ 50,473	\$ 12,086	\$ 117,583	\$ 102,633	\$ 14,950
Interest expense	6,135	7,112	(977)	11,127	13,926	(2,799)
Net interest income	56,424	43,361	13,063	106,456	88,707	17,749
Provision for credit losses	2,900	-	2,900	2,650	1,400	1,250
Net interest income after provision for credit losses	53,524	43,361	10,163	103,806	87,307	16,499
Noninterest income	2,601	1,646	955	4,867	2,993	1,874
Noninterest expense	17,140	14,964	2,176	33,297	30,616	2,681
Income before income taxes	38,985	30,043	8,942	75,376	59,684	15,692
Income tax expense	10,916	8,563	2,353	21,280	17,010	4,270
Net income	\$ 28,069	\$ 21,480	\$ 6,589	\$ 54,096	\$ 42,674	\$ 11,422
Net income available to common shareholders per share, basic	\$ 1.90	\$ 1.44	\$ 0.46	\$ 3.66	\$ 2.85	\$ 0.81
Net income available to common shareholders per share, diluted	\$ 1.87	\$ 1.44	\$ 0.43	\$ 3.61	\$ 2.85	\$ 0.76

### Net Interest Income and Net Interest Margin

Net interest income before provision for credit losses increased to \$56.4 million for the three months ended June 30, 2022 compared to \$43.4 million for the same period of 2021. Our net interest margin for the second quarter of 2022 was 3.77%, an increase of 52 basis points from 3.25% for the same period of 2021 due to the recent increases in the Federal Reserve benchmark interest rate.

Net interest income before provision for credit losses increased to \$106.5 million for the six months ended June 30, 2022 compared to \$88.7 million for the same period of 2021. Our net interest margin for the six months ended June 30, 2022 was 3.60%, an increase of 18 basis points from 3.43% for the same period of 2021.

For the three months ended June 30, 2022, the average yield on interest-earning assets was 4.18%, an increase of 40 basis points from 3.78% for the same period of 2021. For the six months ended June 30, 2022, the average yield on interest-earning assets was 3.98%, an increase of 2 basis points from 3.96% for the same period of 2021. The increases in yield during the three and six months period was primarily due to the recent increases in market interest rates. Also, the participation in the PPP slightly impacted the loan yield due to the 1% loan rate on PPP loans. Also, a \$191.5 million purchase of agency collateralized mortgage obligations during the third quarter of 2021 contributed to the yield decline in securities. Interest income, interest expense, net interest income, and the net interest margin are all influenced by the distribution of assets and liabilities and the income earned and costs incurred on such assets and liabilities. For the three months ended June 30, 2022, average interest-earning assets totaled \$6.01 billion, an increase of \$643.4 million from the comparable 2021 period. For the six months ended June 30, 2022, average interest-earning assets totaled \$5.97 billion, an increase of \$739.2 million from the comparable 2021 period. The increase in average interest-earning assets during the three and six months period was primary related to the loan portfolio growth, investment securities portfolio growth and increase in cash balances.

As of June 30, 2022, 74% of our loan portfolio was tied to the Prime Rate, which has the potential to re-price daily, and 22% was tied to the London Interbank Offered Rate, or LIBOR, or other indices, which re-price periodically. Approximately 81% of our adjustable-rate loan portfolio had an interest rate floor at various levels, which provides us with some protection in the current environment with the Prime Rate often at a level below the floor interest rate. Approximately 9% of our loan portfolio had interest rate ceilings at various rates limiting the amount of interest rate increases that can be passed on to the borrower.

The average cost of interest-bearing liabilities decreased 15 basis points to 0.60% for the three months ended June 30, 2022 from 0.75% for the same period of 2021. The average cost of interest-bearing liabilities decreased 20 basis points to 0.55% for the six months ended June 30, 2022 from 0.75% for the same period of 2021. The decrease in the cost of interest-bearing liabilities during the three and six months period was primarily due overall lower costs related to certificate of deposit accounts, offset by the impact of increasing market interest rates and its effect on the cost of existing and new depositors. For the three months ended June 30, 2022, average interest-bearing deposits totaled was \$4.13 billion, an increase of \$314.8 million from the comparable 2021 period. For the six months ended June 30, 2022, average interest-bearing deposits totaled \$4.1 billion, an increase of \$389.3 million from the comparable 2021 period. The increases in average interest-bearing deposits during the three and six months period occurred across all deposit types.

The following tables present, for the periods indicated, the information regarding the distribution of average assets, liabilities and shareholders' equity, as well as the net interest income from average interest-earning assets and the resulting yields expressed in percentages. Non-accrual loans are included in the calculation of average loans and leases while non-accrued interest thereon is excluded from the computation of yields earned.

	Three months ended June 30,					
	2022			2021		
	Average Balance	Interest Income or Expense	Average Yield or Cost	Average Balance	Interest Income or Expense	Average Yield or Cost
<b>ASSETS</b>						
<i>(Dollars in thousands)</i>						
Interest-earning assets:						
Loans <sup>(1,2)</sup>	\$ 4,777,353	\$ 58,541	4.92%	\$ 4,132,451	\$ 47,906	4.65%
Investment securities <sup>(3)</sup>	430,203	2,370	2.21%	269,000	2,058	3.07%
Federal funds sold	20,088	46	0.92%	20,437	19	0.36%
Other earning assets	780,380	1,708	0.88%	942,710	597	0.25%
Total interest-earning assets	6,008,024	62,665	4.18%	5,364,598	50,580	3.78%
Deferred loan fees, net	(9,084)			(4,924)		
Allowance for credit losses on loans	(58,568)			(64,842)		
Noninterest earning assets:						
Cash and due from banks	11,363			10,620		
Bank furniture and fixtures	10,028			11,468		
Right of use assets	21,287			19,735		
Other assets	150,653			131,023		
Total assets	<u>\$ 6,133,703</u>			<u>\$ 5,467,678</u>		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand/savings	2,172,002	\$ 2,468	0.46%	\$ 1,811,524	\$ 1,548	0.34%
TCD \$250K or more	892,410	1,211	0.54%	926,161	1,688	0.73%
Other time certificates	918,476	1,131	0.49%	967,086	1,731	0.72%
Total interest-bearing deposits	3,982,888	4,810	0.48%	3,704,771	4,967	0.54%
Subordinated debt	147,841	1,325	3.59%	111,193	2,145	7.74%
Total interest-bearing liabilities	4,130,729	6,135	0.60%	3,815,964	7,112	0.75%
Non-interest bearing liabilities:						
Demand deposits	1,318,482			1,019,333		
Lease Liability	21,602			21,765		
Other liabilities	56,630			57,055		
Total liabilities	<u>5,527,443</u>			<u>4,914,117</u>		
Shareholders' equity	606,260			553,561		
Total liabilities and shareholders' equity	<u>\$ 6,133,703</u>			<u>\$ 5,467,678</u>		
Net interest income		<u>\$ 56,530</u>			<u>\$ 43,468</u>	
Net interest spread			3.59%			3.03%
Net interest margin			3.77%			3.25%

(1) Includes average non-accrual loans.

(2) Includes net loan fee income.

(3) Yields on securities have been adjusted to a tax-equivalent basis.



	Six months ended June 30,					
	2022			2021		
	Average Balance	Interest Income or Expense	Average Yield or Cost	Average Balance	Interest Income or Expense	Average Yield or Cost
<i>(Dollars in thousands)</i>						
<b>ASSETS</b>						
Interest-earning assets:						
Loans <sup>(1,2)</sup>	\$ 4,573,357	\$ 110,660	4.88%	\$ 4,088,879	\$ 97,765	4.82%
Investment securities <sup>(3)</sup>	442,981	4,594	2.09%	255,675	3,942	3.11%
Federal funds sold	20,105	65	0.65%	20,953	43	0.41%
Other earning assets	936,921	2,478	0.53%	868,663	1,090	0.25%
Total interest-earning assets	5,973,364	117,797	3.98%	5,234,170	102,840	3.96%
Deferred loan fees, net	(7,710)			(4,636)		
Allowance for loan losses	(59,255)			(64,150)		
Noninterest earning assets:						
Cash and due from banks	11,474			10,273		
Bank furniture and fixtures	10,233			11,619		
Right of use assets	21,519			18,299		
Other assets	139,551			129,043		
Total assets	<u>\$ 6,089,176</u>			<u>\$ 5,334,618</u>		
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>						
Interest-bearing liabilities:						
Deposits:						
Interest-bearing demand/ savings	2,125,241	\$ 3,919	0.37%	\$ 1,761,488	\$ 3,004	0.34%
TCD \$250K or more	910,689	2,237	0.50%	922,677	3,606	0.79%
Other time certificates	929,419	2,321	0.50%	934,378	3,640	0.79%
Total interest-bearing deposits	3,965,349	8,477	0.43%	3,618,543	10,250	0.57%
Subordinated debt	147,812	2,650	3.62%	105,303	3,676	7.04%
Total interest-bearing liabilities	4,113,161	11,127	0.55%	3,723,846	13,926	0.75%
Non-interest bearing liabilities:						
Demand deposits	1,293,477			987,365		
Lease Liability	22,030			20,534		
Other liabilities	58,746			56,909		
Total liabilities	5,487,414			4,788,654		
Shareholders' equity	601,762			545,964		
Total liabilities and shareholders' equity	<u>\$ 6,089,176</u>			<u>\$ 5,334,618</u>		
Net interest income		<u>\$ 106,670</u>			<u>\$ 88,914</u>	
Net interest spread			3.43%			3.21%
Net interest margin			3.60%			3.43%

(1) Includes average non-accrual loans.

(2) Includes net loan fee income.

(3) Yields on securities have been adjusted to a tax-equivalent basis.

In addition to the distribution, yields and costs of assets and liabilities, net income is also affected by changes in the volume of and rates on assets and liabilities. The following tables show the change in interest income and interest expense and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates.

**Three months ended June 30, 2022 compared  
to three months ended June 30, 2021**

	<b>Net Change</b>	<b>Rate</b>	<b>Volume</b>
	<i>(In thousands)</i>		
Interest income:			
Loans and leases	\$ 10,635	\$ 2,847	\$ 7,788
Investment securities <sup>(1)</sup>	312	(686)	998
Federal funds sold	27	28	(1)
Other earning assets	1,111	1,230	(119)
Total interest income	12,085	3,419	8,666
Interest expense:			
Interest-bearing demand	728	431	297
Money market	190	128	62
Savings	2	(1)	3
Time certificates of deposits	(1,077)	(934)	(143)
Subordinated debt	(820)	(1,383)	563
Total interest expense	(977)	(1,759)	782
Net interest income	\$ 13,062	\$ 5,178	\$ 7,884

<sup>(1)</sup> Amounts have been adjusted to a tax-equivalent basis

**Six months ended June 30, 2022 compared  
to six months ended June 30, 2021**

	<b>Net Change</b>	<b>Rate</b>	<b>Volume</b>
	<i>(In thousands)</i>		
Interest income:			
Loans and leases	\$ 12,895	\$ 1,185	\$ 11,710
Investment securities <sup>(1)</sup>	652	(1,583)	2,235
Federal funds sold	22	24	(2)
Other earning assets	1,388	1,296	92
Total interest income	14,957	922	14,035
Interest expense:			
Interest-bearing demand	803	322	481
Money market	110	(74)	184
Savings	2	(2)	4
Time certificates of deposits	(2,688)	(2,623)	(65)
Subordinated debt	(1,026)	(2,182)	1,156
Long-term borrowings	-	-	-
Total interest expense	(2,799)	(4,559)	1,760
Net interest income	\$ 17,756	\$ 5,481	\$ 12,275

<sup>(1)</sup> Amounts have been adjusted to a tax-equivalent basis

***Provision for Credit Losses***

In response to the credit risk inherent in our business, we maintain allowances for credit losses through charges to earnings.

The Bank recorded a \$2.9 million provision for credit losses for the three months ended June 30, 2022 compared to no provision for credit losses for the same period in 2021. This provision for credit losses was primarily due to growth in loan portfolio, coupled with possibility of a mild recession. Net charge-offs were zero for the three months ended June 30, 2022, compared to net charge-offs of \$1.2 million for the three months ended June 30, 2021. Net charge-offs were \$1.2 million for the six

months ended June 30, 2022, compared to net charge-offs of \$1.2 million for the six months ended June 30, 2021. Net charge-offs during the 2022 period related to one commercial and industrial relationship that was foreclosed on during the quarter.

The provision for credit losses includes the consideration of the impact to the national and local economies resulting from the COVID-19 pandemic, and risk rating changes within the loan portfolio. The Bank will continue to monitor the continuing impact of the pandemic on credit risks and losses. The provision for credit losses is based on the Bank's determination of the allowance for credit losses under a current expected credit losses methodology. We also apply qualitative factors in calculating allowance levels by loan type, which are revised quarterly and take into consideration reasonable and supportable economic forecasts, the mix of the loan portfolio, concentration levels and trends, local and national economic conditions, changes in capabilities, experience of lending management and staff, and other external factors such as industry conditions, competition and regulatory requirements.

Non-performing loans decreased to \$11.6 million at June 30, 2022, compared to \$14.8 million as of December 31, 2021. The decrease was mainly from transfers to other real estate owned and repossessed asset of \$7.2 million, payoffs of \$4.2 million and charge-offs of \$1.2 million, offset by migration to nonaccrual of \$8.5 million and \$1.0 million of a loan more than 90 days past due and still accruing interest. The ratio of allowance for credit losses on loans to total loans decreased to 1.25% of total loans at June 30, 2022 compared to 1.36% at December 31, 2021. The 11 basis points decrease between periods is primarily attributable to the factors applied in the economic forecasts of the Bank's CECL model, such as charge-offs and loan growth.

Management believes that through the application of the allowance methodology's quantitative and qualitative components, that the provision and overall level of allowance for credit losses on loans is adequate for current expected credit losses inherent in the portfolio as of June 30, 2022. For details on the non-performing loans, please see the table under Non-Performing Assets below.

Additionally, a separate reserve is maintained related to off-balance sheet items such as commitments to extend credits, or letters of credit. See the "Contractual Obligations" section below for further discussion of off-balance sheet items.

### ***Noninterest Income***

We earn noninterest income primarily through fees related to:

- Services provided to deposit customers;
- Services provided in connection with trade finance; and
- Services provided to current loan customers.

In addition, we may earn rental income from OREO property, income from increases in the cash surrender value of bank owned life insurance policies ("BOLI"), and sale of loans and investment securities.

The following table presents, for the periods indicated, the major categories of noninterest income:

	<b>Three months ended</b>		
	<b>June 30,</b>		<b>Increase</b>
	<b>2022</b>	<b>2021</b>	<b>(Decrease)</b>
	<i>(In thousands)</i>		
Fees and service charges on deposit accounts	\$ 723	\$ 525	\$ 198
Letter of credit fee income	1,329	811	518
BOLI income	100	98	2
Net loss on sale of loans	-	(261)	261
Other income	449	473	(24)
Total noninterest income	<u>\$ 2,601</u>	<u>\$ 1,646</u>	<u>\$ 955</u>

Noninterest income for the three months ended June 30, 2022, was \$2.6 million, compared to \$1.6 million for the corresponding period in 2021. The \$955,000 increase was attributable to an increase of \$198,000 in fees and service charges on deposits accounts due to higher average deposit balances and an increase of \$518,000 in trade finance letters of credit fee income from increased activity. There was also a \$0 loss on sale of loans, compared to a \$261,000 net loss on sale of two commercial loans sold at a discount in the 2021 period.

	<b>Six months ended</b>		<b>Increase</b>
	<b>June 30,</b>		<b>(Decrease)</b>
	<b>2022</b>	<b>2021</b>	
	<i>(In thousands)</i>		
Fees and service charges on deposit accounts	\$ 1,395	\$ 951	\$ 444
Letter of credit fee income	2,261	1,619	642
BOLI income	199	194	5
Net loss on sale of loans	-	(640)	640
Other income	1,012	869	143
Total noninterest income	<u>\$ 4,867</u>	<u>\$ 2,993</u>	<u>\$ 1,874</u>

Noninterest income for the six months ended June 30, 2022, was \$4.9 million, compared to \$3.0 million for the corresponding period in 2021. The \$1.9 million increase was attributable to an increase of \$444,000 in fees and service charges on deposits accounts due to higher average deposit balances and an increase of \$642,000 in trade finance letters of credit fee income from increased activity. There was also a \$640,000 increase noninterest income from no sales of loans in the period, compared to a \$640,000 net loss on sale of loans in the 2021 period, including a sold shared national credit loan at a discount of \$398,000, two commercial loans sold at a discount of \$261,000 and one mortgage loan sold at a gain of \$20,000. Additionally, there was an increase of \$143,000 in other income.

### ***Noninterest Expense***

Noninterest expense is the cost, other than interest expense and the provision for credit losses, associated with providing banking and financial services to customers and conducting business.

The following table presents, for the periods indicated, the major categories of noninterest expense:

	<b>Three months ended</b>		<b>Increase</b>
	<b>June 30,</b>		<b>(Decrease)</b>
	<b>2022</b>	<b>2021</b>	
	<i>(In thousands)</i>		
Salaries and employee benefits	\$ 11,688	\$ 10,285	\$ 1,403
Net occupancy expense	1,441	1,429	12
Business development and promotion expense	176	117	59
Professional services	1,460	996	464
Office supplies and equipment expense	459	476	(17)
OREO related expense	385	-	385
Other expense	1,531	1,661	(130)
Total noninterest expense	<u>\$ 17,140</u>	<u>\$ 14,964</u>	<u>\$ 2,176</u>

Total noninterest expense was \$17.1 million for the three months ended June 30, 2022 compared to \$15.0 million for the corresponding period in 2021. The \$2.2 million increase was primarily the result of i) a \$1.4 million increase in salaries and benefits mainly due to hiring additional staff to support the Bank's growth and higher capitalized direct loan origination costs, ii) a \$464,000 increase in professional fees mainly from higher legal and other professional fees, and (iii) a \$385,000 increase in OREO related

expense from maintenance, legal and other foreclosure-related costs, offset by a \$130,000 decrease in other expense resulting primarily from a \$260,000 decrease in FDIC assessments compared to the prior period.

	Six months ended		
	June 30,		Increase
	2022	2021	(Decrease)
	<i>(In thousands)</i>		
Salaries and employee benefits	\$ 23,328	\$ 21,408	\$ 1,920
Net occupancy expense	2,863	2,830	33
Business development and promotion expense	277	190	87
Professional services	2,703	1,977	726
Office supplies and equipment expense	948	914	34
OREO related expense	401	-	401
Other expense	2,777	3,297	(520)
Total noninterest expense	\$ 33,297	\$ 30,616	\$ 2,681

Total noninterest expense was \$33.3 million for the six months ended June 30, 2022 compared to \$30.6 million for the corresponding period in 2021. The \$2.7 million increase was primarily the result of i) a \$1.9 million increase in salaries and benefits mainly due to hiring additional staff to support the Bank's growth and lower capitalized direct loan origination costs, ii) a \$648,000 increase in professional fees from higher data processing fees and higher legal and other professional fees, (iii) a \$401,000 increase in OREO related expense from maintenance, legal and other foreclosure-related costs, offset by a \$520,000 decrease in other expense resulting primarily from a \$710,000 decrease in FDIC assessments compared to the prior period.

### ***Provision for Income Taxes***

We accounted for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enacted date.

We record net tax assets to the extent we believe these assets will more likely than not be realized. In making such determination, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. A valuation allowance is provided when it is more likely than not that some portion of deferred tax assets will not be realized. As of June 30, 2022 and December 31, 2021, the Bank determined that a valuation allowance for deferred tax assets was not required.

We recorded net tax expense of \$10.9 million and \$8.6 million for the three months ended June 30, 2022 and 2021, respectively, resulting in an effective tax rate of 28.00% and 28.50%, respectively. We recorded net tax expense of \$21.3 million and \$17.0 million for the six months ended June 30, 2022 and 2021, respectively, resulting in an effective tax rate of 28.23% and 28.50%, respectively.

As of June 30, 2022 and December 31, 2021, the total amount related to uncertain tax positions was zero, net of federal tax benefit. The Bank does not expect the amount of unrecognized tax benefit to change significantly within the next twelve months.

### ***Financial Condition***

Total assets as of June 30, 2022 were \$6.23 billion compared to \$6.05 billion as of December 31, 2021. Earning assets as of June 30, 2022 totaled \$6.11 billion compared to \$5.95 billion as of December 31, 2021. Total deposits were \$5.41 billion as of June 30, 2022 compared to \$5.23 billion as of December 31, 2021.

## Loans

The largest component of assets and our greatest source of interest income is our loan portfolio. The following table sets forth the amount and type of our loans and leases outstanding at the end of each of the periods indicated.

	June 30, 2022	December 31, 2021	June 30, 2021
	<i>(In thousands)</i>		
Loans (by portfolio and class):			
Real estate – mortgage:			
Real estate—residential	\$ 581,412	\$ 543,917	\$ 558,148
Real estate—commercial	2,583,484	2,259,432	2,019,995
Total real estate – mortgage	3,164,896	2,803,349	2,578,143
Real estate – construction:			
Real estate construction — residential	168,420	130,842	120,363
Real estate construction — commercial	203,217	202,482	224,322
Total real estate construction loans	371,637	333,324	344,685
Commercial & industrial	1,336,631	1,234,425	1,241,309
SBA (PPP)	22,186	42,467	95,764
Trade finance	24,663	11,309	18,359
Consumer & other	128	118	143
Total gross loans and leases	4,920,141	4,424,992	4,278,403
Less: allowance for credit losses on loans	(61,396)	(59,969)	(63,635)
Less: deferred loan fees, net	(9,525)	(6,316)	(5,329)
Total net loans	\$ 4,849,220	\$ 4,358,707	\$ 4,209,439

The majority of the Bank's loans are made to customers and businesses in the state of California and/or secured by properties located primarily in the greater Los Angeles metropolitan area and to a lesser extent, the San Francisco Bay and New York areas. All loans are typically made based on substantially the same credit standards regardless of where the customers and/or collateral properties are located although there may be circumstances whereby geographical location would require more stringent requirements for a loan.

Total gross loans increased by \$495.1 million, or 11.2%, to \$4.92 billion as of June 30, 2022 from \$4.42 billion as of December 31, 2021. Real estate mortgage loans, which include real estate loans collateralized by various types of commercial and residential real estate, increased \$361.5 million from \$2.80 billion as of December 31, 2021 to \$3.16 billion at June 30, 2022. Real estate construction loans which are loans made to borrowers and developers for the purpose of constructing residential or commercial properties, increased \$38.3 million from \$333.3 million at December 31, 2021 to \$371.6 million at June 30, 2022. Commercial & industrial loans increased \$102.2 million from \$1.23 billion at December 31, 2021 to \$1.34 billion at June 30, 2022, and trade finance loans, which are primarily working capital revolving and term loans for business operations, increased \$13.4 million from \$11.3 million at December 31, 2021 to \$24.7 million at June 30, 2022.

SBA loans decreased \$20.3 million from \$42.5 million at December 31, 2021 to \$22.2 million at June 30, 2022. SBA loans consisted entirely of loans originated under the SBA's Payroll Protection Program. The decrease in SBA loans during the six months ended June 30, 2022 is due to forgiveness of PPP loans.

Management's focus from a lending perspective now is to continue monitoring the Bank's existing loan relationships due to the economic shutdown caused by the COVID-19. In addition, because of the recent declines in COVID-19 cases and more re-opening of the economy, management is also keenly focused on growing new and existing relationships. We anticipate that the next two years will be challenging from an economic standpoint as the Fed tries to calm inflation but the Bank sees much opportunity in this environment and while underwriting will remain cautious, the Bank wants to be ready to capture new business.

The following table represent the breakdown of the PPP loans as of June 30, 2022.

	<b>June 30, 2022</b>		<b>December 31, 2021</b>	
	<b>Count</b>	<b>Amount</b>	<b>Count</b>	<b>Amount</b>
	<i>(In thousands)</i>		<i>(In thousands)</i>	
<b>PPP Loan Balance Range</b>				
Less than equal to \$350,000	34	5,606	69	10,990
Greater than \$350,000 and less than equal to \$2.0 million	12	11,910	31	26,807
Greater than \$2.0 million	2	4,670	2	4,670
<b>Total as of June 30, 2022:</b>	<b>48</b>	<b>22,186</b>	<b>102</b>	<b>42,467</b>

### ***Non-Performing Assets***

Non-performing assets are composed of loans on non-accrual status and Other Real Estate Owned (“OREO”) and Repossessed Assets, and certain Troubled Debt Restructurings (“TDRs”). TDR’s that are on non-accrual status are included in non-performing assets while TDR’s that are performing according to their revised terms are not included in nonperforming assets. Generally, loans are placed on non-accrual status when they become 90 days or more past due or at such earlier time as management determines timely recognition of interest to be in doubt, unless they are both fully secured and in process of collection. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower’s financial condition is such that collection of principal and contractually due interest is not likely. When, in our judgment, the borrower’s ability to make required interest and principal payments has resumed and collectability is no longer in doubt, the loan could be returned to accrual status. OREO consists of real property acquired through foreclosure or similar means that the Bank intends to offer for sale.

A TDR is a debt restructuring in which a bank, for economic or legal reasons specifically related to a borrower’s financial difficulties, grants a concession to the borrower that it would not otherwise consider. At June 30, 2022, the Bank had two performing restructured loans totaling \$2.0 million and a non-performing restructured loan of \$1.2 million. At December 31, 2021, the Bank had three performing restructured loans totaling \$25.2 million and a non-performing restructured loan of \$4.9 million classified as TDRs.

In order to encourage banks to work with impacted borrowers, the CARES Act and U.S. banking agencies have provided relief from TDR accounting, which include a capital benefit in the form of reduced risk-weighted assets, as TDRs are more heavily risk-weighted for capital purposes. Beginning in late March 2020, the Bank granted various loan accommodation program in the form of payment deferrals, to provide relief to borrowers experiencing financial hardship due to COVID-19 pandemic. Section 4013 of the CARES Act, as amended by the CAA, permits a financial institution to elect to temporarily suspend TDR accounting under ASC Subtopic 310-40 in certain circumstances. To be eligible under Section 4013 of the CARES Act, a loan modification must be (1) related to the COVID-19 pandemic; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (a) 60 days after the date of termination of the federal National Emergency or (b) January 1, 2022. The federal banking regulators, in consultation with the FASB, issued the Interagency Statement on April 7, 2020 confirming that, for loans not subject to Section 4013 of the CARES Act, short-term modifications (i.e. six months or less) made on a good faith basis in response to the COVID-19 pandemic to borrowers who were current as of the implementation date of a loan modification, or modifications granted under government mandated modification programs, are not considered as TDRs under ASC Subtopic 310-40. Therefore, modified loans that met the required guidelines for relief are excluded from the TDRs.

The following table summarizes the loans for which the accrual of interest has been discontinued, loans more than 90 days past due and still accruing interest, OREO and other repossessed assets and loans held for sale:

	<b>As of June 30, 2022</b>	<b>As of December 31, 2021</b>	<b>As of June 30, 2021</b>
	<i>(Dollars in thousands)</i>		
Non-accrual loans	\$ 10,625	\$ 14,824	\$ 20,220
Accruing loans and leases past due 90 days or more	<u>1,020</u>	<u>-</u>	<u>1,679</u>
Total non-performing loans (NPLs)	11,645	14,824	21,899
OREO and other repossessed assets	<u>21,449</u>	<u>-</u>	<u>-</u>
Total non-performing assets (NPAs)	<u>\$ 33,094</u>	<u>\$ 14,824</u>	<u>\$ 21,899</u>
Performing TDRs	\$ 2,011	\$ 25,181	\$ 25,281
Selected ratios:			
NPLs to total gross loans	0.24%	0.34%	0.51%
NPAs to total assets	0.53%	0.25%	0.39%

Total non-performing assets were \$33.1 million and \$14.8 million at June 30, 2022 and December 31, 2021 and \$21.9 million as of June 30, 2021. As of June 30, 2022, total non-accrual loans were \$10.6 million compared to \$14.8 million as of December 31, 2021 and \$20.2 million as of June 30, 2021. See “Notes to Consolidated Interim Financial Statements (Unaudited) Note 9 — *Loans, Leases and Allowance for Credit Losses on Loans*” for further details regarding non-accrual and past due loan by loan class.

The following table summarizes the migration of non-performing assets from January 1, 2022 to June 30, 2022:

	<b>Loans 90+ Days Past Due &amp; Still Accruing</b>	<b>Non Accrual Loans</b>	<b>OREO and Repossessed Assets</b>
	<i>(In thousands)</i>		
Balance, December 31, 2021	\$ -	\$ 14,824	\$ -
Transfers to OREO	-	(7,215)	7,215
Other additions	1,020	-	-
Sales/Payoffs	-	(4,240)	-
Migration to non-accrual	-	8,477	-
Charge-offs	-	(1,221)	-
First and second lien payoffs	<u>-</u>	<u>-</u>	<u>14,234</u>
Balance, June 30, 2022	<u>\$ 1,020</u>	<u>\$ 10,625</u>	<u>\$ 21,449</u>

The \$4.2 million decrease in nonaccrual loans during the six months ended June 30, 2022 was primarily related to 1) foreclosure of one commercial and industrial relationship totaling \$3.5 million and one residential real estate loans totaling \$3.8 million, 2) payoffs of \$2.0 million related to one commercial and industrial relationship and paydown of \$2.1 million related to one



commercial real estate loan, and 3) charge-offs of \$1.2 million related to the one commercial and industrial loan foreclosure. These reductions were offset by migrations to nonaccrual of \$8.4 million.

There were no loans over 90 days past due and still accruing at June 30, 2022 and December 31, 2021.

OREO and repossessed assets totaled \$21.4 million and zero at June 30, 2022 and December 31, 2021. The balance at June 30, 2022 included residential real estate of \$18.0 million and other repossessed assets of \$3.5 million. During the first quarter of 2022 the Bank took ownership of assets of one commercial and industrial relationship totaling \$3.5 million and a property of a residential real estate loan totaling \$3.8 million as well as the payoff of the second lien on the property of \$8.3 million. During the second quarter, the Bank paid off the first lien on the property for \$5.9 million.

OREO and repossessed assets are initially recorded at the fair value of the property based on appraisal, less estimated selling costs. Any cost in excess of the fair value at the time of acquisition is accounted for as a loan charge-off and deducted from the allowance for credit losses on loans. A valuation allowance is established for any subsequent declines in value through a charge to earnings. There was no valuation allowance related to OREO and repossessed assets at June 30, 2022. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in noninterest income or expense, as appropriate.

### *Allowance for Credit Losses*

See “Notes to Consolidated Interim Financial Statements Note 9 — Loans and Allowance for Credit Losses on Loans” for further details regarding allowance for credit losses on loans. The allowance for credit losses on loans is maintained at a level which, in management’s judgment, is adequate to absorb current expected credit losses in the loan portfolio. Management estimates the allowance balance using relevant available information, from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors.

Our loan portfolio is categorized into several segments for purposes of determining allowance amounts by loan segment. The loan segments we currently evaluate are: commercial & industrial, international trade finance, real estate, real estate construction and SBA. Real estate is further segmented by individual product type with a general class, residential or commercial. The commercial class is represented by office, industrial, retail, multifamily, special purpose and land commercial product types. The residential class is represented by single family residential (“SFR”) and land residential. Real estate construction is similarly further segmented by office, industrial, retail, multifamily and SFR product types. The SBA portfolio represents the PPP loans. Within these loan pools, we then evaluate loans rated as pass credits, separately from loans designated as “Special mention” or adversely classified loans. The allowance amounts for pass rated loans, which are not reviewed individually, are determined using historical loss rates developed through migration analyses. The adversely classified loans are further grouped into three credit risk rating categories: substandard, doubtful and loss. All loans in the doubtful category are analyzed individually and all loans in the loss category are charged off within the quarter identified as such.

The Bank performs an analysis to estimate the credit losses for off-balance sheet commitments, including letters of credit, acceptances outstanding, and committed loan amounts, on a quarterly basis. On a quarterly basis, management performs a qualitative evaluation for AFS debt securities in an unrealized loss position to determine if the impairment of an investment’s value is related to credit or all other factors under the guidance of ASC 326-30. The ASC 326-20 requires to estimate the lifetime credit loss allowance for the HTM debt securities. The Bank holds the HTM debt securities that are issued by the government agencies which are highly rated by the agencies and have a long history of no credit losses so no ACL on these securities are recorded.

Although we believe that our allowance for credit losses is adequate and believe that we have considered all risks, there can be no assurance that our allowance will be adequate to absorb future losses. Factors such as a prolonged and deepened recession, higher unemployment rates than we have already anticipated, deterioration of California real estate values as well as natural disasters, civil unrest, terrorism and pandemic diseases like the COVID-19 pandemic can have a significantly negative impact on the performance of our loan portfolio and the occurrence of any single one of these factors may lead to additional future losses which can negatively impact our earnings, capital and liquidity.

The table below summarizes loans, average loans, non-performing loans and changes in the allowance for credit losses on loans arising from loan losses and additions to the allowance from provisions charged to operating expense:

**Allowance for Credit Losses & Loss Histories**

	Three months ended June 30,		Six months ended		Year ended
	2022	2021	2022	2021	December 31, 2021
<i>(Dollars in thousands)</i>					
Allowance for credit losses:					
Balance at beginning of period	\$ 58,496	\$ 64,883	\$ 59,969	\$ 63,426	\$ 63,426
Actual charge-offs:					
Commercial & Industrial	-	431	1,222	431	1,697
Real estate mortgage	-	817	1	817	817
Total charge-offs	-	1,248	1,223	1,248	2,514
Less recoveries:					
Commercial & Industrial	-	-	-	57	57
Total recoveries	-	-	-	57	57
Net loans charged-off (recovered)	-	1,248	1,223	1,191	2,457
Provision for (reversal of) credit losses	2,900	-	2,650	1,400	(1,000)
Balance at end of period	\$ 61,396	\$ 63,635	\$ 61,396	\$ 63,635	\$ 59,969
Total gross loans at end of period	\$ 4,920,141	\$ 4,278,403	\$ 4,920,141	\$ 4,278,403	\$ 4,424,992
Average total loans	\$ 4,777,353	\$ 4,132,451	\$ 4,573,357	\$ 4,088,879	\$ 4,138,592
Non-performing loans	\$ 11,645	\$ 21,899	\$ 11,645	\$ 21,899	\$ 14,824
Selected ratios:					
Net charge-offs (recoveries) to average loans <sup>(1)</sup>	0.00%	0.12%	0.05%	0.06%	0.06%
Provision for (reversal of) credit losses to average loans <sup>(1)</sup>	0.24%	0.00%	0.12%	0.07%	-0.02%
Allowances for credit losses to loans at end of period	1.25%	1.49%	1.25%	1.49%	1.36%
Allowance for credit losses to non-performing loans	5.27x	2.91x	5.27x	2.91x	4.05x

(1) Net charge-offs to average loans and provisions for allowance for credit losses to average loans for the periods presented are calculated on an annualized basis. See the above section entitled "Provision for Credit Losses" for further discussion regarding our provision.

The table below summarizes net (charge-offs) recoveries, average loans, and the ratio of net (charge-offs) recoveries to average assets:

	Three months ended June 30,					
	2022			2021		
	Net (Charge-offs) Recoveries	Avg. Loans	Net (Charge-off) Recovery Ratio	Net (Charge-offs) Recoveries	Avg. Loans	Net (Charge-off) Recovery Ratio
Commercial & Industrial	\$ -	\$ 1,327,662	0.00%	\$ (431)	\$ 1,172,697	-0.15%
Trade Finance	-	22,412	0.00%	-	16,463	0.00%
Real estate construction	-	359,943	0.00%	-	352,356	0.00%
Real estate mortgage	-	3,036,754	0.00%	(817)	2,486,489	-0.13%
SBA	-	26,428	0.00%	-	100,982	0.00%
Consumer & other	-	4,154	0.00%	-	1,203	0.00%
<b>Net (charge-offs) recoveries</b>	<b>\$ -</b>	<b>\$ 4,777,353</b>	<b>0.00%</b>	<b>\$ (1,248)</b>	<b>\$ 4,130,190</b>	<b>-0.12%</b>

Net charge-offs (recoveries) to average loans were 0.00% for the three months ended June 30, 2022 compared to 0.12% for the three months ended June 30, 2021. The decrease in the net charge-off ratio between periods was due to there being no net charge-offs during the quarter.

	Six months ended June 30,					
	2022			2021		
	Net (Charge-offs) Recoveries	Avg. Loans	Net (Charge-off) Recovery Ratio	Net (Charge-offs) Recoveries	Avg. Loans	Net (Charge-off) Recovery Ratio
Commercial & Industrial	\$ (1,222)	\$ 1,259,875	-0.19%	\$ (374)	\$ 1,162,835	-0.06%
Trade Finance	-	18,273	0.00%	-	16,933	0.00%
Real estate construction	-	351,340	0.00%	-	355,716	0.00%
Real estate mortgage	(1)	2,907,554	0.00%	(817)	2,458,856	-0.07%
SBA	-	31,339	0.00%	-	91,762	0.00%
Consumer & other	-	4,976	0.00%	-	1,629	0.00%
<b>Net (charge-offs) recoveries</b>	<b>\$ (1,223)</b>	<b>\$ 4,573,357</b>	<b>-0.05%</b>	<b>\$ (1,191)</b>	<b>\$ 4,087,731</b>	<b>-0.06%</b>

Net charge-offs (recoveries) to average loans were 0.05% for the six months ended June 30, 2022 compared to 0.06% for the six months ended June 30, 2021. The decrease in the net charge-off ratio between periods was due to comparable net charge-offs, offset by higher average loans.

#### *Allowance for Credit Losses Related to Undisbursed Loan and Lease Commitments*

We maintain an allowance for credit losses for undisbursed loan commitments. Management estimates the amount by applying the loss factors used in our allowance for credit losses on loans using the current expected credit losses methodology to our estimate of the expected usage of undisbursed commitments for each loan type. Provisions for credit losses for undisbursed loan commitments are recorded in other expense. The allowance for credit losses on undisbursed loan commitments totaled \$1.2 million at June 30, 2022 and December 31, 2021. There was no provision for credit losses on undisbursed loan commitment for the three and six months ended June 30, 2022 and 2021.

#### *Investment Securities Available-for-Sale and Held-to-Maturity and Trading*

The Bank classifies its debt and equity securities in two categories: held-to-maturity or available-for-sale. Securities that could be sold in response to changes in interest rates, increased loan demand, liquidity needs, capital requirements, or other similar factors are classified as securities available-for-sale. These securities are carried at fair value. Unrealized holding gains or losses, net of the related tax effect, on available-for-sale securities are excluded from income and are reported as a separate component of shareholders' equity as other comprehensive income net of applicable taxes until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis. Securities classified as held-to-maturity are those that

the Bank has the intent and ability to hold until maturity. These securities are carried at amortized cost, adjusted for the amortization or accretion of premiums or discounts.

Management performs a credit impairment analysis of the investment securities portfolio in accordance with FASB's ASC 326 current expected credit losses (CECL). Under the standard, the credit loss evaluations of debt securities classified as available-for-sale and held-to-maturity are separated.

Management performs a quarterly qualitative evaluation for available-for-sale securities in an unrealized loss position to determine if the impairment of an investment's value (fair value being below amortized cost) is related to credit or all other factors (such as due to changes in interest rates, illiquidity in the market, changes in general market conditions, etc.). In determining whether a security's decline in fair value is credit related, management considers a number of factors including, but not limited to: (i) the extent to which the fair value of the investment is less than its amortized cost; (ii) the financial condition and near-term prospects of the issuer; (iii) downgrades in credit ratings; (iv) payment structure of the security, (v) the ability of the issuer of the security to make scheduled principal and interest payments and (vi) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads. If it is determined through the Bank's qualitative assessment of available-for-sale securities that the decline in fair value below a security's amortized cost can be attributed to credit loss, the Bank records the amount of credit loss through a charge to provision for credit losses in current period earnings. If the Bank determines the security's unrealized loss, or a portion thereof, is not related to credit, the Bank records the non-credit related loss, net of tax, through a debit to accumulated other comprehensive income. The Bank have made a policy election to exclude accrued interest from the amortized cost basis of available-for-sale securities and report accrued interest in accrued interest receivables in the consolidated balance sheets. Available-for-sale securities are placed on non-accrual status when we no longer expect to receive all contractual amounts due, which is generally at 90 days past due. Accrued interest receivable is reversed against interest income when a security is placed on non-accrual status. Accordingly, we do not recognize an allowance for credit loss against accrued interest receivable.

For held-to-maturity securities, the Bank recognizes expected lifetime credit losses on a collective basis according to shared risk characteristics. Credit losses on held-to-maturity securities are only recognized at the individual security level when the Bank determines a security no longer possesses risk characteristics similar to others in the portfolio.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective-interest method. Dividend and interest income are recognized when earned.

Our portfolio of investment securities consists primarily of investment grade corporate notes, U.S. Agency mortgage-backed securities ("MBS"), municipal bonds, collateralized mortgage obligations ("CMOs") and U.S. Government agency securities, U.S. treasury bills, and small business administration ("SBA") securities. We have generally categorized our entire securities portfolio as available-for-sale securities. We invest in securities to generate interest income and to maintain a liquid source of funding for our lending and other operations, including withdrawals of deposits. We do not engage in active trading in our investment securities portfolio. While management has the intent and ability to hold all securities until maturity, we have realized and from time to time and again may realize gains (or losses) from sales of selected securities primarily in response to changes in interest rates or to re-position the portfolio. The Bank owns three mortgage-backed securities considered held-to-maturity as of June 30, 2022 with a carrying value of \$12.8 million. At June 30, 2022, investment securities classified as available-for-sale with a carrying value of \$56.9 million were pledged to secure public deposits.

The table below shows the amortized cost, gross unrealized gains and losses, estimated fair value of securities available-for-sale as of June 30, 2022 and December 31, 2021:

<b>June 30, 2022</b>				
	<b>Amortized cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Estimated fair value</b>
	<b>(In thousands)</b>			
Asset-backed securities	\$ 3,278	\$ 25	\$ (17)	\$ 3,286
Corporate notes	144,186	99	(6,918)	137,367
U.S. Agency mortgage-backed securities	12,951	12	(461)	12,502
Collateralized mortgage obligations	178,314	-	(10,380)	167,934
Municipal securities	75,246	79	(9,082)	66,243
U.S. Agency principal-only strip securities	481	-	(27)	454
SBA securities	114	-	(1)	113
U.S. Treasury Bill	14,934	-	(2,236)	12,698
Total securities available-for-sale	<u>\$ 429,504</u>	<u>\$ 215</u>	<u>\$ (29,122)</u>	<u>\$ 400,597</u>

  

<b>December 31, 2021</b>				
	<b>Amortized cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Estimated fair value</b>
	<b>(In thousands)</b>			
Asset-backed securities	\$ 3,362	\$ 19	\$ (19)	\$ 3,362
Corporate notes	142,279	5,386	(362)	147,303
U.S. Agency mortgage-backed securities	14,991	122	(222)	14,891
Collateralized mortgage obligations	190,491	430	(234)	190,687
Municipal securities	78,288	2,509	(132)	80,665
U.S. Agency principal-only strip securities	553	-	-	553
SBA securities	170	-	(1)	169
U.S. Treasury Bill	14,931	-	(650)	14,281
Total securities available-for-sale	<u>\$ 445,065</u>	<u>\$ 8,466</u>	<u>\$ (1,620)</u>	<u>\$ 451,911</u>

As of June 30, 2022, available-for-sale securities decreased by \$51.3 million or 11.4% to \$400.6 million, compared to \$451.9 million as of December 31, 2021. The decrease was primarily due to \$7.8 million in maturities and calls of corporate notes and municipal securities, \$14.3 million in principal reductions and \$35.8 million in fair value decreases, offset by purchases of \$7.0 million in corporate securities. As of June 30, 2022, available-for-sale securities had a net unrealized loss of \$28.9 million compared to a net unrealized gain of \$6.8 million as of December 31, 2021. The decrease in net unrealized gain was attributable to decreases in the value of all classes of securities due to recent increases in long term interest rates, offset by increases in market prices for corporate notes as a result of tightening credit spreads to the U.S. Treasury curve.

The carrying value of our held-to-maturity investment securities was \$12.8 million at June 30, 2022 and \$14.0 million at December 31, 2021. The decrease between periods was due to principal paydowns during the quarter.

The table below shows the amortized cost, unrecognized gross gains and losses, and estimated fair value of securities held-to-maturity as of June 30, 2022 and December 31, 2021:

June 30, 2022				
	Amortized cost	Gross unrecognized gains	Gross unrecognized losses	Estimated fair value
(In thousands)				
Mortgage-backed securities	\$ 12,784	\$ -	\$ (1,128)	\$ 11,656
December 31, 2021				
	Amortized cost	Gross unrecognized gains	Gross unrecognized losses	Estimated fair value
(In thousands)				
Mortgage-backed securities	\$ 13,962	\$ 37	\$ (71)	\$ 13,928

### ***Deposits***

Total deposits at June 30, 2022 were \$5.41 billion, an increase of \$182.4 million or 3.5% from the balance of \$5.23 billion as of December 31, 2021. Compared to December 31, 2021, noninterest-bearing demand deposits increased by \$80.2 million or 6.1%, interest-bearing demand deposits increased by \$206.7 million or 10.2%, saving deposits increased by \$1.9 million or 5.1%. Additionally, time deposits decreased \$106.4 million or 5.8%. The increase in deposits was due to organic growth of customer relationships as well as the expanding of existing relationships.

The following table shows the balance of each major category of deposit at the dates indicated:

	June 30, 2022		December 31, 2021	
	Amount	% of Total Deposits	Amount	% of Total Deposits
(Dollars in thousands)				
Noninterest-bearing deposits	\$ 1,385,934	25.63%	\$ 1,305,692	25.00%
Interest-bearing deposits:				
Interest-bearing demand	2,239,501	41.41%	2,032,819	38.90%
Savings	39,784	0.74%	37,839	0.72%
Time certificates of \$250,000 or more	870,376	16.09%	934,444	17.88%
Other time certificates	872,357	16.13%	914,717	17.50%
Total deposits	\$ 5,407,952	100.00%	\$ 5,225,511	100.00%

Our time certificates of deposit are the largest single component of our deposits continues to be time certificates of deposit. We market and receive time certificates of deposit from our existing and new high net worth customers, especially from the Chinese communities within our branch network. While we do not attempt to be a market leader in offered interest rates, we attempt to offer competitive rates on these time certificates of deposit within a range offered by other competing banks.

### ***Borrowings***

At June 30, 2022 and December 31, 2021, there were no advances outstanding from Federal Home Loan Bank of San Francisco ("FHLB").

## ***Subordinated Debentures***

On June 16, 2021, the Bank completed a public offering of \$150.0 million in aggregate principal amount of 3.375% fixed-to-floating rate subordinated notes due June 15, 2031. A majority of the proceeds from the placement of the notes were used to repay the subordinated notes due 2026. The subordinated notes mature on June 15, 2031 and bear interest at a fixed rate per annum of 3.375%, payable semi-annually in arrears until June 15, 2026. On that date, the subordinated notes will bear interest at a floating rate per annum equal to a benchmark rate, which is expected to be the Three-Month Term SOFR, plus 278 basis points, payable quarterly in arrears; provided, however, in the event that the then-current benchmark rate is less than zero, then the benchmark rate will be deemed zero. The Bank may, at its option, redeem the subordinated notes in whole or in part beginning on June 15, 2026 at par and, in other certain limited circumstances. The subordinated notes have been structured to qualify as Tier 2 capital for regulatory purposes. Debt issuance costs incurred in conjunction with the offering were \$2.4 million.

## **Capital Resources**

Current risk-based regulatory capital standards generally require banks to maintain a ratio of “core” or “Tier 1” capital (consisting principally of common equity) to risk-weighted assets of at least 8.0%, a ratio of only common equity Tier 1 capital to risk-weighted assets of at least 6.5%, a ratio of Tier 1 capital to adjusted total assets (leverage ratio) of at least 5.0% and a ratio of total capital (which includes Tier 1 capital plus certain forms of subordinated debt, a portion of the allowance for credit losses on loans and preferred stock) to risk-weighted assets of at least 10.0%. Risk-weighted assets are calculated by multiplying the balance in each category of assets by a risk factor, which ranges from zero for cash assets and certain government obligations to 100% for some types of loans, and adding the products together. The Bank elected to permanently opt-out of excluding accumulated other comprehensive income from common equity tier 1 capital.

A new capital conservation buffer of 2.50% became effective starting January 1, 2019 and must be met to avoid limitations on the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses. The Bank's capital conservation buffer was 4.61% and 5.27% as of June 30, 2022 and December 31, 2021, respectively.

In September 2019, the FDIC finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio (“CBLR”) framework), as required by the EGRCPA. The CBLR framework is designed to reduce the 15 requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework. In order to qualify for the CBLR framework, a community banking organization must have a tier 1 leverage ratio of greater than 9 percent, less than \$10 billion in total consolidated assets, and limited amounts of off-balance sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well capitalized ratio requirements under the Prompt Corrective Action regulations and will not be required to report or calculate risk-based capital. The CBLR framework was available for banks to use beginning in their March 31, 2020, Call Report. We elected to not opt in to the CBLR framework. The FDIC also finalized a rule that permits non-advanced approaches banking organizations to use the simpler regulatory capital requirements for mortgage servicing assets, certain deferred tax assets arising from temporary differences, investments in the capital of unconsolidated financial institutions, and minority interest when measuring their tier 1 capital as of January 1, 2020. Banking organizations may use this new measure of tier 1 capital under the CBLR framework. We did not adopt the CBLR framework.

In December 2018, the Federal Reserve announced that a banking organization that experiences a reduction in retained earnings due to the CECL adoption as of the beginning of the fiscal year in which CECL is adopted may elect to phase in the regulatory capital impact of adopting CECL. Transitional amounts are calculated for the following items: retained earnings, temporary difference deferred tax assets and credit loss allowances eligible for inclusion in regulatory capital. When calculating regulatory capital ratios, 25% of the transitional amounts are phased in during the first year. An additional 25% of the transitional amounts are phased in over each of the next two years and at the beginning of the fourth year, the day-one effects of CECL are completely reflected in regulatory capital. We did not elect to phase in the regulatory capital impact of adopting CECL.

Additionally, in March 2020, the Office of the Comptroller of the Currency, Treasury, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation announced the 2020 CECL interim final rule (IFR) designed to allow eligible firms to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of the COVID-19 pandemic. The 2020 CECL IFR allows firms that adopt CECL before December 31, 2020 to defer 100 percent of the day one transitional amounts described above through December 31, 2021 for regulatory capital purposes. Additionally, the 2020 CECL IFR allows electing firms to defer through December 31, 2021 the approximate portion of the post day one allowance attributable to CECL relative to the incurred loss methodology. This is

calculated by applying a 25% scaling factor to the CECL provision. The Bank did not adopt the transition guidance and the 2020 CECL IFR relief.

On August 6, 2021, the Bank received approval from the California Department of Financial Protection and Innovation for the repurchase of up to \$50 million in the Bank's common stock or 5% of total outstanding shares, whichever is less, in the open market. The timing, price and volume of the share repurchases will be determined by Bank management based on its evaluation of market conditions and other relevant factors. This repurchase was approved by shareholders at the Bank's Annual Shareholders Meeting on May 18, 2021. The share repurchase program may be suspended, terminated or modified at any time by the Bank for any reason, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity, and other factors deemed appropriate.

In May of 2022, the Board of Directors elected to re-commence the repurchase plan which began in 2021 and received all the required approvals. Therefore, this repurchase plan calls for the repurchase of up to approximately \$32 million of common stock in the open market. As of June 30, 2022, the Bank has purchased 192,159 shares of its common stock at an average price of \$67.46 per share for a total of \$13.0 million.

Our goal is to exceed the Basel III minimum regulatory capital requirements for well capitalized institutions. At June 30, 2022 and December 31, 2021, our capital ratios were above the Basel III minimum requirements for well capitalized institutions. On a quarterly basis, we perform a stress test on our capital to determine our level of capital in various adverse economic scenarios looking out twenty-four months into the future. Below are the results of our stress tests as of the dates indicated below:

	<u>At June 30, 2022</u>	<u>At December 31, 2021</u>
<b>Leverage Ratio</b>		
Preferred Bank	9.92%	9.54%
Minimum requirement for "Well-Capitalized" institution	5.00%	5.00%
<b>Common Equity Tier 1 Risk-Based Capital Ratio</b>		
Preferred Bank	10.61%	11.26%
Minimum requirement for "Well-Capitalized" institution	6.50%	6.50%
<b>Tier 1 Risk-Based Capital Ratio</b>		
Preferred Bank	10.61%	11.26%
Minimum requirement for "Well-Capitalized" institution	8.00%	8.00%
<b>Total Risk-Based Capital Ratio</b>		
Preferred Bank	14.28%	15.37%
Minimum requirement for "Well-Capitalized" institution	10.00%	10.00%

## Commitments and Contingencies

In the normal course of business, we enter into off-balance sheet arrangements consisting of commitments to extend credit, to fund commercial letters of credit and standby letters of credit. Commercial letters of credit are originated to facilitate transactions both domestic and foreign while standby letters of credit are originated to issue payments on behalf of the Bank's customers when specific future events occur. Historically, the Bank has rarely issued payment under standby letters of credit, in which the Bank's customer is obligated to reimburse the Bank. The Bank could also liquidate collateral or offset a customer's deposit accounts to satisfy this payment.

Financial instrument transactions are subject to our normal credit standards, financial controls and risk limiting and monitoring procedures. Collateral requirements are based on a case-by-case evaluation of each customer and product.

The following table presents these commitments as of June 30, 2022:



Other Commitments	Amount of Commitment Expiring per Period				
	Total Amounts Committed	Less Than 1 Year	1-3 Years	3-5 Years	After 5 Years
	<i>(In thousands)</i>				
Commitments to extend credit	\$ 1,176,209	\$ 558,061	\$ 530,399	\$ 66,222	\$ 21,527
Commercial letters of credit	9,452	9,452	-	-	-
Standby letters of credit	260,607	71,564	79,646	50,107	59,290
Commitments to fund investments in affordable housing partnerships	20,036	13,264	4,552	1,032	1,188
Lease commitments	21,387	298	1,238	5,767	14,084
Future contract commitments	2,143	1,071	1,072	-	-
Total	<u>\$ 1,489,834</u>	<u>\$ 653,710</u>	<u>\$ 616,907</u>	<u>\$ 123,128</u>	<u>\$ 96,089</u>

## Liquidity

Based on our existing business plan, we believe that our level of liquid assets is sufficient to meet our current and presently anticipated funding needs for at least the next twelve months. We rely on deposits as the principal source of funds and, therefore, must be in a position to service depositors' needs as they arise. We attempt to maintain a loan-to-deposit ratio below approximately 95%. Our loan-to-deposit ratio was 91.0% at June 30, 2022 compared to 84.7% at December 31, 2021. This increase in our loan-to-deposit ratio was due to loan portfolio growth outpacing deposit growth between periods.

Borrowings from the FHLB are another source of funding for our loan and investment activities. At June 30, 2022, we had no outstanding FHLB borrowings, and we could borrow up to \$111.3 million with collateral of specifically identified loans and securities. In addition, we have pledged securities with a fair value of \$121.5 million at the Federal Reserve Discount Window which we may borrow from on an overnight basis. We have one uncommitted fed funds line with a financial institution for \$25.0 million. As an additional condition of borrowing from the FHLB, we are required to purchase FHLB stock. As of June 30, 2022, the Bank was required to maintain the minimum stock requirement of \$15.0 million of FHLB stock based on the volume of "membership assets" as defined by the FHLB. At June 30, 2022, the Bank held \$15.0 million in FHLB stock. For the three months ended June 30, 2022 and 2021, dividends from the FHLB totaled \$224,000 and \$264,000, respectively, representing an average yield of 5.99% and 7.06%, respectively. For the six months ended June 30, 2022 and 2021, dividends from the FHLB totaled \$446,000 and \$449,000, respectively, representing an average yield of 6.00% and 6.03%, respectively.

We also attempt to maintain a total liquidity ratio (liquid assets, including cash and due from banks, federal funds sold and investment securities not pledged as collateral expressed as a percentage of total deposits) above approximately 18%. Our total liquidity ratios were 23% at June 30, 2022 and 32% at December 31, 2021. We also calculate and have certain thresholds for the Bank's on-balance sheet liquidity ratio. We believe that in the event the level of liquid assets (our primary liquidity) does not meet our liquidity needs, other available sources of liquid assets (our secondary liquidity), including the sales of securities under agreements to repurchase, sales of unpledged investment securities or loans, utilizing the discount window borrowings from the Federal Reserve Bank as well as borrowing from the FHLB could be employed to meet those funding needs. We have a Contingency Funding Plan which is reviewed annually by the Board of Directors which sets forth actions to be taken in the event that our liquidity ratios fall below Board-established guidelines. We also perform quarterly liquidity stress tests to model various adverse scenarios contained in the Contingency Funding Plan. Although we believe that our funding resources will be more than adequate to meet our obligations, we cannot be certain of this adequacy if economic deterioration or other negative events occur that could impair our ability to meet our funding obligations.

## Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market prices and rates, foreign currency exchange rates, commodity prices and equity prices. Market risk arises primarily from interest rate risk inherent in our lending and deposit taking activities. To that end, management actively monitors and manages interest rate risk exposure. The Bank does not have any market risk sensitive instruments entered into for trading purposes. We manage interest rate sensitivity by matching the re-pricing opportunities on earning assets to those on funding liabilities. Management uses various asset/liability strategies to manage the re-pricing characteristics of assets and liabilities designed to ensure that exposure to interest rate fluctuations is limited and within guidelines of acceptable levels of risk-taking.

Interest rate risk is addressed by our Investment Committee which is comprised of the Chief Executive Officer and members of our Board. The Investment Committee monitors interest rate risk by analyzing the potential impact on the net portfolio of equity value and net interest income from potential changes in interest rates, and considers the impact of alternative strategies or changes in balance sheet structure. The Investment Committee manages the balance sheet in part to maintain the potential impact on net portfolio value and net interest income within acceptable ranges despite rate changes in interest rates.

Exposure to interest rate risk is monitored continuously by senior management and is reviewed by the Investment Committee at least quarterly. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine changes in net portfolio value and net interest income in the event of hypothetical changes in interest rates. If potential changes to net portfolio value and net interest income resulting from the analysis of hypothetical interest rate changes are not within Board-approved limits, the Board may direct management to adjust the asset and liability mix to bring interest rate risk within Board-approved limits. This analysis of hypothetical interest rate changes is performed on a quarterly basis by a third party vendor utilizing detailed data that we provide to them.

### ***Market Value of Portfolio Equity***

The Bank measures the impact of market interest rate changes on the net present value of estimated cash flows from assets, liabilities and off-balance sheet items, defined as the market value of portfolio equity, using a simulation model. This simulation model assesses the changes in the market value of interest rate sensitive financial instruments that would occur in response to an instantaneous and sustained increase or decrease in market interest rates.

The following table presents forecasted changes in net portfolio value using a base market rate and the estimated change to the base scenario given an immediate and sustained upward movement in interest rates of 100, 200, 300 and 400 basis points and an immediate and sustained downward movement in interest rates of 100 and 200 basis points as of June 30, 2022.

<b>Market Value of Portfolio Equity</b>				
<b>Interest Rate Scenario</b>	<b>Market Value</b>	<b>Percentage Change from Basis</b>	<b>Percentage of Total Assets</b>	<b>Percentage of Portfolio Equity Book Value</b>
<i>(Dollars in thousands)</i>				
Up 400 basis points	1,531,912	39.0%	25.5%	258.9%
Up 300 basis points	1,443,654	31.0%	23.9%	244.0%
Up 200 basis points	1,344,178	22.0%	22.1%	227.2%
Up 100 basis points	1,230,093	11.6%	20.1%	207.9%
Base	<b>1,101,912</b>	-	17.9%	186.3%
Down 100 basis points	997,204	-9.5%	16.1%	168.6%
Down 200 basis points	897,358	-18.6%	14.3%	151.7%

The computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, asset prepayments and deposit decay, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions management may undertake in response to changes in interest rates. Actual amounts may differ from the projections set forth above should market conditions vary from the underlying assumptions.

### ***Net Interest Income***

In order to measure interest rate risk as of June 30, 2022, we used a simulation model to project changes in net interest income that result from forecasted changes in interest rates. This analysis calculates the difference between net interest forecasted using a rising and a falling interest rate scenario and a net interest income forecast using a base market interest rate derived from the current treasury yield curve. The income simulation model includes various assumptions regarding the re-pricing relationships for each of our products. Many of our assets are floating rate loans, which are assumed to reprice immediately, and to the same extent as the change in market rates according to their contracted index. Some loans and investment vehicles include the opportunity of prepayment (embedded options), and accordingly the simulation model uses national indexes to estimate these prepayments and

reinvest their proceeds at current yields. Non-term deposit products reprice more slowly, usually changing less than the change in market rates and at management's discretion.

This analysis indicates the impact of changes in net interest income for the given set of rate changes and assumptions. It assumes no growth in the balance sheet and that its structure will remain similar to the structure at year end. It does not account for all factors that may impact this analysis, including changes by management to mitigate the impact of interest rate changes or secondary impacts such as changes to the credit risk profile as interest rates change. Furthermore, loan prepayment rate estimates and spread relationships change regularly. Interest rate changes create changes in actual loan prepayment rates that will differ from the market estimates incorporated in this analysis. Changes that vary significantly from the assumptions may have significant effects on net interest income.

For the rising and falling interest rate scenarios, the base market interest rate forecast was increased or decreased on an instantaneous and sustained basis.

#### Sensitivity of Net Interest Income June 30, 2022

<u>Interest Rate Scenario</u>	<u>Adjusted Net Interest Income</u>	<u>Percentage Change from Basis</u>	<u>Net Interest Margin Percent</u>	<u>Net Interest Margin Change (in basis points)</u>
<i>(Dollars in thousands)</i>				
Up 400 basis points	\$ 397,530	68.0%	6.33%	253
Up 300 basis points	\$ 357,109	50.9%	5.69%	190
Up 200 basis points	\$ 316,913	33.9%	5.07%	127
Up 100 basis points	\$ 276,438	16.8%	4.43%	63
Base	\$ 236,670	-	3.80%	-
Down 100 basis points	\$ 214,837	-9.2%	3.45%	(35)
Down 200 basis points	\$ 210,097	-11.2%	3.38%	(42)

#### *Inflation*

The majority of our assets and liabilities are monetary items held by us, the dollar value of which may be affected by inflation, which has risen dramatically in recent months. Only a small portion of total assets is in premises and equipment which minimizes any material effect of asset values and depreciation expenses that may result from fluctuating market values due to inflation. Higher inflation rates may increase operating expenses or have other adverse effects on our borrowers, making collection on extensions of credit more difficult for us. Rates of interest paid or charged generally rise if the marketplace believes inflation rates will increase.

#### **Recent Accounting Pronouncements**

For information regarding recent accounting pronouncements, refer to Note 3 to the Consolidated Interim Financial Statements, "Recent Accounting Pronouncement."

#### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

For quantitative and qualitative disclosures regarding market risks in our portfolio, see, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Quantitative and Qualitative Disclosures About Market Risk" above.

#### **ITEM 4. Controls and Procedures**

As of the end of the period covered by this Report, the Bank carried out an evaluation, under the supervision and with the participation of management, including the Bank's Chief Executive Officer along with the Bank's Chief Financial Officer, of the effectiveness of the design and operation of the Bank's disclosure controls and procedures pursuant to SEC rules, as such rules are adopted by the FDIC. Based upon that evaluation as of the end of the period covered by this Report, the Bank's Chief Executive Officer and Chief Financial Officer concluded that the Bank's disclosure controls and procedures are effective. There have been no

changes in the Bank's internal controls during the period covered by this Report that have materially affected or are reasonably likely to materially affect the Bank's internal controls over financial reporting.

The Bank's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Bank in the reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Bank's disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that are filed under the Exchange Act is accumulated and communicated to management, including the Bank's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

We are not involved in any material legal proceedings. From time to time, we are a party to claims and legal proceedings arising in the ordinary course of business. There are no such claims or pending legal proceedings or, to the best of our knowledge, threatened legal proceedings, to which we are a party which may have a material adverse effect upon our financial condition, results of operations and business prospects.

### ITEM 1A. Risk Factors

There are no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2021 that was filed on March 14, 2022.

### ITEM 2. Unregistered Sale of Equity Securities and Use of Proceeds

Purchase of Equity Securities by the Issuer				Total Number of Shares (or Approximate Dollar Value) that May Yet be Purchased Under the Plan
	Total Number of Shares	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	
June 7, 2022 to June 30, 2022	192,159	\$ 67.46	192,159	\$ 19,582,578

On August 6, 2021, the Bank received approval from the California Department of Financial Protection and Innovation for the repurchase of up to \$50 million in the Bank's common stock or 5% of total outstanding shares, whichever is less, in the open market. The timing, price and volume of the share repurchases will be determined by Bank management based on its evaluation of market conditions and other relevant factors. This repurchase was approved by shareholders at the Bank's Annual Shareholders Meeting on May 18, 2021. The share repurchase program may be suspended, terminated or modified at any time by the Bank for any reason, including market conditions, the cost of repurchasing shares, the availability of alternative investment opportunities, liquidity, and other factors deemed appropriate.

In May of 2022, the Board of Directors elected to re-commence the repurchase plan which began in 2021 and received all the required approvals. Therefore, this repurchase plan calls for the repurchase of up to approximately \$32 million of common stock in the open market. As of June 30, 2022, a total of 192,159 shares were repurchased.

### ITEM 6. Exhibits

The Exhibits listed below are included as part of this Report.

<u>Exhibit No.</u>	<u>Description of Exhibits</u>
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002 filed herewith.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002 filed herewith.
32.1	Certification of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 furnished herewith.
32.2	Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 furnished herewith.

## SIGNATURES

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

Dated: August 8, 2022

PREFERRED BANK  
(Registrant)

By: /s/ Edward J. Czajka

**Edward J. Czajka**  
**Executive Vice President and Chief Financial Officer**  
**(Principal Financial and Accounting Officer) – Duly**  
**Authorized Officer**

CERTIFICATION PURSUANT TO RULE  
13a-14(a) AND 15d-14(a),  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Li Yu, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Preferred Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2022

\_\_\_\_\_  
/s/ Li Yu  
Li Yu  
Chairman and Chief Executive Officer

CERTIFICATION PURSUANT TO RULE  
13a-14(a) AND 15d-14(a),  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Edward J. Czajka, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Preferred Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 8, 2022

\_\_\_\_\_  
/s/ Edward J. Czajka  
Edward J. Czajka  
Executive Vice President and Chief Financial Officer



CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Preferred Bank (the “Bank”) on Form 10-Q for the three months period ended June 30, 2022 as filed with the Federal Deposit Insurance Corporation on the date hereof (the “Report”), I, Li Yu, Chairman and Chief Executive Officer of the Bank, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank.

Date: August 8, 2022

\_\_\_\_\_  
/s/ Li Yu  
Li Yu  
Chairman and Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating acknowledging, or otherwise adopting the signature that appears in typed form within this version of this written statement required by Section 906, has been provided to the Bank and will be retained by the Bank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Preferred Bank (the “Bank”) on Form 10-Q for the three months period ended June 30, 2022 as filed with the Federal Deposit Insurance Corporation on the date hereof (the “Report”), I, Edward J. Czajka, Executive Vice President and Chief Financial Officer of the Bank, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank.

Date: August 8, 2022

\_\_\_\_\_  
/s/ Edward J. Czajka  
Edward J. Czajka  
Executive Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906, or other document authenticating acknowledging, or otherwise adopting the signature that appears in typed form within this version of this written statement required by Section 906, has been provided to the Bank and will be retained by the Bank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.