

HERITAGE FINANCIAL CORP /WA/  
Form PRE 14A  
March 05, 2010

**Proxy Statement Pursuant to Section 14(a) of the  
Securities Exchange Act of 1934**

Filed by the Registrant                       Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

**Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2)).**

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to Rule 14a-12

**HERITAGE FINANCIAL CORPORATION**

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:  
N/A

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(2) Aggregate number of securities to which transactions applies:  
N/A

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:  
N/A

(4) Proposed maximum aggregate value of transaction:  
N/A

(5) Total fee paid:  
N/A

Fee paid previously with preliminary materials: N/A

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:  
N/A

(2) Form, Schedule or Registration Statement No.:  
N/A

(3) Filing Party:  
N/A

(4) Date Filed:  
N/A

March 19, 2010

Dear Fellow Shareholder:

On behalf of the Board of Directors and management of Heritage Financial Corporation, we cordially invite you to attend the annual meeting of shareholders. The meeting will be held at 10:30 a.m., local time, on Wednesday, May 5, 2010 at the Phoenix Inn Suites, 417 Capitol Way N., Olympia, Washington. The matters expected to be acted upon at the meeting are described in the attached Proxy Statement. In addition, we will report on our progress during the past year and address your questions and comments.

We encourage you to attend the meeting in person. Whether or not you plan to attend, please read the enclosed Proxy Statement and then complete, sign and date the enclosed proxy card and return it in the accompanying postpaid return envelope as promptly as possible. This will save us the additional expense of soliciting proxies and will ensure that your shares are represented at the annual meeting.

Your Board of Directors and management are committed to the continued success of Heritage Financial Corporation and the enhancement of your investment. As President and Chief Executive Officer, I want to express my appreciation for your confidence and support.

Sincerely,

Brian L. Vance  
President and Chief Executive Officer

**HERITAGE FINANCIAL CORPORATION**

201 FIFTH AVENUE S.W.

OLYMPIA, WASHINGTON 98501

(360) 943-1500

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**TO BE HELD ON MAY 5, 2010**

Notice is hereby given that the annual meeting of shareholders of Heritage Financial Corporation will be held at the Phoenix Inn Suites, 417 Capitol Way N., Olympia, Washington, on May 5, 2010 at 10:30 a.m., local time. **A proxy card and a Proxy Statement for the annual meeting are enclosed.**

The annual meeting is for the purpose of considering and voting on the following proposals:

- Proposal 1. Election of three directors of Heritage Financial Corporation for three-year terms;
- Proposal 2. Approval of an advisory (non-binding) vote on executive compensation;
- Proposal 3. Ratification of the appointment of KPMG LLP as Heritage Financial Corporation's independent registered public accounting firm for the year ending December 31, 2010;
- Proposal 4. Amendment of the Articles of Incorporation to increase the authorized number of shares of common stock from 15,000,000 to 50,000,000 shares;
- Proposal 5. Adoption of the Heritage Financial Corporation 2010 Omnibus Equity Plan; and
- Proposal 6. A shareholder proposal, if properly presented at the annual meeting, to eliminate classification of terms of the Board of Directors to require that all directors stand for election annually.

Shareholders also will transact such other business as may properly come before the annual meeting, or any adjournment or postponement thereof. As of the date of this notice, we are not aware of any other business to come before the annual meeting.

The Board of Directors has fixed the close of business on March 8, 2010 as the record date for the annual meeting. This means that shareholders of record at the close of business on that date are entitled to receive notice of and to vote at the meeting and any adjournment thereof. **To ensure that your shares are represented at the meeting, please take the time to vote by signing, dating and returning your enclosed proxy card, which is solicited on behalf of the Board of Directors, by following the instructions for voting by mail, or submit your proxy by following the instructions for voting by phone or on the Internet. The proxy will not be used if you attend and vote at the annual meeting in person. Regardless of the number of shares you own, your vote is very important. Please act today.**

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BY ORDER OF THE BOARD OF DIRECTORS

Kaylene M. Lahn  
Secretary

Olympia, Washington

March 19, 2010

**Important: The prompt return of proxies will save us the expense of further requests for proxies to ensure a quorum at the annual meeting. A pre-addressed envelope is enclosed for your convenience. No postage is required if mailed within the United States.**

**201 FIFTH AVENUE S.W.  
OLYMPIA, WASHINGTON 98501  
(360) 943-1500**

**PROXY STATEMENT  
ANNUAL MEETING OF SHAREHOLDERS  
MAY 5, 2010**

The Board of Directors of Heritage Financial Corporation is using this Proxy Statement to solicit proxies from our shareholders for use at the annual meeting of shareholders. We are first mailing this Proxy Statement and the enclosed form of proxy to our shareholders on or about March 19, 2010.

The information provided in this Proxy Statement relates to Heritage Financial Corporation and its wholly-owned bank subsidiaries, Heritage Bank and Central Valley Bank. Heritage Financial Corporation may also be referred to as Heritage or the Company. All references in this Proxy Statement to Heritage, we, us and our or similar references mean Heritage Financial Corporation and its consolidated subsidiaries and all references to Heritage Financial Corporation means Heritage Financial Corporation excluding its subsidiaries, in each case unless otherwise expressly stated or the context requires otherwise.

**INFORMATION ABOUT THE ANNUAL MEETING**

**Time and Place of the Annual Meeting**

Our annual meeting will be held as follows:

**Date:** May 5, 2010

**Time:** 10:30 a.m., local time

**Place:** Phoenix Inn Suites, 417 Capitol Way N., Olympia, Washington

**Matters to Be Considered at the Annual Meeting**

At the meeting, you will be asked to consider and vote upon the following proposals:

- Proposal 1. Election of three directors of Heritage Financial Corporation for three-year terms;
- Proposal 2. Approval of an advisory (non-binding) vote on executive compensation;
- Proposal 3. Ratification of the appointment of KPMG LLP as Heritage Financial Corporation's independent registered public accounting firm for the year ending December 31, 2010;

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- Proposal 4. Amendment of the Articles of Incorporation to increase the authorized number of shares of common stock from 15,000,000 to 50,000,000 shares;
- Proposal 5. Adoption of the Heritage Financial Corporation 2010 Omnibus Equity Plan; and
- Proposal 6. A shareholder proposal, if properly presented at the annual meeting, to eliminate classification of terms of the Board of Directors to require that all directors stand for election annually.

You also will transact any other business that may properly come before the annual meeting. As of the date of this Proxy Statement, we are not aware of any business to be presented for consideration at the annual meeting other than the matters described in this Proxy Statement.

**Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Shareholders to Be Held on May 5, 2010**

Our Proxy Statement and Annual Report to Shareholders are available at [www.hf-wa.com/proxy](http://www.hf-wa.com/proxy). The following materials are available for review:

Proxy Statement;

Proxy Card;

Annual Report to Shareholders; and

Directions to attend the annual meeting, where you may vote in person.

**Who is Entitled to Vote?**

We have fixed the close of business on March 8, 2010, as the record date for shareholders entitled to notice of and to vote at our annual meeting. Only holders of record of Heritage's common stock on that date are entitled to notice of and to vote at the annual meeting. You are entitled to one vote for each share of Heritage common stock you own. On March 8, 2010, there were \_\_\_\_\_ shares of Heritage common stock outstanding and entitled to vote at the annual meeting.

**How Do I Vote at the Annual Meeting?**

Proxies are solicited to provide all shareholders of record on the voting record date an opportunity to vote on matters scheduled for the annual meeting and described in these materials. You are a shareholder of record if your shares of Heritage common stock are held in your name. If you are a beneficial owner of Heritage common stock held by a broker, bank or other nominee (i.e., in street name), please see the instructions in the following question.

Shares of Heritage common stock can only be voted if the shareholder is present in person or by proxy at the annual meeting. To ensure your representation at the annual meeting, we recommend you vote by proxy even if you plan to attend the annual meeting. You can always change your vote at the meeting if you are a shareholder of record.

Voting instructions are included on your proxy card. Shares of Heritage common stock represented by properly executed proxies will be voted by the individuals named on the proxy card in accordance with the shareholder's instructions. Where properly executed proxies are returned to us with no specific instruction as how to vote at the annual meeting, the persons named in the proxy will vote the shares FOR the election of each of management's director nominees, FOR the approval of an advisory vote on executive compensation, FOR ratification of the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2010, FOR the amendment of the Articles of Incorporation to increase the authorized number of shares of common stock, FOR the adoption of the Heritage Financial Corporation 2010 Omnibus Equity Plan and AGAINST the shareholder proposal to eliminate classification of terms of the Board of Directors to require all directors stand for election annually. If any other matters are properly presented at the annual meeting for action, the persons named in the enclosed proxy and acting thereunder will have the discretion to vote on these matters in accordance with their best judgment. We do not currently expect that any other matters will be properly presented for action at the annual meeting.

You may receive more than one proxy card depending on how your shares are held. For example, you may hold some of your shares individually, some jointly with your spouse and some in trust for your children. In this case, you will receive three separate proxy cards to vote.

**What if My Shares Are Held in Street Name by a Broker?**

If you are the beneficial owner of shares held in street name by a broker, your broker, as the record holder of the shares, is required to vote the shares in accordance with your instructions. If you do not give instructions to your broker, your broker may nevertheless vote the shares with respect to discretionary items, but will not be permitted to vote your shares with respect to non-discretionary items, pursuant to current industry practice. In the case of non-discretionary items, the shares not voted will be treated as broker non-votes. The proposals to elect directors and to adopt the 2010 Omnibus Equity Plan are considered non-discretionary items under the rules governing brokers that are members of the New York Stock Exchange; therefore, you must provide instructions to your broker in order to have your shares voted on these proposals.

If your shares are held in street name, you will need proof of ownership to be admitted to the annual meeting. A recent brokerage statement or letter from the record holder of your shares are examples of proof of ownership. If you want to vote your shares of common stock held in street name in person at the annual meeting, you will have to get a written proxy in your name from the broker, bank or other nominee who holds your shares.

**How Will My Shares of Common Stock Held in the 401(k) Employee Stock Ownership Plan Be Voted?**

We maintain a 401(k) employee stock ownership plan (KSOP) which owns 4.6% of Heritage's common stock. Our employees participate in the KSOP. Each KSOP participant may instruct the trustee of the plan how to vote the shares of Heritage common stock allocated to his or her account under the KSOP by completing a vote authorization form. If a KSOP participant properly executes a vote authorization form, the KSOP trustee will vote the participant's shares in accordance with the participant's instructions. Unallocated shares of Heritage common stock held by the KSOP will be voted by the trustee in the same proportion as shares for which the trustee has received voting instructions. Allocated shares for which proper voting instructions are not received will be voted by the trustee as directed by the KSOP administrator. In order to give the trustee sufficient time to vote, all vote authorization forms, which are in the form of a proxy card, from KSOP participants must be received by the transfer agent on or before April 30, 2010.

**How Many Shares Must Be Present to Hold the Meeting?**

A quorum must be present at the meeting for any business to be conducted. The presence at the meeting, in person or by proxy, of at least a majority of the shares of Heritage common stock entitled to vote at the annual meeting as of the record date will constitute a quorum. Proxies received but marked as abstentions or broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting.

**What if a Quorum Is Not Present at the Meeting?**

If a quorum is not present at the scheduled time of the meeting, a majority of the shareholders present or represented by proxy may adjourn the meeting until a quorum is present. The time and place of the adjourned meeting will be announced at the time the adjournment is taken, and no other notice will be given unless a new record date for the meeting is set. An adjournment will have no effect on the business that may be conducted at the meeting.

**Vote Required to Approve Proposal 1: Election of Directors**

Directors are elected by a plurality of the votes cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Accordingly, the three nominees for election as directors who receive the highest number of votes actually cast will be elected. Pursuant to our Articles of Incorporation, shareholders are not permitted to cumulate their votes for the election of directors. Votes may be cast for or withheld from each nominee. Votes that are withheld and broker non-votes will have no effect on the outcome of the election because the nominees receiving the greatest number of votes will be elected. **Our Board of Directors unanimously recommends that you vote FOR the election of each of its director nominees.**

**Vote Required to Approve Proposal 2: Advisory Vote on Executive Compensation**

Approval of the advisory vote on executive compensation requires the affirmative vote of the majority of the votes cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Abstentions will have the effect of a vote against this proposal. **Our Board of Directors unanimously recommends that you vote FOR the approval of the advisory vote on executive compensation.**

**Vote Required to Approve Proposal 3: Ratification of the Appointment of Our Independent Registered Public Accounting Firm**

Ratification of the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2010, requires the affirmative vote of the majority of the votes cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Abstentions will have the effect of a vote against this proposal. **Our Board of Directors unanimously recommends that you vote FOR the proposal to ratify the appointment of KPMG LLP as our independent registered public accounting firm for the year ending December 31, 2010.**

**Vote Required to Approve Proposal 4: Proposed Amendment to the Articles of Incorporation to Increase the Authorized Number of Shares of Common Stock**

The approval of the proposed Amendment to the Articles of Incorporation to increase the authorized number of shares of common stock requires the affirmative vote of a majority of the outstanding shares entitled to vote at the annual meeting by holders of Heritage common stock. Abstentions will have the same effect as a vote against the proposal. **Our Board of Directors unanimously recommends that you vote FOR the amendment to the Articles of Incorporation to increase the authorized number of shares of common stock.**

**Vote Required to Approve Proposal 5: Adoption of the Heritage Financial Corporation 2010 Omnibus Equity Plan**

The adoption of the Heritage Financial Corporation 2010 Omnibus Equity Plan requires the affirmative vote of a majority of the votes cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Abstentions will have the same effect as a vote against the proposal. Broker non-votes do not constitute votes cast and therefore will have no effect on the approval of the proposal. In determining the percentage of votes that have been affirmatively voted on this proposal, the affirmative votes will be measured against the aggregate votes for and against the proposal, plus the abstentions from voting on the proposal. **Our Board of Directors unanimously recommends that you vote FOR the adoption of the Heritage Financial Corporation 2010 Omnibus Equity Plan.**

**Vote Required to Approve Proposal 6: Shareholder Proposal to Eliminate Classification of Terms of the Board of Directors to Require that all Directors Stand for Election Annually**

This proposal requires the affirmative vote of the majority of shares cast, in person or by proxy, at the annual meeting by holders of Heritage common stock. Abstentions will have the effect of a vote against this proposal. **Our Board of Directors unanimously recommends that you vote AGAINST the proposal to eliminate classification of terms of the Board of Directors to require that all Directors stand for election annually.**

**May I Revoke My Proxy?**

You may revoke your proxy before it is voted by:

submitting a new proxy with a later date;

notifying the Secretary of Heritage in writing before the annual meeting that you have revoked your proxy; or

voting in person at the annual meeting.

If you plan to attend the annual meeting and wish to vote in person, we will give you a ballot at the annual meeting. However, if your shares are held in street name, you must bring a validly executed proxy from the nominee indicating that you have the right to vote your shares.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth, as of March 8, 2010, information regarding share ownership of:

those persons or entities (or groups of affiliated persons or entities) known by management to beneficially own more than five percent of Heritage's common stock other than directors and executive officers;

each director and director nominee of Heritage;

each executive officer of Heritage named in the Summary Compensation Table appearing under Executive Compensation below (known as named executive officers); and

all current directors and executive officers of Heritage as a group.

Persons and groups who beneficially own in excess of five percent of Heritage's common stock are required to file with the Securities and Exchange Commission (SEC), and provide a copy to Heritage, reports disclosing their ownership pursuant to the Securities Exchange Act of 1934. To our knowledge, no other person or entity, other than the ones set forth below, beneficially owned more than five percent of the outstanding shares of Heritage's common stock as of the close of business on the voting record date.

Beneficial ownership is determined in accordance with the rules and regulations of the SEC. In accordance with Rule 13d-3 of the Securities Exchange Act, a person is deemed to be the beneficial owner of any shares of common stock if he or she has voting and/or investment power with respect to those shares. Therefore, the table below includes shares owned by spouses, other immediate family members in trust, shares held in retirement accounts or funds for the benefit of the named individuals, and other forms of ownership, over which shares the persons named in the table may possess voting and/or investment power. In addition, in computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to outstanding options that are currently exercisable or exercisable within 60 days after the voting record date are included in the number of shares beneficially owned by the person and are deemed outstanding for the purpose of calculating the person's percentage ownership. These shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other person. As of March 8, 2010, there were \_\_\_\_\_ shares of Heritage common stock outstanding.

Name	Number of Shares Beneficially Owned	Percent of Common Stock Outstanding
<b>Beneficial Owners of More Than 5%</b>		
<b>(Other than Directors and Executive Officers)</b>		
Wellington Management Company, LLP (1) 75 State Street  Boston Massachusetts 02108	726,600	6.54%
<b>Directors</b>		
Brian S. Charneski (2)	34,870	*
Gary B. Christensen (3)	52,941	*
John A. Clees (4)	86,227	*
Kimberly T. Ellwanger (5)	9,000	*
Peter N. Fluetsch (6)	36,505	*
Daryl D. Jensen (7)	179,234	1.61
Jeffrey S. Lyon (8)	27,268	*
Donald V. Rhodes (9)	361,115	3.25
Philip S. Weigand (10)	137,241	1.24
<b>Named Executive Officers</b>		
D. Michael Broadhead (11)	71,347	*
Donald J. Hinson (12)	9,165	*
Gregory D. Patjens (13)	54,232	*
David A. Spurling (14)	30,664	*
Brian L. Vance (15)	209,459	1.89
<b>Directors and Executive Officers of Heritage as a group (14 persons)</b>	1,299,268	11.70%

\* Less than one percent of shares outstanding.

- (1) According to a Schedule 13G filed with the SEC on February 12, 2010, Wellington Management Company, LLP has shared voting power with respect to 692,200 shares and shared dispositive power with respect to 726,600 shares.
- (2) Includes 8,200 shares issuable upon exercise of options.
- (3) Includes 8,037 shares issuable upon exercise of options, 32,904 shares held jointly with his spouse and 12,000 shares owned by entities controlled by Mr. Christensen.
- (4) Includes 5,575 shares issuable upon exercise of options.
- (5) Includes 4,000 shares issuable upon exercise of options and 5,000 shares held jointly with her spouse.
- (6) Includes 4,025 shares issuable upon exercise of options and 32,480 shares held solely by his spouse.
- (7) Includes 10,662 shares issuable upon exercise of options.
- (8) Includes 8,200 shares issuable upon exercise of options and 3,000 shares held as custodian for a minor.
- (9) Includes 7,248 shares issuable upon exercise of options and \_\_\_\_\_ vested shares in the KSOP.

- (10) Includes 8,200 shares issuable upon exercise of options, 15,960 shares held solely by his spouse and 49,920 shares held jointly with his spouse.
- (11) Includes 21,395 shares issuable upon exercise of options and vested shares in the KSOP.
- (12) Includes 4,040 shares issuable upon exercise of options and vested shares in the KSOP.
- (13) Includes 14,310 shares issuable upon exercise of options and vested shares in the KSOP.
- (14) Includes 13,910 shares issuable upon exercise of options and vested shares in the KSOP.
- (15) Includes 53,550 shares issuable upon exercise of options, 315 shares held by children and vested shares in the KSOP.

**PROPOSAL 1 ELECTION OF DIRECTORS**

Our Board of Directors consists of ten members and is divided into three classes. Approximately one-third of the directors are elected annually to serve for a three-year period or until their respective successors are elected and qualified. The table below sets forth information regarding each director of Heritage and each nominee for director, including his or her age, position and term of office. The Board Governance and Nominating Committee of the Board of Directors selects nominees for election as directors. Each of our nominees currently serves as a Heritage director. Each nominee has consented to being named in this Proxy Statement and has agreed to serve if elected. If a nominee is unable to stand for election, the Board of Directors may either reduce the number of directors to be elected or select a substitute nominee. If a substitute nominee is selected, the proxy holders will vote your shares for the substitute nominee, unless you have withheld authority. At this time, we are not aware of any reason why a nominee might be unable to serve if elected.

**The Board of Directors recommends you vote FOR the election of Messrs. Charneski, Fluetsch, and Vance.**

Name	Age (1)	Position(s) Held with Heritage	Director Since	Term to Expire
<b>Nominees</b>				
Brian S. Charneski	48	Director	2000	2013(2)
Peter N. Fluetsch	72	Director	1999	2013(2)
Brian L. Vance	55	Director, President and Chief Executive Officer	2002	2013(2)
<b>Directors Continuing in Office</b>				
Daryl D. Jensen	70	Director	1985	2011
Jeffrey S. Lyon	57	Director	2000	2011
Donald V. Rhodes	73	Chairman	1989	2011
Gary B. Christensen	61	Director	2005	2012
John A. Clees	62	Director	2005	2012
Kimberly T. Ellwanger	50	Director	2006	2012
Philip S. Weigand	72	Director	1985	2012

(1) As of December 31, 2009.

(2) Assuming re-election.

**Business Experience of Directors**

The business experience of each director of Heritage for at least the past five years and the experience, qualifications, attributes, skills and areas of expertise of each director that makes the director uniquely qualified to serve as a director is set forth below. All nominees and directors have held their present positions for at least five years unless otherwise indicated.

Brian S. Charneski is the President of L&E Bottling Company in Olympia, Washington and is Chairman of Pepsi Northwest Beverages, LLC, a regional beverage manufacturing joint venture with PepsiCo, Inc. headquartered in Tumwater, Washington. Mr. Charneski is a director of the American Beverage Association. Mr. Charneski was elected to the board of directors of the Pepsi-Cola Bottlers Association in 2010, having

previously served on that board from 1998 through 2008, including chairing the Association from 2005 to 2007. Mr. Charneski serves on the board of trustees of Saint Martin's University and has been a past director of the Washington Center for Performing Arts and The Community Foundation of the South Sound. Mr. Charneski is a 1985 graduate of Seattle University with a Bachelors of Arts in Economics. Mr. Charneski provides a depth of knowledge in corporate and regulatory matters as he is a strong advocate for the American Beverage Association. He brings significant financial, economic and corporate expertise to the Board.

Peter N. Fluetsch is the Chief Executive Officer of Sunset Air, Inc. in Lacey, Washington, a heating and air conditioning contractor that he founded in 1976. Mr. Fluetsch has been a board member of the Sheetmetal Contractors Association of Western Washington for twenty four years as well as a board member of the Sheetmetal Contractors National Association for four years. Mr. Fluetsch is a current board member of the Providence Saint Peter Foundation and served on their board since 2000. Mr. Fluetsch was the founding member and served several terms on the board of the Thurston County Economic Development Council. Mr. Fluetsch served as chairman of the City of Tumwater's planning commission, twelve years as the Chairman of public works for the City Council of Tumwater and served as the Mayor and Executive Officer for four years for the City of Tumwater. Mr. Fluetsch brings to the Board a diverse background in politics, community involvement and expertise of the Sheetmetal industry. He provides broad and experienced knowledge to the Board.

Brian L. Vance currently serves as President and Chief Executive Officer of Heritage and Heritage Bank, and Vice Chairman and Chief Executive Officer of Central Valley Bank. Mr. Vance joined Heritage in 1996 as its Executive Vice President and Chief Credit Officer. Effective October 1, 1998, Mr. Vance was appointed President and Chief Operating Officer of Heritage Bank and in March of 2003, he was named President and Chief Executive Officer of Heritage Bank. On October 1, 2006, Mr. Vance was appointed to his current position. Prior to joining Heritage Bank, Mr. Vance was employed for 24 years with West One Bank, a bank with offices in Idaho, Utah, Oregon and Washington. Prior to leaving West One, he was Senior Vice President and Regional Manager of Banking Operations for the south Puget Sound region. Mr. Vance serves as trustee of the South Puget Sound Community College and serves as a director of the University of Washington Tacoma Milgard School of Business Foundation, the Pierce County Economic Development Board, the Boys and Girls Club and the Community Foundation. Mr. Vance is the President of the Washington Financial League. Mr. Vance's experience with the financial services industry, which includes credit administration, management and strategic forecasting, brings valuable management and financial analysis skills to the Board.

Daryl D. Jensen served as President of Sunset Life Insurance Company of America from 1973 until his retirement in 1999. Currently, Mr. Jensen is Chief Financial Officer of Western Institutional Review Board, located in Olympia, Washington. He serves as a director of Sunset Life Insurance Company and Kansas City Life Insurance Company, and is a member of the Audit Committee of Kansas City Life Insurance Company. Mr. Jensen is also a director of Panorama City Corporation, a large retirement community located in Lacey, Washington. Mr. Jensen has served as a director of Central Valley Bank since 1989. Mr. Jensen is a member of the American Academy of Actuaries. Mr. Jensen brings significant financial services industry expertise to the Board. His management and financial operations experience broaden the Board's perspective on insurance and financial services matters.

Jeffrey S. Lyon is the Chairman and Chief Executive Officer of GVA Kidder Mathews, headquartered in Seattle, Washington. Mr. Lyon serves as a director for GVA Worldwide and Kidder Mathews-Segner Inc. Mr. Lyon is a member of the Real Estate Advisory Board of Washington State University, a member of the Business Advisory Board for the Milgard School of Business at the University of Washington, Tacoma and is also on the Tacoma-Pierce County Economic Development Board. Mr. Lyon has over 34 years of experience in the commercial real estate industry in the Puget Sound area. Mr. Lyon provides an expertise in the commercial real estate industry with excellent entrepreneurial and leadership skills, which prove beneficial to the Board.

Donald V. Rhodes currently serves as Chairman of Heritage Financial Corporation and Heritage Bank, and since 1986, Chairman of Central Valley Bank, a subsidiary of Heritage which was acquired on March 5, 1999. Mr. Rhodes joined Heritage Bank in 1989 as President and Chief Executive Officer and was elected Chairman in

1990. Mr. Rhodes serves as a director of the Federal Home Loan Bank of Seattle. Mr. Rhodes' significant experience in the financial services industry has proven to provide a depth of knowledge and judgment to the Board. He has provided the management and leadership skills required as the Chairman of the Company.

Gary B. Christensen is the President, Chief Executive Officer and Chairman of the Board of R.E. Powell Distributing, a fuel, lubricant and propane distributorship headquartered in Grandview, Washington. In 2004, R.E. Powell Distributing was named one of five inductees into the University of Washington sponsored Leadership Circle at the 6<sup>th</sup> Annual UW Minority Business of the Year Awards dinner. Mr. Christensen is also the Chief Executive Officer and Chairman of the Board of MidValley Chrysler, Jeep, Dodge Inc. Mr. Christensen is a current member of the Chevron Oil Company National Wholesale Council, a director of the Safari Club International and a founding director and current President of Central Washington Chapter of Safari Club International. Mr. Christensen serves as a director for Central Valley Bank and recently retired from serving as the Chairman of the Board of Directors for Yakima County Development Association. Mr. Christensen provides significant knowledge in corporate matters with his proven leadership in the success of his multiple companies. He also provides extensive knowledge of the Yakima Valley market, where our subsidiary bank, Central Valley Bank, is located.

John A. Clees is Tax Services Director at the consulting and accounting firm of RSM McGladrey and McGladrey & Pullen LLP in Olympia, Washington. Prior to this, Mr. Clees was the President of Clees Miles CPA Group, Olympia, Washington from 1995 until the Group was sold to RSM McGladrey. Prior to that time, he was the managing partner of Gattis, Clees and Company, an accounting firm with offices in Seattle and Olympia, Washington. Mr. Clees is a graduate of the University of Washington with a Bachelor of Arts in Economics and a graduate of the University of Washington School of Law. Mr. Clees is licensed as both a Certified Public Accountant and an attorney in the State of Washington. Mr. Clees is the past chair and continuing board member of the Community Foundation of South Puget Sound, a board member of the Providence St. Peter Hospital Foundation and of the Providence St. Peter Hospital Community Board of Directors. He is also a founding board member of Together, a board member of the South Puget Sound Community College Foundation and the Boys and Girls Club of Thurston County. Mr. Clees served on Heritage's Board of Directors from 1990 to 2000 and served as a non-voting consultant to Heritage's Board of Directors and Audit Committee from 2000 until June 2005. Mr. Clees provides important tax and accounting expertise as well as a legal perspective to the board with a solid understanding of corporate governance matters.

Kimberly T. Ellwanger was Senior Director of Corporate Affairs and Associate General Counsel at Microsoft Corporation of Redmond, Washington from 1991 until her retirement in October of 1999. At Microsoft, she directed the Company's government affairs practice, including opening a Washington D.C. office and developing a network of state and government affairs representation. Prior to Microsoft, Ms. Ellwanger was a Partner at Perkins Coie in Seattle, Washington from 1985 to 1991, where her practice included state and local tax planning, tax litigation, bankruptcy, general business and corporate advice and transactions. She has been involved in numerous civic and professional activities including currently serving on the Board of the South Sound YMCA, and the UW Law Alumni Magazine Editorial Board. She also has served as Chair of the Washington Council on International Trade and the Dean's Advisory Committee of the University of Washington Law School. Ms. Ellwanger graduated with high honors from the University of Washington School of Law and graduated Phi Beta Kappa from Vassar College with an honors degree in economics. Ms. Ellwanger brings significant legal expertise, which is complimented with her knowledge and experience in corporate and government matters.

Philip S. Weigand is a graduate of Stanford University with a Bachelor of Arts and a graduate of Boston University with a Master's of Science in Public Relations. Mr. Weigand is also a retired Lieutenant Colonel of the U.S. Marine Corps with 20 years of active service during which time he was awarded the Silver Star Medal for Heroism and the Bronze Star Medal. From 1988 to 2007, Mr. Weigand was a real estate agent with Virgil Adams Real Estate with experience in real estate sales and development in the Thurston County market. He also serves as a member of the Board of Trustees of St. Martin's University in Lacey, Washington and is a director of the Boys & Girls Clubs of Thurston County, Washington. Mr. Weigand brings significant knowledge of the south Puget Sound real estate market, adds valuable public relations and communications skills and is a longstanding member of the board with a solid understanding of the financial services industry.

**MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS**

**AND CORPORATE GOVERNANCE MATTERS**

**Board of Directors**

The Board of Directors of Heritage conducts its business through meetings of the Board and through its committees. During the year ended December 31, 2009, the Board of Directors of Heritage held 14 meetings. No director of Heritage attended fewer than 75% of the total meetings of the Board and committees on which the director served during this period.

**Committees and Committee Charters**

The Board of Directors of Heritage has standing Audit and Finance, Compensation, Risk and Board Governance and Nominating Committees, and has adopted written charters for each of these committees. You may obtain a copy of these documents, free of charge, by writing to: Kaylene M. Lahn, Secretary, Heritage Financial Corporation, 201 Fifth Avenue S.W., Olympia, Washington, 98501, or by calling (360) 943-1500. The charters, with the exception of the Risk Committee Charter, are also available on our website at [www.hf-wa.com](http://www.hf-wa.com).

**Audit and Finance Committee**

The Audit and Finance Committee consists of Directors Jensen (Chairman), Charneski, Christensen, Clees and Weigand. The Committee meets quarterly and on an as needed basis to evaluate the effectiveness of Heritage's internal controls for safeguarding its assets and ensuring the integrity of the financial reporting. The Committee also appoints the independent registered public accounting firm and reviews the audit report prepared by the independent registered public accounting firm. The Audit Committee met ten times during the year ended December 31, 2009 and held quarterly conference calls to review our earnings releases and periodic filings with the SEC.

Each member of the Audit Committee is independent in accordance with the requirements for companies listed on The Nasdaq Stock Market. Director Jensen has been designated by the Board of Directors as the audit committee financial expert, as defined by the SEC. Director Jensen is the Chief Financial Officer of Western Institutional Review Board.

**Board Governance and Nominating Committee**

The Board Governance and Nominating Committee consists of Directors Jensen (Chairman), Clees, Ellwanger, Fluetsch and Lyon. The Board Governance and Nominating Committee and its Chair are appointed annually by the Board of Directors. The Committee meets annually and on an as needed basis, and is responsible for selecting qualified individuals to fill expiring directors' terms and openings on the Board of Directors. Final approval of director nominees is determined by the full Board, based on the recommendations of the Committee. The Committee's role includes oversight of our corporate governance program. The Committee's duties include the development and administration of the Company's corporate governance standards and the internal evaluation of the Board's performance. The Board Governance and Nominating Committee did not meet during the year ended December 31, 2009 because of scheduling conflicts, but met during January 2010 to nominate directors for election.

In its deliberations for selecting candidates for nominees as director, the Committee considers the candidate's knowledge of the banking business and involvement in community, business and civic affairs, and also considers whether the candidate would provide for adequate representation of our market areas. Any director nominated by the Committee must be highly qualified with regard to some or all the attributes listed in the preceding sentence. In searching for qualified director candidates to fill vacancies on the Board, the Committee solicits its current Board of Directors for names of potentially qualified candidates. Additionally, the Committee may request that members of the Board of Directors pursue their own business contacts for the names of

potentially qualified candidates. The Committee would then consider the potential pool of director candidates, select the top candidate based on the candidates' qualifications and the Board's needs, and conduct an investigation of the proposed candidate's background to ensure there is no past history that would cause the candidate not to be qualified to serve as a director of Heritage. The Committee will consider director candidates recommended by the Company's shareholders. If a shareholder has submitted a proposed nominee, the Committee would consider the proposed nominee, along with any other proposed nominees recommended by members of the Board of Directors, in the same manner in which the Committee would evaluate its nominees for director. For a description of the proper procedure for shareholder nominations, see "Shareholder Proposals" in this Proxy Statement.

As noted above, the Board Governance and Nominating Committee Charter provides for a number of criteria that are considered when selecting new members of the Board. Those criteria as well as work experience, community involvement, skills and viewpoints are considered to provide for diversity on our Board of Directors. These diversity factors are considered when the Committee and Board are seeking to fill a vacancy or new seat on the Board.

#### **Compensation Committee**

The Compensation Committee is comprised of Directors Fluetsch (Chairman), Charneski, Christensen, Ellwanger and Jensen. The Compensation Committee meets on an as needed basis regarding the personnel, compensation and benefits related matters of Heritage. The Committee also meets outside of the presence of Mr. Vance to discuss his compensation and make its recommendation to the full Board, which then votes on Mr. Vance's compensation. Mr. Vance makes recommendations to the Compensation Committee regarding the compensation of all other executive officers. The Committee considers the recommendations of Mr. Vance and makes its recommendation to the full Board, which then votes on executive compensation. This Committee met nine times during the year ended December 31, 2009.

#### **Risk Committee**

The Risk Committee reviews risks inherent in our business such as credit risk, market and liquidity risk, operational risk and the regulatory component of compliance risk. The members of the Risk Committee are Directors Clees (Chairman), Ellwanger, Fluetsch, Lyon, Vance and Rhodes. There were four meetings of the Risk Committee during the year ended December 31, 2009.

#### **Leadership Structure**

As noted above, the positions of Board Chairman and of President and Chief Executive Officer are held by two persons. This has been the case since 2006. The Board believes this structure is appropriate for the Company because it provides segregation of duties between managing the Company and the facilitation of the Board.

#### **Board Involvement in Risk Management Process**

A risk management officer reports directly to the Risk Committee Chair and the Audit and Finance Committee Chair, while administratively reporting to the Chief Executive Officer of the Company. The Board and senior management are diligent and prudent in managing risks of the Company.

#### **Corporate Governance**

**Director Independence.** Our common stock is listed on the Nasdaq Global Select Market. In accordance with Nasdaq requirements, at least a majority of our directors must be independent directors. The Board of Directors has determined that eight of our ten directors are independent. Directors Charneski, Christensen, Clees, Ellwanger, Fluetsch, Jensen, Lyon and Weigand are all independent. Only Brian L. Vance, who serves as

President and Chief Executive Officer of Heritage Financial Corporation and Heritage Bank, and Donald V. Rhodes, the Chairman of Heritage and its financial institution subsidiaries and the former President and Chief Executive Officer of Heritage Financial Corporation and Heritage Bank, are not independent.

**Code of Ethics.** The Board of Directors has adopted a written Code of Ethics Policy that applies to our directors, officers and employees. You may obtain a copy of the Code of Ethics free of charge by writing to: Kaylene M. Lahn, Secretary, Heritage Financial Corporation, Inc., 201 Fifth Avenue S.W., Olympia, Washington 98501, or by calling (360) 943-1500. In addition, our Code of Ethics is available on our website at [www.hf-wa.com](http://www.hf-wa.com).

**Shareholder Communication with the Board of Directors.** The Board of Directors maintains a process for shareholders to communicate with the Board of Directors. Shareholders wishing to communicate with the Board of Directors should send any communication to Kaylene M. Lahn, Secretary, Heritage Financial Corporation, Inc., 201 Fifth Avenue S.W., Olympia, Washington 98501. Any such communication should state the number of shares beneficially owned by the shareholder making the communication.

**Annual Meeting Attendance by Directors.** It is Heritage's policy that its directors attend the annual meeting of shareholders. At the 2009 annual meeting, all of Heritage's directors were in attendance, except for Director Charneski.

**Related Party Transactions.** We have followed a policy of granting loans to our executive officers and directors, which fully comply with all applicable federal regulations, including those governing loans and other transactions with affiliated persons of Heritage. Loans to our directors and executive officers are made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with all customers, and do not involve more than the normal risk of collectability or present other unfavorable features.

All loans and aggregate loans to individual directors and executive officers, without regard to loan amount, are completely documented and underwritten using the same underwriting policies, procedures, guidelines and documentation requirements as are used for non-director and non-executive customers of Heritage. Following the normal underwriting approvals by underwriting personnel, all such loans are then presented for review and approval by the Board of Directors of Heritage Bank or Central Valley Bank, as the case may be, pursuant to Regulation O of the Federal Reserve Board, and the requirements of the Federal Deposit Insurance Corporation and the Washington State Department of Financial Institutions, Division of Banks. There are no exceptions to these procedures and all approvals are documented in the Board meeting minutes. There were \$8.9 million balances outstanding on loans to directors and executive officers at December 31, 2009.

**DIRECTORS COMPENSATION**

The following table shows the compensation paid to our non-employee directors for the year ended December 31, 2009. Compensation for Brian L. Vance, who is the President and Chief Executive Officer of Heritage, is included in the section below entitled Executive Compensation.

<b>Name</b>	<b>Fee Earned or Paid In Cash (\$)</b>	<b>Option Awards (\$)(1)(2)</b>	<b>All Other Compensation (3)</b>	<b>Total (\$)</b>
Brian S. Charneski	26,050	3,495		29,545
Gary B. Christensen	26,200	4,544		30,744
John A. Clees	26,200	3,495		29,695
Kimberly T. Ellwanger	23,350	3,495		26,845
Peter N. Fluetsch	25,700	3,495		29,195
Daryl D. Jensen	30,300	4,544		34,844
Jeffrey S. Lyon	23,200	3,495		26,695