

BANCORP RHODE ISLAND INC

Form 10-Q

May 04, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

**For the quarterly period ended March 31, 2011
or**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1937**

For the transition period from _____ to _____

Commission File No. 001-16101

BANCORP RHODE ISLAND, INC.

(Exact name of Registrant as specified in its charter)

Rhode Island

05-0509802

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

ONE TURKS HEAD PLACE, PROVIDENCE, RI 02903

(Address of principal executive offices)

(401) 456-5000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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 and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post files). Yes ☐ No ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting
company ☐

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock, as of May 2, 2011:

Common Stock Par Value \$0.01

4,694,741 shares

(class)

(outstanding)

BANCORP RHODE ISLAND, INC.
Quarterly Report on Form 10-Q
Table of Contents

Description	Page Number
Cover Page	1
Table of Contents	2
 <u>Part I Financial Information</u> 	
<u>Item 1. Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Operations</u>	4
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Condensed Notes to Consolidated Financial Statements</u>	7-27
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28-44
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	45
<u>Item 4. Controls and Procedures</u>	46
 <u>Part II Other Information</u> 	
<u>Item 1. Legal Proceedings</u>	47
<u>Item 1A. Risk Factors</u>	47-48
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
<u>Item 3. Defaults Upon Senior Securities</u>	49
<u>Item 5. Other Information</u>	49
<u>Item 6. Exhibits</u>	50
<u>Signature Page</u>	51
<u>Exhibit 10.6(c)</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	

Exhibit 32.1

Exhibit 32.2

Special Note Regarding Forward Looking Statements

We make certain forward looking statements in this Quarterly Report on Form 10-Q and in other documents that we incorporate by reference into this report that are based upon our current expectations and projections about future events. We intend these forward looking statements to be covered by the safe harbor provisions for forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and we are including this statement for purposes of these safe harbor provisions. You can identify these statements by reference to a future period or periods by our use of the words estimate, project, may, believe, intend, anticipate, plan, seek, expect and similar terms or variations. Actual results may differ materially from those set forth in forward looking statements as a result of risks and uncertainties, including those detailed from time to time in our filings with the Federal Deposit Insurance Corporation (FDIC) and the Securities and Exchange Commission (SEC). Our forward looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume any obligation to update any forward looking statements.

Table of Contents

BANCORP RHODE ISLAND, INC.
Consolidated Balance Sheets (unaudited)

	March 31, 2011	December 31, 2010
	<i>(In thousands)</i>	
ASSETS:		
Cash and due from banks	\$ 16,573	\$ 14,384
Overnight investments	551	395
Total cash and cash equivalents	17,124	14,779
Available for sale securities (amortized cost of \$359,299 and \$357,402, respectively)	361,579	360,025
Stock in Federal Home Loan Bank of Boston	16,274	16,274
Loans and leases receivable:		
Commercial loans and leases	783,696	780,264
Residential mortgage loans	160,658	164,877
Consumer and other loans	210,094	210,348
Total loans and leases receivable	1,154,448	1,155,489
Allowance for loan and lease losses	(18,222)	(18,654)
Net loans and leases receivable	1,136,226	1,136,835
Premises and equipment, net	11,677	11,889
Goodwill, net	12,262	12,262
Accrued interest receivable	4,411	4,842
Investment in bank-owned life insurance	31,580	31,277
Prepaid expenses and other assets	15,375	15,576
Total assets	\$ 1,606,508	\$ 1,603,759
LIABILITIES:		
Deposits:		
Demand deposit accounts	\$ 254,291	\$ 264,274
NOW accounts	65,127	70,327
Money market accounts	113,126	96,285
Savings accounts	343,286	341,667
Certificate of deposit accounts	325,831	347,613
Total deposits	1,101,661	1,120,166
Overnight and short-term borrowings	36,068	40,997
Wholesale repurchase agreements	19,801	20,000
Federal Home Loan Bank of Boston borrowings	273,582	260,889
Subordinated deferrable interest debentures	13,403	13,403
Other liabilities	31,801	19,626
Total liabilities	1,476,316	1,475,081

SHAREHOLDERS' EQUITY:

Common stock, par value \$0.01 per share, authorized 11,000,000 shares:		
Issued: 5,074,192 and 5,047,942 shares, respectively	50	50
Additional paid-in capital	74,556	73,866
Treasury stock, at cost: 385,950 and 373,850 shares, respectively	(12,897)	(12,527)
Retained earnings	67,001	65,584
Accumulated other comprehensive income, net	1,482	1,705
Total shareholders' equity	130,192	128,678
Total liabilities and shareholders' equity	\$ 1,606,508	\$ 1,603,759

See accompanying notes to unaudited consolidated financial statements

Table of Contents

BANCORP RHODE ISLAND, INC.
Consolidated Statements of Operations (unaudited)

	Three Months Ended March 31,	
	2011	2010
	<i>(In thousands, except per share data)</i>	
Interest and dividend income:		
Overnight investments	\$	\$ 5
Mortgage-backed securities	2,625	3,229
Investment securities	397	550
Federal Home Loan Bank of Boston stock dividends	12	
Loans and leases	14,550	14,568
Total interest and dividend income	17,584	18,352
Interest expense:		
Deposits	1,459	2,278
Overnight and short-term borrowings	10	18
Wholesale repurchase agreements	139	139
Federal Home Loan Bank of Boston borrowings	2,296	2,665
Subordinated deferrable interest debentures	165	164
Total interest expense	4,069	5,264
Net interest income	13,515	13,088
Provision for loan and lease losses	1,125	1,600
Net interest income after provision for loan and lease losses	12,390	11,488
Noninterest income:		
Total other-than-temporary impairment losses on available for sale securities		(1,592)
Non-credit component of other-than-temporary losses recognized in other comprehensive income		1,021
Credit component of other-than-temporary impairment losses on available for sale securities		(571)
Service charges on deposit accounts	1,140	1,264
Income from bank-owned life insurance	303	315
Loan related fees	220	189
Gain on sale of available for sale securities	212	475
Commissions on nondeposit investment products	194	237
Net (loss) gain on lease sales and commissions on loans originated for others	(4)	36
Other income	267	370
Total noninterest income	2,332	2,315

Noninterest expense:

Edgar Filing: BANCORP RHODE ISLAND INC - Form 10-Q

Salaries and employee benefits	5,934	5,843
Occupancy	907	861
Data processing	681	654
Professional services	606	632
FDIC insurance	477	475
Operating	454	462
Marketing	353	258
Equipment	276	255
Loan workout and other real estate owned	206	336
Loan servicing	144	176
Other expenses	1,231	536
Total noninterest expense	11,269	10,488
Income before income taxes	3,453	3,315
Income tax expense	1,146	1,096
Net income	\$ 2,307	\$ 2,219
Per share data:		
Basic earnings per common share	\$ 0.49	\$ 0.48
Diluted earnings per common share	\$ 0.49	\$ 0.48
Cash dividends declared per common share	\$ 0.19	\$ 0.17
Weighted average common shares outstanding basic	4,683	4,622
Weighted average common shares outstanding diluted	4,715	4,650
<i>See accompanying notes to unaudited consolidated financial statements</i>		

Table of Contents

BANCORP RHODE ISLAND, INC.
Consolidated Statements of Changes in Shareholders' Equity (unaudited)

Three months ended March 31,	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total
	<i>(In thousands, except per share data)</i>					
2010						
Balance at December 31, 2009	\$ 50	\$ 72,783	\$ (12,309)	\$ 59,012	\$ 1,125	\$ 120,661
Net income				2,219		2,219
Other comprehensive income:						
Unrealized holding gains on securities available for sale, net of taxes of (\$1,213)					2,252	2,252
Reclassification adjustment for net gains included in net income, net of taxes of \$166					(309)	(309)
Non-credit portion OTTI, net of taxes of \$358					(663)	(663)
Total comprehensive income						3,499
Exercise of stock options		220				220
Macrolease acquisition		211				211
Share repurchases			(218)			(218)
Share-based compensation		92				92
Dividends on common stock (\$0.17 per common share)				(786)		(786)
Balance at March 31, 2010	\$ 50	\$ 73,306	\$ (12,527)	\$ 60,445	\$ 2,405	\$ 123,679
2011						
Balance at December 31, 2010	\$ 50	\$ 73,866	\$ (12,527)	\$ 65,584	\$ 1,705	\$ 128,678
Net income				2,307		2,307
Other comprehensive income:						
Unrealized holding gains on securities available for sale, net of taxes of \$46					(85)	(85)
Reclassification adjustment for net gains included in net income, net of taxes of \$74					(138)	(138)
Total comprehensive income						2,084
Exercise of stock options		397				397
Share repurchases			(370)			(370)

Edgar Filing: BANCORP RHODE ISLAND INC - Form 10-Q

Share-based compensation	153	153
Tax benefit from exercise of stock options	140	140
Dividends on common stock (\$0.19 per common share)	(890)	(890)

Balance at March 31, 2011	\$	50	\$	74,556	\$	(12,897)	\$	67,001	\$	1,482	\$	130,192
---------------------------	----	----	----	--------	----	----------	----	--------	----	-------	----	---------

See accompanying notes to unaudited consolidated financial statements

Table of Contents

BANCORP RHODE ISLAND, INC.
Consolidated Statements of Cash Flows (unaudited)

	Three Months Ended March 31,	
	2011	2010
	<i>(In thousands)</i>	
Cash flows from operating activities:		
Net income	\$ 2,307	\$ 2,219
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion, net	(276)	(1,444)
Provision for loan and lease losses	1,125	1,600
Income from bank-owned life insurance	(303)	(315)
Share-based compensation expense	153	92
Net loss (gain) on lease sales	14	(17)
Gain on sale of available for sale securities	(212)	(475)
Credit component of other-than-temporary impairment losses on available for sale securities		571
Loss on sale of other real estate owned		56
Proceeds from sales of leases	5	907
Leases originated for sale	(19)	(890)
Decrease in accrued interest receivable	431	101
Decrease in prepaid expenses and other assets	766	146
Decrease in other liabilities	(2,879)	(5,372)
Net cash provided by (used in) operating activities	1,112	(2,821)
Cash flows from investing activities:		
Available for sale securities:		
Purchases	(30,085)	(31,313)
Maturities and principal repayments	39,128	41,081
Proceeds from sales	4,176	3,311
Net increase in loans and leases	(180)	(12,368)
Capital expenditures for premises and equipment	(143)	(210)
Proceeds from sale of other real estate owned		345
Net cash provided by investing activities	12,896	846
Cash flows from financing activities:		
Net (decrease) increase in deposits	(18,505)	8,787
Net decrease in overnight and short-term borrowings	(5,128)	(2,320)
Proceeds from long-term borrowings	89,500	33,700
Repayment of long-term borrowings	(76,807)	(40,793)
Exercise of stock options	27	2
Tax benefit from exercise of stock options	140	
Dividends on common stock	(890)	(786)

Net cash used in financing activities	(11,663)	(1,410)
Net increase (decrease) in cash and cash equivalents	2,345	(3,385)
Cash and cash equivalents at beginning of period	14,779	20,830
Cash and cash equivalents at end of period	\$ 17,124	\$ 17,445
Supplementary Disclosures:		
Cash paid for interest	\$ 4,441	\$ 5,749
Cash paid for income taxes	519	43
Non-cash investing and financing transactions:		
Change in accumulated other comprehensive income, net of taxes	(223)	1,943
Goodwill increase related to Macrolease acquisition		23
Treasury stock acquisitions from shares tendered in stock option exercises	370	218
Transfer of loans to other real estate owned	445	724
Non-credit component of other-than-temporary impairment, net of taxes		663
(Purchase) sale of available for sale securities not yet settled	(15,054)	5,467
<i>See accompanying notes to unaudited consolidated financial statements</i>		

Table of Contents

BANCORP RHODE ISLAND, INC.

Notes to Consolidated Financial Statements (unaudited)

(1) Basis of Presentation

Bancorp Rhode Island, Inc. (the Company), a Rhode Island corporation, is the holding company for Bank Rhode Island (the Bank). The Company has no significant assets other than the common stock of the Bank. For this reason, substantially all of the discussion in this Quarterly Report on Form 10-Q relates to the operations of the Bank and its subsidiaries.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. These estimates and assumptions are based on management's estimates and judgment and are evaluated on an ongoing basis using historical experiences and other factors, including the current economic environment. Estimates and assumptions are adjusted when facts and circumstances dictate. A recessionary environment, illiquid credit markets and declines in consumer spending have combined to increase the uncertainty inherent in management's estimates and assumptions. As future events cannot be determined with precision, actual results could differ significantly from management's estimates. Material estimates that are particularly susceptible to change relate to the determination of the allowance for loan and lease losses, evaluation of investments for other-than-temporary impairment, review of goodwill for impairment and income taxes.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Bank Rhode Island, along with the Bank's wholly-owned subsidiaries, BRI Investment Corp. (a Rhode Island passive investment company), Macrolease Corporation (an equipment financing company), Acorn Insurance Agency, Inc. (a licensed insurance agency) and BRI Realty Corp. (a real estate holding company). All significant intercompany accounts and transactions have been eliminated in consolidation.

The unaudited interim consolidated financial statements of the Company conform to accounting principles generally accepted in the United States (U.S. GAAP) and prevailing practices within the banking industry and include all necessary adjustments (consisting of only normal recurring adjustments) that, in the opinion of management, are required for a fair presentation of the results and financial condition of the Company. Prior period amounts are reclassified whenever necessary to conform to the current year classifications.

The Company considers events or transactions that occur after the balance sheet date but before the consolidated financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through the date of the issuance of these consolidated financial statements.

The unaudited interim results of consolidated operations are not necessarily indicative of the results for any future interim period or for the entire year. These interim consolidated financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the annual consolidated financial statements and accompanying notes included in the Company's 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC).

(2) Earnings per Share

Basic earnings per share (EPS) exclude dilution and are computed by dividing net income by the weighted average number of common shares and participating securities outstanding during the period. 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 additional common stock that then share in the earnings of the Company.

Table of Contents

The following sets forth a reconciliation of basic EPS and diluted EPS:

	Three Months Ended	
	March 31, 2011	March 31, 2010
	(In thousands, except per share data)	
Basic EPS Computation:		
Numerator:		
Net income	\$ 2,307	\$ 2,219
Denominator:		
Weighted average shares outstanding	4,683	4,622
Basic EPS	\$ 0.49	\$ 0.48
Diluted EPS Computation:		
Numerator:		
Net income	\$ 2,307	\$ 2,219
Denominator:		
Weighted average shares outstanding	4,683	4,622
Dilutive effect of stock options	31	28
Dilutive effect of contingent shares	1	
Diluted weighted average shares outstanding	4,715	4,650
Diluted EPS	\$ 0.49	\$ 0.48

For the three months ended March 31, 2011 and 2010, average options to purchase 220,750 and 231,950 shares of common stock, respectively, were outstanding but excluded from the computation of diluted EPS because they were anti-dilutive.

(3) Recently Adopted Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Instruments*. ASU No. 2010-06 amends ASC 820 to require additional disclosures regarding fair value measurements. Specifically, the ASU requires entities to disclose the amounts and reasons for significant transfers between Level 1 and Level 2 of the fair value hierarchy, to disclose reasons for any transfers in or out of Level 3 and to separately disclose information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements. In addition, the ASU also amends ASC 820 to clarify certain existing disclosure requirements. Except for the requirement to disclose information about purchases, sales, issuances and settlements in the reconciliation of recurring Level 3 measurements separately, the amendments to ASC 820 made by ASU No. 2010-06 are effective for interim and annual reporting periods beginning after December 15, 2009. The adoption of these provisions of ASU No. 2010-06 on January 1, 2010 did not have a material impact on the Company's consolidated financial statements. The requirement to separately disclose purchases, sales, issuances and settlements of recurring Level 3 measurements is effective for interim and annual reporting periods beginning after December 15, 2010. The adoption of the remaining provisions of this ASU on January 1, 2011 did not have a material impact on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU No. 2010-20, *Receivables (Topic 310): Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU No. 2010-20 amends ASC 310, *Receivables*, by requiring more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. An entity is required to disclose the nature of credit risk associated with its financing receivables and the assessment of that risk in estimating its allowance for credit losses, as well as changes in the

allowance and the reason for those changes. The new and amended disclosures required under ASC 2010-20 that relate to information as of the end of a reporting period are effective for public entities with fiscal years and interim reporting periods ending on or after December 15, 2010. The Company adopted these provisions of the ASU on October 1, 2010. The disclosures that include information for activity that occurs during a reporting period are effective for public companies with the fiscal years or the first interim period beginning after December 15, 2010. The Company adopted these provisions of the ASU on January 1, 2011. The adoption of ASU No. 2010-20 required significant expansion to the Company's disclosures surrounding loans and leases receivable and the allowance for loan and lease losses. See *Note 6 - Credit Quality of Loans and Leases and Allowance for Loans and Leases*.

Table of Contents

In January 2011, the FASB issued ASU No. 2011-01, *Receivables (Topic 310): Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20*. ASU No. 2011-01 deferred the effective date for the troubled debt restructuring (TDR) disclosures that are required by ASU No. 2010-20. The TDR disclosures are to be required when the FASB completes its separate project on identifying TDRs (see *Note 4 Recently Issued Accounting Pronouncements*).

(4) Recently Issued Accounting Pronouncements

In April 2011, the FASB issued ASU No. 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. ASU No. 2011-02 provides additional guidance clarifying when the restructure of a receivable should be considered a TDR. Specifically, the ASU provides guidance in determining whether the creditor has granted a concession and whether the debtor is experiencing financial difficulty. Public entities are required to adopt ASU No. 2011-02 for interim and annual periods beginning on or after June 15, 2011 with early adoption permitted. For purposes of TDR disclosures, this ASU applies retrospectively to restructurings occurring on or after the beginning of the annual period of adoption. However, any changes in the method used to measure impairment apply prospectively. Beginning in the period ASU No. 2011-02 is adopted, public entities will also be subject to the requirements to disclose the activity-based information about TDRs under ASU No. 2010-20 that was previously deferred. The Company does not expect the adoption of this ASU to have a material impact on the Company's consolidated financial statements.

(5) Available for Sale Securities

The Company categorizes available for sale securities by major category, including government-sponsored enterprise (GSE) obligations, trust preferred collateralized debt obligations (CDOs), collateralized mortgage obligations and GSE mortgage-backed securities. Major categories are determined by the nature and risks of the securities and consider, among other things, the issuing entity, type of investment and underlying collateral. The Company categorizes obligations and/or securities issued by the Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association and Federal Farm Credit Banks Funding Corporation as GSE obligations and/or securities.

A summary of available for sale securities by major categories follows:

	Amortized Cost ⁽¹⁾	Unrealized Gains	Unrealized Losses	Fair Value
<i>(In thousands)</i>				
At March 31, 2011:				
GSE obligations	\$ 80,984	\$ 332	\$ (397)	\$ 80,919
Trust preferred CDOs	1,518		(917)	601
Collateralized mortgage obligations	24,595	419	(136)	24,878
GSE mortgage-backed securities	252,202	5,227	(2,248)	255,181
Total	\$ 359,299	\$ 5,978	\$ (3,698)	\$ 361,579
At December 31, 2010:				
GSE obligations	\$ 80,992	\$ 436	\$ (394)	\$ 81,034
Trust preferred CDOs	1,518		(956)	562
Collateralized mortgage obligations	28,885	517	(1,234)	28,168
GSE mortgage-backed securities	246,007	6,076	(1,822)	250,261
Total	\$ 357,402	\$ 7,029	\$ (4,406)	\$ 360,025

(1) Amortized cost is net of write-downs as a result of other-than-temporary impairment.

Table of Contents

The Company sells available for sale securities to capitalize on fluctuations in the market. During the quarter ended March 31, 2011, \$4.2 million of available for sale securities were sold, generating \$212,000 of gains compared to \$8.8 million of available for sale securities sold, generating \$475,000 of gains during the same quarter of 2010. The cost of securities used in calculating gains on the sale of available for sale securities is determined using the specific identification method.

The following table sets forth certain information regarding temporarily impaired available for sale securities:

	Number of Holdings	Less than One Year Fair Value	One Year or Longer Unrealized Losses	Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
<i>(Dollars in thousands)</i>							
At March 31, 2011:							
GSE obligations	7	\$ 34,597	\$ (397)	\$	\$	\$ 34,597	\$ (397)
Trust preferred CDOs	2			601	(917)	601	(917)
Collateralized mortgage obligations	2	213		6,436	(136)	6,649	(136)
GSE mortgage-backed securities	23	93,396	(2,248)			93,396	(2,248)
Total	34	\$ 128,206	\$ (2,645)	\$ 7,037	\$ (1,053)	\$ 135,243	\$ (3,698)
At December 31, 2010:							
GSE obligations	7	\$ 39,599	\$ (394)	\$	\$	\$ 39,599	\$ (394)
Trust preferred CDOs	2			562	(956)	562	(956)
Collateralized mortgage obligations	3	1,912	(12)	7,896	(1,222)	9,808	(1,234)
GSE mortgage-backed securities	15	60,592	(1,822)			60,592	(1,822)
Total	27	\$ 102,103	\$ (2,228)	\$ 8,458	\$ (2,178)	\$ 110,561	\$ (4,406)

The following table sets forth the maturities of available for sale securities:

	Within One Year		After One, But Within Five Years		After Five, But Within Ten Years		After Ten Years	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(In thousands)</i>								
At March 31, 2011:								
GSE obligations	\$ 16,000	\$ 16,222	\$ 64,984	\$ 64,697	\$	\$	\$	\$
Trust preferred CDOs							1,518	601
Collateralized mortgage obligations					13,189	13,522	11,406	11,356
GSE mortgage-backed securities			1,988	2,067	9,577	10,194	240,637	242,920
Total	\$ 16,000	\$ 16,222	\$ 66,972	\$ 66,764	\$ 22,766	\$ 23,716	\$ 253,561	\$ 254,877
At December 31, 2010:								
GSE obligations	\$	\$	\$ 70,997	\$ 71,076	\$ 9,995	\$ 9,957	\$	\$
Trust preferred CDOs							1,518	562

Collateralized mortgage obligations				15,059	15,426	13,827	12,743
GSE mortgage-backed securities	2,220	2,315	10,396	11,055	233,390	236,891	
Total	\$	\$	\$ 73,217	\$ 73,391	\$ 35,450	\$ 36,438	\$ 248,735
							\$ 250,196

At March 31, 2011 and December 31, 2010, respectively, \$253.2 million and \$245.8 million of available for sale securities were pledged as collateral for repurchase agreements, municipal deposits, treasury, tax and loan deposits, swap agreements, current and future Federal Home Loan Bank of Boston (FHLB) borrowings and future Federal Reserve discount window borrowings.

The Company performs regular analysis on the available for sale securities portfolio to determine whether a decline in fair value indicates that an investment is other-than-temporarily impaired. In making these other-than-temporary determinations, management considers, among other factors, the length of time and extent to which the fair value has been less than amortized cost, projected future cash flows, credit subordination and the creditworthiness, capital adequacy and near-term prospects of the issuers. Management also considers the Company's capital adequacy, interest rate risk, liquidity and business plans in assessing whether it is more likely than not that the Company will sell or be required to sell the securities before recovery.

Table of Contents

If the Company determines that a decline in fair value is other-than-temporary and that it is more likely than not that the Company will not sell or be required to sell the security before recovery of its amortized cost, the credit portion of the impairment loss is recognized in earnings and the noncredit portion is recognized in accumulated other comprehensive income. The credit portion of the other-than-temporary impairment represents the difference between the amortized cost and the present value of the expected future cash flows of the security. If the Company determines that a decline in fair value is other-than-temporary and it will more likely than not sell or be required to sell the security before recovery of its amortized cost, the entire difference between the amortized cost and the fair value of the security will be recognized in earnings.

In performing the analysis for the two collateralized debt obligations (CDO A and CDO B) held by the Company, which are backed by pools of trust preferred securities, future cash flow scenarios for each security were estimated based on varying levels of severity for assumptions of future delinquencies, recoveries and prepayments. These estimated cash flow scenarios were used to determine whether the Company expects to recover the amortized cost basis of the securities. Projected credit losses were compared to the current level of credit enhancement to assess whether the security is expected to incur losses in any future period and therefore become other-than-temporarily impaired.

CDO A has experienced \$99.0 million, or 42.8%, in deferrals/defaults of the security s underlying collateral to date, including an additional \$5.0 million during the first quarter of 2011. Projected credit loss severity assumptions were increased in estimated future cash flow scenarios and it was determined that management expects to recover the security s amortized cost. At March 31, 2011, credit related other-than-temporary impairment losses on this security since its purchase totaled \$484,000.

CDO B has experienced \$176.5 million, or 30.6%, in deferrals/defaults of the security s underlying collateral to date. The Company has not received its scheduled quarterly interest payments since June 30, 2009 because the security is adding interest to the principal rather than paying out. Projected credit loss severity assumptions were increased in estimated future cash flow scenarios and it was determined that management expects to recover the security s amortized cost. At March 31, 2011, credit related other-than-temporary impairment losses on this security since its purchase totaled \$932,000.

The following table provides a reconciliation of the beginning and ending balances for credit losses on debt securities for which a portion of an other-than-temporary impairment was recognized in other comprehensive income:

	Credit Component of Other-Than-Temporary Impairment Losses For Which a Portion Was Recognized in Other Comprehensive Income	
	2011	2010
	<i>(In thousands)</i>	
Balance, January 1	\$ (1,416)	\$ (384)
Credit losses for which an other-than-temporary impairment was previously recognized		(571)
Balance, March 31	\$ (1,416)	\$ (955)

The decline in fair value of the remaining available for sale securities in an unrealized loss position is due to general market concerns of the liquidity and creditworthiness of the issuers of the securities. Management believes that it will recover the amortized cost basis of the securities and that it is more likely than not that it will not sell the securities before recovery. As such, management has determined that the securities are not other-than-temporarily impaired as of March 31, 2011. If market conditions for securities worsen or the creditworthiness of the underlying issuers deteriorates, it is possible that the Company may recognize additional other-than-temporary impairments in future

periods.

Table of Contents**(6) Credit Quality of Loans and Leases and Allowance for Loan and Lease Losses**

At March 31, 2011, there were \$15.3 million of nonaccrual loans and leases in the portfolio. There were \$3.2 million of loans past due 60 to 89 days at March 31, 2011. At March 31, 2011, the Bank had no commitments to lend additional funds to borrowers whose loans were on nonaccrual. This compares to \$16.5 million of nonaccrual loans and \$2.4 million of loans past due 60 to 89 days as of December 31, 2010. There were \$9.6 million of impaired loans with \$651,000 of specific impairment reserves at March 31, 2011, while included in nonaccrual loans as of December 31, 2010 were impaired loans of \$10.8 million with specific reserves of \$1.5 million.

The following table sets forth information pertaining to the Company's recorded investment of loans and leases accounted for on a nonaccrual basis and past due 90 days or more, but still accruing.

	March 31, 2011			December 31, 2010		
		90+ Days, Still Accruing			90+ Days, Still Accruing	
	Nonaccrual		Total	Nonaccrual		Total
	<i>(In thousands)</i>					
Commercial loans and leases:						
Commercial real estate owner occupied	\$ 4,342	\$ 450	\$ 4,792	\$ 5,272	\$	\$ 5,272
Commercial and industrial	2,138	117	2,255	2,462		2,462
Multifamily	1,050		1,050	717		717
Small business	981	78	1,059	1,090		1,090
Construction	232		232	470		470
Leases and other	591		591	581		581
Total commercial loans and leases	9,334	645	9,979	10,592		10,592
Residential mortgage loans:						
One- to four-family adjustable rate	3,972		3,972	4,089		4,089
One- to four-family fixed rate	954		954	956		956
Total residential mortgage loans	4,926		4,926	5,045		5,045
Consumer and other loans:						
Home equity term loans	919		919	826		826
Home equity lines of credit	74		74	50		50
Total consumer and other loans	993		993	876		876
Total nonperforming loans and leases	\$ 15,253	\$ 645	\$ 15,898	\$ 16,513	\$	\$ 16,513

Table of Contents

The following table sets forth information pertaining to the Company's recorded investment of past due loans and leases.

	March 31, 2011			
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due ⁽¹⁾	Total
	<i>(In thousands)</i>			
Commercial loans and leases:				
Commercial real estate nonowner occupied	\$ 380	\$	\$	\$ 380
Commercial real estate owner occupied	2,633		450	3,083
Commercial and industrial	783	1,167	117	2,067
Multifamily	401			401
Small business	738	504	78	1,320
Leases and other	1,348	524		1,872
Total past due commercial loans and leases	6,283	2,195	645	9,123
Residential mortgage loans:				
One- to four-family adjustable	2,115	979		3,094
One- to four family fixed rate				
Total past due residential mortgage loans	2,115	979		3,094
Consumer and other loans:				
Home equity term loans	816			816
Home equity lines of credit	386			386
Unsecured and other		5		5
Total past due consumer and other loans	1,202	5		1,207
Total past due loans and leases	\$ 9,600	\$ 3,179	\$ 645	\$ 13,424

	December 31, 2010			
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due ⁽¹⁾	Total
	<i>(In thousands)</i>			
Commercial loans and leases:				
Commercial real estate nonowner occupied	\$ 282	\$ 143	\$	\$ 425
Commercial real estate owner occupied	832			832
Commercial and industrial	346	204		550
Multifamily	299	661		960
Small business	812	180		992
Leases and other	1,053	711		1,764

Edgar Filing: BANCORP RHODE ISLAND INC - Form 10-Q

Total past due commercial loans and leases	3,624	1,899	5,523
Residential mortgage loans:			
One- to four-family adjustable	2,005	415	2,420
One- to four family fixed rate	142		142
Total past due residential mortgage loans	2,147	415	2,562
Consumer and other loans:			
Home equity term loans	398	115	513
Home equity lines of credit	299		299
Unsecured and other	7		7
Total past due consumer and other loans	704	115	819
Total past due loans and leases	\$ 6,475	\$ 2,429	\$ 8,904

(1) 90+ Days Past Due includes only those loans and leases that are still accruing. All other loans and leases 90 days or more are included as a component of nonaccrual loans and leases.

The Company maintains an allowance for loan and lease losses sufficient to absorb probable losses in its loan and lease portfolios. Arriving at an appropriate level of allowance for loan and lease losses requires the creation and maintenance of a risk rating system that accurately classifies all loans and leases by category and further by degree of credit risk. A specified level of allowance is established within each classification and is based upon statistical analysis of loss trends, historical migration and delinquency patterns, anticipated trends in the loan and lease portfolios and industry standards and trends. The levels of allowance within each classification are subject to periodic reviews and, therefore, are subject to change.

Table of Contents

Generally, commercial loans and leases are individually risk rated on a scale of 1 through 7. Ratings 1 through 5 are considered pass, or satisfactory credit exposures. Ratings 6, or special mention, and 7, or substandard, are negative ratings and loans and leases with these ratings are considered watch list assets. Loans and leases categorized as special mention have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects of the loan or lease at some future date. Loans and leases categorized as substandard are inadequately protected by the payment capacity of the obligor or by the collateral pledged, if any. Substandard loans and leases have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

A reserve percentage is assigned to each risk rating category based on the perceived risk of default and loss in conjunction with the Company's historical loss experience. At March 31, 2011 and December 31, 2010, the reserve percentages ranged from and 0.00% to 1.50% for pass-rated loans and leases. Special mention and substandard loans and leases were assigned reserve percentages of 5.00% and 15.00%, respectively. Macrolease-generated loans and leases and small business loans are excluded from the aforementioned commercial risk rating scale and are reserved at 1.00% and 2.00%, respectively, at March 31, 2011 and December 31, 2010. These portfolios are much smaller and historical evidence has shown that these portfolios experience fairly moderate losses.

Risk classifications for residential mortgage loans are stratified initially by type of loan. At March 31, 2011 and December 31, 2010, current fixed rate loans were reserved at 0.40%, while current adjustable rate mortgage (ARM) loans were reserved at 1.00%. Additionally, these loans are classified by delinquency, ranging from one payment delinquent to four or more payments delinquent. The reserve percentages for delinquent residential mortgage loans ranged from 2.00% to 25.00% at March 31, 2011 and December 31, 2010.

Consumer and other loans are also classified by type of loan. At March 31, 2011 and December 31, 2010, home equity term loans in which the Bank has a subordinated interest and home equity lines of credit were reserved at 0.90%. Home equity term loans in which the Bank has a first position interest are reserved for based on delinquency status, ranging from 0.40% for current loans to 25.00% for loans that are over 90 days delinquent at March 31, 2011 and December 31, 2010. Unsecured and other consumer loans are reserved at 7.00% at March 31, 2011 and December 31, 2010. Loans that are fully secured by depository accounts at the Bank are not reserved for.

Nonperforming commercial loans and leases in excess of \$100,000 are deemed to be impaired. In addition, loans that have been modified as troubled debt restructurings, including residential mortgage and consumer loans regardless of dollar amount, are deemed to be impaired loans. Loans and leases deemed to be impaired are individually reviewed and a specific reserve is established rather than collectively reserved for based on risk rating profile. The reserves for impaired loans and leases are determined by reviewing the fair values of the collateral (if collateral-dependent), observable market prices of the loans and leases or the present value of expected future cash flows.

The management portion of the reserve is the most difficult to quantify. It is maintained to protect against probable, yet unexpected losses, which may include a larger loss or allocation on a loan or lease than is covered by the normal reserve percentage for that asset. It is not practical to quantify a specific amount for this portion of the allowance for loan and lease losses. Rather, an acceptable range is sought. Factors that bring a level of uncertainty to probable losses in the Bank's portfolio include, but are not limited to, economic and interest rate uncertainty, real estate market uncertainty, large relationship exposures and industry concentrations. A management reserve range of 0.08% to 0.20% of loans and leases is supported by these factors.

Table of Contents

Early identification and reclassification of deteriorating credits is a critical component of the Company's ongoing evaluation process and includes a formal analysis of the allowance each quarter, which considers, among other factors, the character and size of the loan and lease portfolio, charge-off experience, delinquency and nonperforming loan and lease patterns, business and economic conditions and other asset quality factors. These factors are based on observable information as well as subjective assessment and interpretation. Besides numerous subjective judgments as to the number of categories, appropriate level of allowance with respect to each category and judgments as to categorization of any individual loan or lease, additional subjective judgments are involved when ascertaining the probability, as well as, the extent of any probable losses.

While management evaluates currently available information in establishing the allowance for loan and lease losses, future additions to the allowance may be necessary if conditions differ substantially from the assumptions used in making evaluations. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's allowance for loan and lease losses and carrying amounts of other real estate owned. Such agencies may require the financial institution to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

Loans deemed uncollectible are charged against the allowance for loan and lease losses, while recoveries of amounts previously charged-off are added to the allowance for loan and lease losses. Generally, amounts are charged-off once the probability of loss has been established, with consideration given to such factors as the customer's financial condition, underlying collateral and guarantees, and general and industry economic conditions. Additionally, in accordance with certain regulatory guidance, residential mortgage and home equity loans are charged-off after 120 days of cumulative delinquency. Home equity lines of credit are charged-off after 180 days of cumulative delinquency.

An analysis of the activity in the allowance for loan and lease losses is as follows:

	Three Months Ended March 31,	
	2011	2010
	<i>(In thousands)</i>	
Balance at beginning of period	\$ 18,654	\$ 16,536
Loans and leases charged-off:		
Commercial loans and leases	(1,288)	(1,163)
Residential mortgage loans	(379)	(347)
Consumer and other loans	(19)	(102)
Total loans and leases charged-off	(1,686)	(1,612)
Recoveries of loans and leases previously charged-off:		
Commercial loans and leases	122	97
Residential mortgage loans		
Consumer and other loans	7	4
Total recoveries of loans and leases previously charged-off	129	101
Net charge-offs	(1,557)	(1,511)
Provision for loan and lease losses charged against income		
Commercial loans and leases	923	857
Residential mortgage loans	(74)	78
Consumer and other loans	276	665
Total provision for loan and lease losses charged against income	1,125	1,600

Balance at end of period	\$	18,222	\$	16,625
--------------------------	----	--------	----	--------

At March 31, 2011 and December 31, 2010, there were no significant purchases or sales of loans and/or leases. In addition, there were no reclassifications of loans and/or leases to held for sale.

Table of Contents

The following tables set forth information pertaining to the recorded investment of loans and leases that are collectively and individually evaluated for impairment and the related balance in the allowance for loan and lease losses.

	Individually Evaluated for Impairment		Collectively Evaluated for Impairment	
	Recorded Investment	Allowance for Loan and Lease Losses	Recorded Investment	Allowance for Loan and Lease Losses
	(In thousands)			
At March 31, 2011:				
Commercial loans and leases:				
Commercial real estate nonowner occupied	\$	\$	\$ 196,353	\$ 2,654
Commercial real estate owner occupied	4,342	93	178,769	3,618
Commercial and industrial	2,126	260	158,878	2,487
Multifamily	955	85	83,817	1,452
Small business	361	86	61,872	1,239
Construction	232		28,041	431
Leases and other	125	108	66,069	475
Total commercial loans and leases	8,141	632	773,799	12,356
Residential mortgage loans:				
One- to four-family adjustable rate	545	7	100,431	1,420
One- to four-family fixed rate			59,106	232
Total residential mortgage loans	545	7	159,537	1,652
Consumer and other loans:				
Home equity term loans	895	12	124,744	715
Home equity lines of credit			82,038	738
Unsecured and other			1,489	113
Total consumer and other loans	895	12	208,271	1,566
Premium on loans acquired			576	
Net deferred loan origination costs			2,684	
Total loans and leases	\$ 9,581	\$ 651	\$ 1,144,867	\$ 15,574

At December 31, 2010:

Commercial loans and leases:				
Commercial real estate nonowner occupied	\$	\$	\$ 200,809	\$ 2,700
Commercial real estate owner occupied	5,272	392	174,494	3,462
Commercial and industrial	2,288	287	155,591	2,323
Multifamily	717	108	79,217	1,387
Small business	462	141	62,379	1,318
Construction	470	220	29,879	452
Leases and other	125	108	66,770	472

Edgar Filing: BANCORP RHODE ISLAND INC - Form 10-Q

Total commercial loans and leases	9,334	1,256	769,139	12,114
Residential mortgage loans:				
One- to four-family adjustable rate	549	7	105,792	1,313
One- to four-family fixed rate			57,948	460
Total residential mortgage loans	549	7	163,740	1,773
Consumer and other loans:				
Home equity term loans	906	101	124,208	721
Home equity lines of credit			82,778	745
Unsecured and other			1,511	114
Total consumer and other loans	906	101	208,497	1,580
Premium on loans acquired			598	
Net deferred loan origination costs			2,726	
Total loans and leases	\$ 10,789	\$ 1,364	\$ 1,144,700	\$ 15,467

Table of Contents

The following tables set forth information pertaining to the unpaid principal and the recorded investment for impaired loans and leases both requiring a specific reserve and not requiring a specific reserve.

	March 31, 2011			
	Requiring a Specific Reserve	Not Requiring a Specific Reserve	Total Impaired Loans and Leases	Unpaid Principal
<i>(In thousands)</i>				
Commercial loans and leases:				
Commercial real estate owner occupied	\$ 2,553	\$ 1,789	\$ 4,342	\$ 5,068
Commercial and industrial	1,865	261	2,126	3,581
Multifamily	707	248	955	1,272
Small business	148	213	361	366
Construction		232	232	469
Leases and other	125		125	125
Total impaired commercial loans and leases	5,398	2,743	8,141	10,881
Residential mortgage loans:				
One- to four-family adjustable rate	258	287	545	545
Total impaired residential mortgage loans	258	287	545	545
Consumer and other loans:				
Home equity term loans	736	159	895	895
Total impaired consumer and other loans	736	159	895	895
Total impaired loans and leases	\$ 6,392	\$ 3,189	\$ 9,581	\$ 12,321

	December 31, 2010			
	Requiring a Specific Reserve	Not Requiring a Specific Reserve	Total Impaired Loans and Leases	Unpaid Principal
<i>(In thousands)</i>				
Commercial loans and leases:				
Commercial real estate owner occupied	\$ 3,483	\$ 1,789	\$ 5,272	\$ 5,998
Commercial and industrial	2,008	280	2,288	3,743
Multifamily	717		717	717
Small business	312	150	462	538
Construction	470		470	470
Leases and other	125		125	125
Total impaired commercial loans and leases	7,115	2,219	9,334	11,591
Residential mortgage loans:				
One- to four-family adjustable rate	259	290	549	731

Total impaired residential mortgage loans	259	290	549	731
Consumer and other loans:				
Home equity term loans	745	161	906	906
Total impaired consumer and other loans	745	161	906	906
Total impaired loans and leases	\$ 8,119	\$ 2,670	\$ 10,789	\$ 13,228

Table of Contents

The following tables set forth information pertaining to the average recorded investment of impaired loans and leases, total interest income recognized and interest income recognized using the cash-basis method of accounting during the periods that the loans and leases were impaired for the years shown.

	March 31, 2011		Three Months Ended March 31, 2010		March 31, 2010	
	Average Recorded Investment	Total Interest Income Recognized	Interest Income Recognized Using Cash- Basis (In thousands)	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Using Cash- Basis
Commercial loans and leases:						
Commercial real estate nonowner occupied	\$	\$	\$	\$ 1,067	\$	\$
Commercial real estate owner occupied	4,772	76		4,742		
Commercial and industrial	2,265	23		1,807		
Multifamily	1,057	1		154		
Small business	422			761	1	
Construction	351			529		
Leases and other	125	2		889	2	
Total impaired commercial loans and leases	8,992	102		9,949	3	
Residential mortgage loans:						
One- to four-family adjustable rate	547			266		
One- to four-family fixed rate						
Total impaired residential mortgage loans	547			266		
Consumer and other loans:						
Home equity term loans	901			177		
Home equity lines of credit				49		
Total impaired consumer and other loans	901			226		
Total impaired loans and leases	\$ 10,440	\$ 102	\$	\$ 10,441	\$ 3	\$

Table of Contents

Management believes that the Company's internal risk rating system for commercial loans and credit scores obtained from credit reporting agencies for residential mortgage and consumer loans are meaningful credit quality indicators. Risk ratings are evaluated and credit scores are obtained at least quarterly. The following table sets forth information pertaining to the recorded investment in loans and leases by credit quality indicator.

	March 31, 2011	December 31, 2010
	<i>(In thousands)</i>	
Commercial loans and leases (risk rating):		
Pass-rated	\$ 741,575	\$ 735,869
Special mention	15,527	19,825
Substandard	24,838	22,779
Total commercial loans and leases	781,940	778,473
Residential mortgage loans (credit score):		
Greater than 750	85,280	84,695
725 - 750	14,598	18,930
680 - 724	18,933	19,310
650 - 679	8,348	6,558
620 - 649	3,934	6,278
Less than 620	18,976	19,883
Data not available	10,013	8,635
Total residential mortgage loans	160,082	164,289
Consumer and other loans (credit score):		
Greater than 750	153,289	151,710
725 - 750	21,680	21,984
680 - 724	19,008	20,252
650 - 679	5,909	5,605
620 - 649	1,922	2,756
Less than 620	6,153	6,006
Data not available	1,205	1,090
Total consumer and other loans	209,166	209,403
Premium on loans acquired	576	598
Net deferred loan origination costs	2,684	2,726
Total loans and leases	\$ 1,154,448	\$ 1,155,489

(7) Derivatives

All derivatives are recognized as either assets or liabilities on the balance sheet and are measured at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and resulting designation. Derivatives used to hedge the exposure to changes in fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected cash flows or other types of forecasted transactions are considered cash flow hedges. For derivatives designated as fair value hedges, changes in the fair value of the derivative are recognized in earnings together with the changes in the fair value of the related hedged item. The net amount, if any, representing hedge ineffectiveness, is reflected in earnings. For derivatives designated as cash flow hedges, the effective portion of

changes in the fair value of the derivative is recorded in other comprehensive income and recognized in earnings when the hedged transaction affects earnings. The ineffective portion of changes in the fair value of cash flow hedges is recognized directly in earnings. For derivatives not designated as hedges, changes in fair value are recognized in earnings, in noninterest income. The Company may use interest rate contracts (swaps, caps and floors) as part of interest rate risk management strategy. Interest rate swap, cap and floor agreements are entered into as hedges against future interest rate fluctuations on specifically identified assets or liabilities. The Company did not have derivative fair value or derivative cash flow hedges at March 31, 2011 or December 31, 2010.

Table of Contents

Derivatives not designated as hedges are not speculative but rather result from a service the Company provides to certain customers for a fee. The Company executes interest rate swaps with commercial banking customers to aid them in managing their interest rate risk. The interest rate swap contracts allow the commercial banking customers to convert floating rate loan payments to fixed rate loan payments. The Company concurrently enters into mirroring swaps with a third party financial institution, effectively minimizing its net risk exposure resulting from such transactions. The third party financial institution exchanges the customer's fixed rate loan payments for floating rate loan payments.

As the interest rate swaps associated with this program do not meet hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of March 31, 2011, the Company had ten interest rate swaps with an aggregate notional amount of \$34.6 million related to this program. During the three months ended March 31, 2011 and 2010, the Company recognized net gains of \$8,000 and \$32,000, respectively, related to changes in the fair value of these swaps.

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the consolidated balance sheets as of March 31, 2011 and December 31, 2010:

	Asset Derivatives	
	March 31, 2011	December 31, 2010
	(In thousands)	
Other Assets		
Derivatives not designated as hedging instruments		
Interest rate products	\$ 614	\$ 790
Total derivatives not designated as hedging instruments	\$ 614	\$ 790
	Liability Derivatives	
	March 31, 2011	December 31, 2010
	(In thousands)	
Other Liabilities		
Derivatives not designated as hedging instruments		
Interest rate products	\$ 648	\$ 832
Total derivatives not designated as hedging instruments	\$ 648	\$ 832

The table below presents the effect of the Company's derivative financial instruments on the consolidated income statements for the three months ended March 31, 2011 and 2010:

	Location of Gain	Amount of Gain Recognized in Income on Derivative (1)
	Recognized in Income on Derivative	Three Months Ended March 31, 2011 2010
Derivatives Not Designated as Hedging Instruments		<i>(In thousands)</i>