

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Bank of Marin Bancorp  
Form 10-Q  
November 06, 2018  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

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

Commission File Number 001-33572

Bank of Marin Bancorp  
(Exact name of Registrant as specified in its charter)  
California 20-8859754  
(State or other jurisdiction of incorporation) (IRS Employer Identification No.)

504 Redwood Blvd., Suite 100, Novato, CA 94947  
(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code: (415) 763-4520

Indicate by check mark whether the registrant (1) has filed all reports 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 web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Emerging growth company

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

Indicate by check mark if the registrant is a shell company, as defined in Rule 12b-2 of the Exchange Act.

Yes  No

As of October 31, 2018, there were 6,974,765 shares of common stock outstanding.

---

TABLE OF CONTENTS

PART I	<u>FINANCIAL INFORMATION</u>	<u>Page-3</u>
ITEM 1.	<u>Financial Statements</u>	<u>Page-3</u>
	<u>Consolidated Statements of Condition</u>	<u>Page-3</u>
	<u>Consolidated Statements of Comprehensive Income</u>	<u>Page-4</u>
	<u>Consolidated Statements of Changes in Stockholders' Equity</u>	<u>Page-5</u>
	<u>Consolidated Statements of Cash Flows</u>	<u>Page-6</u>
	<u>Notes to Consolidated Financial Statements</u>	<u>Page-7</u>
ITEM 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>Page-31</u>
ITEM 3.	<u>Quantitative and Qualitative Disclosure about Market Risk</u>	<u>Page-44</u>
ITEM 4.	<u>Controls and Procedures</u>	<u>Page-45</u>
PART II	<u>OTHER INFORMATION</u>	<u>Page-46</u>
ITEM 1.	<u>Legal Proceedings</u>	<u>Page-46</u>
ITEM 1A.	<u>Risk Factors</u>	<u>Page-46</u>
ITEM 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>Page-46</u>
ITEM 3.	<u>Defaults Upon Senior Securities</u>	<u>Page-46</u>
ITEM 4.	<u>Mine Safety Disclosures</u>	<u>Page-46</u>
ITEM 5.	<u>Other Information</u>	<u>Page-46</u>
ITEM 6.	<u>Exhibits</u>	<u>Page-46</u>
	<u>SIGNATURES</u>	<u>Page-48</u>

## PART I FINANCIAL INFORMATION

## ITEM 1. Financial Statements

BANK OF MARIN BANCORP  
CONSOLIDATED STATEMENTS OF CONDITION

September 30, 2018 and December 31, 2017

(in thousands, except share data; unaudited)	September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	\$ 142,718	\$ 203,545
Investment securities		
Held-to-maturity, at amortized cost	164,222	151,032
Available-for-sale, at fair value	405,571	332,467
Total investment securities	569,793	483,499
Loans, net of allowance for loan losses of \$15,817 and \$15,767 at September 30, 2018 and December 31, 2017, respectively	1,713,054	1,663,246
Bank premises and equipment, net	7,602	8,612
Goodwill	30,140	30,140
Core deposit intangible	5,802	6,492
Interest receivable and other assets	76,606	72,620
Total assets	\$ 2,545,715	\$ 2,468,154
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	\$ 1,109,909	\$ 1,014,103
Interest bearing		
Transaction accounts	138,838	169,195
Savings accounts	178,171	178,473
Money market accounts	659,788	626,783
Time accounts	126,140	160,116
Total deposits	2,212,846	2,148,670
Subordinated debentures	5,831	5,739
Interest payable and other liabilities	18,435	16,720
Total liabilities	2,237,112	2,171,129
Stockholders' Equity		
Preferred stock, no par value, Authorized - 5,000,000 shares, none issued	—	—
Common stock, no par value, Authorized - 15,000,000 shares; Issued and outstanding - 6,982,179 and 6,921,542 at September 30, 2018 and December 31, 2017, respectively	145,498	143,967
Retained earnings	172,723	155,544
Accumulated other comprehensive loss, net of taxes	(9,618	) (2,486 )
Total stockholders' equity	308,603	297,025
Total liabilities and stockholders' equity	\$ 2,545,715	\$ 2,468,154

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

Page-3

---

BANK OF MARIN BANCORP  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands, except per share amounts; unaudited)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Interest income				
Interest and fees on loans	\$20,284	\$ 16,738	\$58,795	\$ 49,010
Interest on investment securities				
Securities of U.S. government agencies	2,953	1,525	8,288	4,577
Obligations of state and political subdivisions	546	511	1,788	1,632
Corporate debt securities and other	25	31	104	104
Interest on Federal funds sold and due from banks	400	406	1,088	623
Total interest income	24,208	19,211	70,063	55,946
Interest expense				
Interest on interest-bearing transaction accounts	58	24	158	74
Interest on savings accounts	18	17	54	48
Interest on money market accounts	337	133	789	360
Interest on time accounts	130	138	426	423
Interest on Federal Home Loan Bank ("FHLB") and other borrowings	1	—	2	—
Interest on subordinated debentures	125	111	362	328
Total interest expense	669	423	1,791	1,233
Net interest income	23,539	18,788	68,272	54,713
Provision for loan losses	—	—	—	—
Net interest income after provision for loan losses	23,539	18,788	68,272	54,713
Non-interest income				
Service charges on deposit accounts	475	438	1,407	1,337
Wealth Management and Trust Services	490	539	1,493	1,546
Debit card interchange fees, net	402	390	1,158	1,146
Merchant interchange fees, net	99	88	297	296
Earnings on bank-owned life insurance	227	209	685	628
Dividends on FHLB stock	194	177	582	585
(Losses) gains on investment securities, net	(90)	—	(79)	10
Other income	439	225	1,173	729
Total non-interest income	2,236	2,066	6,716	6,277
Non-interest expense				
Salaries and related benefits	8,069	7,344	25,402	22,106
Occupancy and equipment	1,444	1,364	4,462	4,063
Depreciation and amortization	532	489	1,625	1,433
Federal Deposit Insurance Corporation insurance	186	167	568	490
Data processing	950	946	3,354	2,848
Professional services	727	801	2,836	1,845
Directors' expense	173	175	530	557
Information technology	262	179	795	563
Provision for losses on off-balance sheet commitments	—	100	—	57
Other expense	1,628	1,471	4,989	4,716
Total non-interest expense	13,971	13,036	44,561	38,678
Income before provision for income taxes	11,804	7,818	30,427	22,312
Provision for income taxes	3,124	2,686	7,467	7,446
Net income	\$8,680	\$ 5,132	\$22,960	\$ 14,866

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Net income per common share:				
Basic	\$ 1.25	\$ 0.84	\$ 3.31	\$ 2.43
Diluted	\$ 1.23	\$ 0.83	\$ 3.27	\$ 2.41
Weighted average shares:				
Basic	6,950	6,123	6,936	6,109
Diluted	7,055	6,191	7,031	6,179
Comprehensive income:				
Net income	\$ 8,680	\$ 5,132	\$ 22,960	\$ 14,866
Other comprehensive (loss) income				
Change in net unrealized gain or loss on available-for-sale securities	(2,120	)(362	) (9,421	)6,309
Reclassification adjustment for losses (gains) on available-for-sale securities in net income	90	—	79	(10 )
Net unrealized loss on securities transferred from available-for-sale to held-to-maturity	—	—	(278	)(3,036 )
Amortization of net unrealized losses on securities transferred from available-for-sale to held-to-maturity	128	135	396	299
Subtotal	(1,902	)(227	) (9,224	)3,562
Deferred tax (benefit) expense	(562	)(96	) (2,730	)1,499
Other comprehensive (loss) income, net of tax	(1,340	)(131	) (6,494	)2,063
Comprehensive income	\$ 7,340	\$ 5,001	\$ 16,466	\$ 16,929

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

## BANK OF MARIN BANCORP

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the three and nine months ended September 30, 2018 and 2017

(in thousands, except share data; unaudited)	Common Stock		Retained Earnings	Accumulated	Total
	Shares	Amount		Other Comprehensive Loss ("AOCI"), Net of Taxes	
	Three months ended September 30, 2018				
Balance at July 1, 2018	6,991,821	\$146,195	\$166,281	\$ (8,278)	)\$304,198
Net income	—	—	8,680	—	8,680
Other comprehensive loss	—	—	—	(1,340)	)(1,340 )
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	1,751	—	—	—	—
Stock issued under employee stock purchase plan	121	9	—	—	9
Stock issued under employee stock ownership plan ("ESOP")	3,400	297	—	—	297
Stock-based compensation - stock options	—	124	—	—	124
Stock-based compensation - restricted stock	—	176	—	—	176
Cash dividends paid on common stock (\$0.32 per share)	—	—	(2,238)	—	(2,238 )
Stock purchased by directors under director stock plan	239	19	—	—	19
Stock issued in payment of director fees	1,392	113	—	—	113
Stock repurchased, net of commissions	(16,545)	(1,435)	—	—	(1,435 )
Balance at September 30, 2018	6,982,179	\$145,498	\$172,723	\$ (9,618)	)\$308,603
	Three months ended September 30, 2017				
Balance at July 1, 2017	6,160,952	\$88,949	\$152,883	\$ (1,099)	)\$240,733
Net income	—	—	5,132	—	5,132
Other comprehensive loss	—	—	—	(131)	)(131 )
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	2,893	—	—	—	—
Stock issued under ESOP	10,000	637	—	—	637
Stock-based compensation - stock options	—	141	—	—	141
Stock-based compensation - restricted stock	—	206	—	—	206
Cash dividends paid on common stock (\$0.29 per share)	—	—	(1,788)	—	(1,788 )
Stock purchased by directors under director stock plan	216	13	—	—	13
Stock issued in payment of director fees	1,690	106	—	—	106
Balance at September 30, 2017	6,175,751	\$90,052	\$156,227	\$ (1,230)	)\$245,049

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

## BANK OF MARIN BANCORP

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

For the three and nine months ended September 30, 2018 and 2017

(in thousands, except share data; unaudited)	Common Stock		Retained Earnings	Accumulated	Total
	Shares	Amount		Other Comprehensive Loss ("AOCI"), Net of Taxes	



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

	Nine months ended September 30, 2018				
Balance at January 1, 2018	6,921,542	\$143,967	\$155,544	\$ (2,486)	)\$297,025
Net income	—	—	22,960	—	22,960
Other comprehensive loss	—	—	—	(6,494)	)(6,494 )
Reclassification of stranded tax effects in AOCI	—	—	638	(638)	)—
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	51,826	534	—	—	534
Stock issued under employee stock purchase plan	386	28	—	—	28
Stock issued under ESOP	11,300	898	—	—	898
Restricted stock granted	18,520	—	—	—	—
Restricted stock surrendered for tax withholdings upon vesting	(658)	)(45)	)—	—	(45 )
Restricted stock forfeited / cancelled	(6,028)	)—	—	—	—
Stock-based compensation - stock options	—	566	—	—	566
Stock-based compensation - restricted stock	—	848	—	—	848
Cash dividends paid on common stock (\$0.92 per share)	—	—	(6,419)	)—	(6,419 )
Stock purchased by directors under director stock plan	499	37	—	—	37
Stock issued in payment of director fees	2,735	204	—	—	204
Stock repurchased, net of commissions	(17,943)	)(1,539)	)—	—	(1,539 )
Balance at September 30, 2018	6,982,179	\$145,498	\$172,723	\$ (9,618)	)\$308,603
	Nine months ended September 30, 2017				
Balance at January 1, 2017	6,127,314	\$87,392	\$146,464	\$ (3,293)	)\$230,563
Net income	—	—	14,866	—	14,866
Other comprehensive income	—	—	—	2,063	2,063
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	8,786	28	—	—	28
Stock issued under employee stock purchase plan	280	17	—	—	17
Stock issued under ESOP	21,732	1,335	—	—	1,335
Restricted stock granted	14,230	—	—	—	—
Stock-based compensation - stock options	—	423	—	—	423
Stock-based compensation - restricted stock	—	634	—	—	634
Cash dividends paid on common stock (\$0.83 per share)	—	—	(5,103)	)—	(5,103 )
Stock purchased by directors under director stock plan	531	35	—	—	35
Stock issued in payment of director fees	2,878	188	—	—	188
Balance at September 30, 2017	6,175,751	90,052	156,227	(1,230)	)245,049

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

BANK OF MARIN BANCORP  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the nine months ended September 30, 2018 and 2017

(in thousands; unaudited)	September 30, 2018	September 30, 2017
Cash Flows from Operating Activities:		
Net income	\$ 22,960	\$ 14,866
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for losses on off-balance sheet commitments	—	57
Noncash contribution expense to employee stock ownership plan	898	637
Noncash director compensation expense	219	170
Stock-based compensation expense	1,414	1,057
Amortization of core deposit intangible	690	354
Amortization of investment security premiums, net of accretion of discounts	2,172	2,204
Accretion of discount on acquired loans	(531)	(706)
Accretion of discount on subordinated debentures	92	117
Net change in deferred loan origination costs/fees	114	85
Loss (gain) on sale of investment securities	79	(10)
Depreciation and amortization	1,625	1,433
Gain on sale of repossessed assets	—	(1)
Earnings on bank-owned life insurance policies	(685)	(628)
Net change in operating assets and liabilities:		
Deferred rent and other rent-related expenses	(278)	38
Interest receivable and other assets	2,780	421
Interest payable and other liabilities	(265)	350
Total adjustments	8,324	5,578
Net cash provided by operating activities	31,284	20,444
Cash Flows from Investing Activities:		
Purchase of held-to-maturity securities	(1,988)	(4,496)
Purchase of available-for-sale securities	(174,617)	(51,130)
Proceeds from sale of available-for-sale securities	16,972	1,321
Proceeds from paydowns/maturities of held-to-maturity securities	15,947	22,352
Proceeds from paydowns/maturities of available-for-sale securities	45,917	37,126
Loans originated and principal collected, net	(50,315)	(37,370)
Purchase of premises and equipment	(615)	(1,143)
Proceeds from sale of other real estate owned or repossessed assets	—	170
Cash paid for low-income housing tax credit investment	(389)	(899)
Net cash used in investing activities	(149,088)	(34,069)
Cash Flows from Financing Activities:		
Net increase in deposits	64,176	118,270
Proceeds from stock options exercised	585	88
Payment of tax withholdings for stock options exercised and vesting of restricted stock	(96)	(60)
Proceeds from stock issued under employee and director stock purchase plans	65	750
Stock repurchased, net of commissions	(1,334)	—
Cash dividends paid on common stock	(6,419)	(5,103)
Net cash provided by financing activities	56,977	113,945
Net (decrease) increase in cash and cash equivalents	(60,827)	100,320
Cash and cash equivalents at beginning of period	203,545	48,804
Cash and cash equivalents at end of period	\$ 142,718	\$ 149,124

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Supplemental disclosure of cash flow information:

Cash paid in interest	\$ 1,737	\$ 1,131
Cash paid in income taxes	\$ 4,900	\$ 6,815
Supplemental disclosure of noncash investing and financing activities:		
Change in net unrealized gain or loss on available-for-sale securities	\$ (9,421	) \$ 6,309
Securities transferred from available-for-sale to held-to-maturity	\$ 27,422	\$ 128,965
Amortization of net unrealized loss on available-for-sale securities transferred to held-to-maturity	\$ 396	\$ 299
Stock issued to ESOP	\$ 898	\$ 637
Stock issued in payment of director fees	\$ 204	\$ 188
Subscription in low-income housing tax credit investment	\$ 3,000	\$ —
Repurchase of stock not yet settled	\$ 205	\$ —

The accompanying notes are an integral part of these consolidated financial statements (unaudited).

Page-6

---

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

## Note 1: Basis of Presentation

The consolidated financial statements include the accounts of Bank of Marin Bancorp (“Bancorp”), a bank holding company, and its wholly-owned bank subsidiary, Bank of Marin (the “Bank”), a California state-chartered commercial bank. References to “we,” “our,” “us” mean Bancorp and the Bank that are consolidated for financial reporting purposes. The accompanying unaudited consolidated interim financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to those rules and regulations. Although we believe that the disclosures are adequate and the information presented is not misleading, we suggest that these interim financial statements be read in conjunction with the annual financial statements and the notes thereto included in our 2017 Annual Report on Form 10-K. In the opinion of Management, the unaudited consolidated financial statements reflect all adjustments, which are necessary for a fair presentation of the consolidated financial position, the results of operations, changes in comprehensive income, changes in stockholders’ equity, and cash flows for the periods presented. All material intercompany transactions have been eliminated. The results of these interim periods may not be indicative of the results for the full year or for any other period.

The NorCal Community Bancorp Trusts I and II, respectively (the “Trusts”) were formed for the sole purpose of issuing trust preferred securities. Bancorp is not considered the primary beneficiary of the Trusts (variable interest entities), therefore the Trusts are not consolidated in our consolidated financial statements, but rather the subordinated debentures are shown as a liability on our consolidated statements of condition (See Note 6, Borrowings). Bancorp accounts for its investment in the securities of the Trusts under the equity method, which is included in interest receivable and other assets in the consolidated statements of condition.

The following table shows: 1) weighted average basic shares, 2) potentially dilutive weighted average common shares related to stock options and unvested restricted stock awards, and 3) weighted average diluted shares. Basic earnings per share (“EPS”) are calculated by dividing net income by the weighted average number of common shares outstanding during each period, excluding unvested restricted stock awards. Diluted EPS are calculated using the weighted average number of potentially dilutive common shares. The number of potentially dilutive common shares included in the quarterly diluted EPS is computed using the average market prices during the three months included in the reporting period under the treasury stock method. The number of potentially dilutive common shares included in year-to-date diluted EPS is a year-to-date weighted average of potentially dilutive common shares included in each quarterly diluted EPS computation. In computing diluted EPS, we exclude anti-dilutive shares such as options whose exercise prices exceed the current common stock price, as they would not reduce EPS under the treasury method. We have two forms of outstanding common stock: common stock and unvested restricted stock awards. Holders of unvested restricted stock awards receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings. Under the two-class method, the difference in EPS is nominal for these participating securities.

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Weighted average basic shares outstanding	6,950	6,123	6,936	6,109
Potentially dilutive common shares related to:				
Stock options	88	53	79	55
Unvested restricted stock awards	17	15	16	15
Weighted average diluted shares outstanding	7,055	6,191	7,031	6,179
Net income	\$8,680	\$ 5,132	\$22,960	\$ 14,866

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Basic EPS	\$1.25	\$ 0.84	\$3.31	\$ 2.43
Diluted EPS	\$1.23	\$ 0.83	\$3.27	\$ 2.41
Weighted average anti-dilutive shares not included in the calculation of diluted EPS	—	23	1	19

Page-7

---

On October 22, 2018, the Bancorp announced a 2:1 stock split, payable on November 27, 2018, to shareholders of record at the close of business on November 9, 2018. Pro forma per share amounts are shown below to reflect the stock split, effective November 27, 2018.

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Basic EPS	\$ 0.62	\$ 0.42	\$ 1.66	\$ 1.22
Diluted EPS	\$ 0.62	\$ 0.41	\$ 1.63	\$ 1.20

## Note 2: Recently Adopted and Issued Accounting Standards

### Accounting Standards Adopted in 2018

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of this ASU (and all subsequent updates) is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. This ASU establishes a five-step model that must be used to recognize revenue that requires the entity to identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the entity satisfies the performance obligation. The ASU does not apply to the majority of our revenue, including revenue associated with financial instruments, such as loans and investment securities, and certain non-interest income, such as earnings on bank-owned life insurance, dividends on Federal Home Loan Bank ("FHLB") stock, gains or losses on sales of investment securities, and deposit overdraft charges. The standard allowed the use of either the full retrospective or modified retrospective transition method. We elected to apply the modified retrospective transition method to incomplete contracts as of the initial date of application on January 1, 2018. The adoption of the new standards did not have a material impact on our financial condition or results of operations as revenue recognition under the new standards did not change significantly from our current practice of recognizing the in-scope non-interest income. In addition, we did not retroactively revise prior period amounts or record a cumulative adjustment to retained earnings upon adoption. We considered the nature, amount, timing, and uncertainty of revenue from contracts with customers and determined that significant revenue streams are sufficiently disaggregated in the consolidated statements of comprehensive income.

Descriptions of our significant revenue-generating transactions that are within the scope of the new revenue recognition standards, which are presented in the consolidated statements of comprehensive income as components of non-interest income, are as follows:

**Wealth Management & Trust ("WM&T") fees** - WM&T services include, but are not limited to: customized investment advisory and management; administrative services such as bill pay and tax reporting; trust administration, estate settlement, custody and fiduciary services. Performance obligations for investment advisory and management services are generally satisfied over time. Revenue is recognized monthly according to a tiered fee schedule based on the client's month-end market value of assets under our management. WM&T does not earn revenue based on performance or incentives. Costs associated with WM&T revenue-generating activities, such as payments to sub-advisors, are recorded separately as part of professional service expenses when incurred.

**Deposit account service charges** - Service charges on deposit accounts consist of monthly maintenance fees, business account analysis fees, business online banking fees, check order charges, and other deposit account-related fees. Performance obligations for monthly maintenance fees and account analysis fees are satisfied, and the related revenue recognized, when we complete our performance obligation each month. Performance obligations related to

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

transaction-based services (such as check orders) are satisfied, and the related revenue recognized, at a point in time when completed, except for business accounts subject to analysis where the transaction-based fees are part of the monthly account analysis fees.

Debit card interchange fees - We issue debit cards to our consumer and small business customers that allow them to purchase goods and services from merchants in person, online, or via mobile devices using funds held in their demand deposit accounts held with us. Debit cards issued to our customers are part of global

Page-8

---

electronic payment networks (such as Visa) who pass a portion of the merchant interchange fees to debit card-issuing member banks like us when our customers make purchases through their networks. Performance obligations for debit card services are satisfied and revenue is recognized daily as the payment networks process transactions. Because we act in an agent capacity, we determined that network costs previously recorded as a component of non-interest expense should be netted with interchange fees recorded in non-interest income.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU make improvements to accounting standards related to financial instruments, including the following:

Requires equity investments, except for those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in fair value recognized in net income.

However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When impairment exists, an entity is required to measure the investment at fair value.

Eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value required under current standards for financial instruments measured at amortized cost on the consolidated balance sheet.

Requires public companies to use the exit price notion when measuring and disclosing the fair value of financial instruments.

Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.

Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

We adopted the requirements of this ASU effective January 1, 2018, which did not have a material impact on our financial condition and results of operations. The fair value of our loans held for investment, which is recorded at amortized cost, now incorporates the exit price notion reflecting factors such as a liquidity premium. See Note 3, Fair Value of Assets and Liabilities.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU provides guidance on how to present and classify eight specific cash flow topics in the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The amendments should be applied using a retrospective transition method to each period presented, if practical. We adopted the requirements of this ASU effective January 1, 2018, which did not impact our financial condition, results of operations, or related financial statement disclosures for the periods presented.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments are intended to help companies evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses and provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments should be applied prospectively and are effective for annual periods after December 31, 2017, including interim periods within those periods. We adopted the amendments effective January 1, 2018, which did not impact our financial condition, results of operations, or related financial statement disclosures for the periods presented.



In May 2017, the FASB issued ASU No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU applies to entities that change the terms or conditions of a share-based payment award. The FASB adopted this ASU to provide clarity in what constitutes a modification and to reduce diversity in practice in applying Topic 718. In order for a change to a share-based arrangement to not require Topic 718 modification accounting treatment, all of the following must be met: no change in fair value, no change in vesting conditions and

no change in the balance sheet classification of the modified award. The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted, including adoption in an interim period. The amendments should be applied prospectively to an award modified on or after the adoption date. We adopted the requirements of this ASU effective January 1, 2018, which did not impact our financial condition, results of operation, or related financial statement disclosures.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This amendment changes both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. It is intended to more closely align hedge accounting with companies' risk management strategies, simplify the application of hedge accounting and increase transparency as to the scope and results of hedging programs. The ASU is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We early adopted the amendments of this ASU in the second quarter of 2018, and elected to perform hedge effectiveness assessments using a qualitative approach instead of quantitative regression analysis going forward. The adoption of this ASU had an immaterial impact to our financial results. The amendments also require additional disclosures, which are included in Note 9, Derivative Financial Instruments and Hedging Activities.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This amendment helps organizations address certain stranded income tax effects in accumulated other comprehensive income (AOCI) resulting from the enactment of the Tax Cuts and Jobs Act of 2017. The ASU requires financial statement preparers to disclose a description of the accounting policy for releasing income tax effects from AOCI, whether or not they elect to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act of 2017, and information about the other income tax effects that are reclassified. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The amendments in this ASU should be applied in either the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate tax rate in the Tax Cuts and Jobs Act of 2017 is recognized. We early adopted this ASU in the first quarter of 2018. See Note 7, Stockholders' Equity.

#### Accounting Standards Not Yet Effective

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The amendments in this ASU intend to increase transparency and comparability among organizations by recognizing an asset, which represents the right to use the asset for the lease term, and a lease liability, which is a lessee's obligation to make lease payments measured on a discounted basis. This ASU generally applies to leasing arrangements exceeding a twelve-month term. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective method of adoption. In July 2018, the FASB issued two amendments to ASU 2016-02: ASU No. 2018-10, Codification Improvements to Topic 842, Leases, which provides various corrections and clarifications to ASU 2016-02; and ASU No. 2018-11, Leases (Topic 842): Targeted Improvements, which provides a new optional transition method and provides a lessor with practical expedients for separating lease and non-lease components of a lease. Early application of the amendments is permitted. We intend to adopt this ASU during the first quarter of 2019, as required. We completed an inventory of our lease agreements and selected a lease accounting software solution. We are in the process of abstracting and inputting lease-related data, developing policies and procedures, and designing related internal controls. As of September 30, 2018, our undiscounted operating lease obligations that were off-balance sheet totaled \$15.4 million (See Note 8, Commitments and Contingencies). Upon adoption of this ASU, the present values of leases currently classified as operating leases will be recognized as lease assets and liabilities on our consolidated balance sheets. Additional disclosures of key information about our leasing arrangements will also be required. We do not expect that the ASU will have a material impact on our retained earnings, capital ratios, results of operations or return on average assets when adopted.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Under the new guidance, entities will be required to present financial assets at the net amount expected to be collected. The measurement of expected credit losses will be based on historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of a credit over its remaining life. In addition, the ASU amends the accounting for expected credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We have formed an internal Current Expected Credit Loss ("CECL") committee and are working with our third party vendor to determine

the appropriate methodologies and resources to utilize in preparation for transition to the new accounting standards. The impact of this ASU on our financial condition and results of operations is not known at this time.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This update simplifies the accounting for share-based payment transactions for acquiring goods and services from nonemployees, applying some of the same requirements as employee share-based payment transactions. The ASU will not affect the accounting for share-based payment awards to nonemployee directors, which will continue to be treated as employee share-based transactions under the current standards. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We do not expect that the ASU will have a material impact on our financial condition or results of operations, as it is not our practice to issue stock-based awards to pay for goods and services from nonemployees, other than nonemployee directors.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this ASU remove, modify and add disclosure requirements for the fair value reporting of assets and liabilities. The modifications and additions relate to Level 3 fair value measurements at the end of the reporting period. ASU 2018-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. Entities making this election are permitted to early adopt the eliminated or modified disclosure requirements and delay the adoption of all the new disclosure requirements until the ASU's effective date. We do not expect that the ASU will have a material impact on our financial condition or results of operations.

In August 2018, the FASB issued ASU No. 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. This standard aligns the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software, regardless of whether they convey a license to the hosted software. The accounting for the service element of a hosting arrangement that is a service contract is not affected by this ASU. The amendments are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. We do not expect that the ASU will have a material impact on our financial condition or results of operations.

In October 2018, the FASB issued ASU No. 2018-16, Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes. This update adds an alternative fifth permissible U.S. benchmark rate to be used for hedge accounting purposes. As we have already adopted the amendments in ASU 2017-12, which changed both the designation and measurement guidance for qualifying hedging relationships, the amendments in ASU 2018-16 are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted in any interim period upon issuance of this ASU if an entity already has adopted ASU 2017-12. We expect this amendment to affect the presentation of our hedging activities, but we do not expect it to have a material impact on our financial condition or results of operations.

Note 3: Fair Value of Assets and Liabilities

#### Fair Value Hierarchy and Fair Value Measurement

We group our assets and liabilities that are measured at fair value in three levels within the fair value hierarchy, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuations are based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Valuations are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuations for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Valuations are based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Values are determined using pricing models and discounted cash flow models and may include significant Management judgment and estimation.

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Transfers between levels of the fair value hierarchy are recognized through our monthly and/or quarterly valuation process in the reporting period during which the event or circumstances that caused the transfer occurred. No such transfers occurred during the first nine months of 2018 or 2017.

The following table summarizes our assets and liabilities that were required to be recorded at fair value on a recurring basis.

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measurement Categories: Changes in Fair Value Recorded In <sup>1</sup>
September 30, 2018					
Securities available-for-sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies	\$246,220	\$	-\$246,220	\$	-OCI
SBA-backed securities	40,181	—	40,181	—	OCI
Debentures of government sponsored agencies	42,914	—	42,914	—	OCI
Privately-issued collateralized mortgage obligations	370	—	370	—	OCI
Obligations of state and political subdivisions	73,373	—	73,373	—	OCI
Corporate bonds	2,513	—	2,513	—	OCI
Derivative financial assets (interest rate contracts)	436	—	436	—	NI
Derivative financial liabilities (interest rate contracts)	163	—	163	—	NI
December 31, 2017					
Securities available-for-sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government agencies	\$188,061	\$	-\$188,061	\$	-OCI
SBA-backed securities	25,982	—	25,817	165	OCI
Debentures of government sponsored agencies	12,938	—	12,938	—	OCI
Privately-issued collateralized mortgage obligations	1,431	—	1,431	—	OCI
Obligations of state and political subdivisions	97,491	—	97,491	—	OCI
Corporate bonds	6,564	—	6,564	—	OCI
Derivative financial assets (interest rate contracts)	74	—	74	—	NI
Derivative financial liabilities (interest rate contracts)	740	—	740	—	NI

<sup>1</sup> Other comprehensive income ("OCI") or net income ("NI").

Securities available-for-sale are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) are used to determine the fair value of securities available-for-sale. If quoted market prices are not available,

we obtain pricing information from reputable third-party service providers, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, probability of default, loss severity and credit spreads (Level 2). Level 2 securities include obligations of state and political subdivisions, U.S. agencies or government-sponsored agencies' debt securities, mortgage-backed securities, government agency-issued, privately-issued collateralized mortgage obligations, and corporate bonds. As of September 30, 2018 and December 31, 2017, there were no Level 1 securities. As of December 31, 2017, we had one Level 3 available-for-sale U.S. government agency obligation, which was paid off during the second quarter of 2018.

Securities held-to-maturity may be written down to fair value (determined using the same techniques discussed above for securities available-for-sale) as a result of other-than-temporary impairment, and we did not record any write-downs during the nine months ended September 30, 2018 or September 30, 2017.

On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming

an orderly transaction. Valuation adjustments may be made to reflect both our own credit risk and the counterparties' credit risk in determining the fair value of the derivatives. Level 2 inputs for the valuations are limited to observable market prices for London Interbank Offered Rate ("LIBOR") and Overnight Index Swap ("OIS") rates (for the very short term), quoted prices for LIBOR futures contracts, observable market prices for LIBOR and OIS swap rates, and one-month and three-month LIBOR basis spreads at commonly quoted intervals. Mid-market pricing of the inputs is used as a practical expedient in the fair value measurements. We project spot rates at reset days specified by each swap contract to determine future cash flows, then discount to present value using either LIBOR or OIS curves depending on whether the swap positions are fully collateralized as of the measurement date. When the value of any collateral placed with counterparties is less than the interest rate derivative liability, a credit valuation adjustment ("CVA") is applied to reflect the credit risk we pose to counterparties. We have used the spread between the Standard & Poor's BBB rated U.S. Bank Composite rate and LIBOR for the closest maturity term corresponding to the duration of the swaps to derive the CVA. A similar credit risk adjustment, correlated to the credit standing of the counterparty, is made when collateral posted by the counterparty does not fully cover their liability to us. For further discussion on our methodology in valuing our derivative financial instruments, refer to Note 9, Derivative Financial Instruments and Hedging Activities.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets, such as impaired loans that are collateral dependent and other real estate owned ("OREO"). As of September 30, 2018 and December 31, 2017, we did not carry any assets measured at fair value on a non-recurring basis.

#### Disclosures about Fair Value of Financial Instruments

The following table summarizes fair value estimates for financial instruments as of September 30, 2018 and December 31, 2017, excluding financial instruments recorded at fair value on a recurring basis (summarized in the first table in this note). The carrying amounts in the following table are recorded in the consolidated statements of condition under the indicated captions. Further, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements such as bank-owned life insurance policies ("BOLI") and non-maturity deposit liabilities. Additionally, we hold shares of FHLB stock and Visa Inc. Class B common stock at cost. These shares are restricted from resale, except among member banks, and their values are discussed in Note 4, Investment Securities.

(in thousands)	September 30, 2018			December 31, 2017		
	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets (recorded at amortized cost)						
Cash and cash equivalents	\$142,718	\$142,718	Level 1	\$203,545	\$203,545	Level 1
Investment securities held-to-maturity	164,222	158,106	Level 2	151,032	151,032	Level 2
Loans, net	1,713,054	1,683,109	Level 3	1,663,246	1,650,198	Level 3
Interest receivable	7,366	7,366	Level 2	7,501	7,501	Level 2
Financial liabilities (recorded at amortized cost)						
Time deposits	126,140	124,796	Level 2	160,116	159,540	Level 2
Subordinated debentures	5,831	7,505	Level 3	5,739	5,118	Level 3
Interest payable	155	155	Level 2	191	191	Level 2

Commitments - The value of unrecognized financial instruments is estimated based on the fee income associated with the commitments which, in the absence of credit exposure, is considered to approximate their settlement value. The



fair value of commitment fees was not material at September 30, 2018 or December 31, 2017.

Note 4: Investment Securities

Our investment securities portfolio consists of obligations of state and political subdivisions, corporate bonds, U.S. government agency securities, including residential and commercial mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMOs") issued or guaranteed by Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), Small Business Administration ("SBA"), or Government National Mortgage Association ("GNMA"), debentures issued by government-sponsored agencies such

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

as FNMA, Federal Farm Credit Bureau, FHLB and FHLMC, and privately issued CMOs, as reflected in the following table.

(in thousands)	September 30, 2018				December 31, 2017			
	Amortized		Gross		Amortized		Gross	
	Cost	Fair Value	Unrealized Gains	Unrealized (Losses)	Cost	Fair Value	Unrealized Gains	Unrealized (Losses)
<b>Held-to-maturity:</b>								
Securities of U.S. government agencies:								
MBS pass-through securities issued by FHLMC and FNMA	\$91,237	\$86,962	\$—	\$(4,275)	\$100,376	\$100,096	\$234	\$(514)
SBA-backed securities	8,723	8,489	—	(234)	—	—	—	—
CMOs issued by FNMA	11,646	11,254	—	(392)	—	—	—	—
CMOs issued by FHLMC	34,169	32,868	—	(1,301)	31,010	30,938	2	(74)
CMOs issued by GNMA	3,734	3,694	—	(40)	—	—	—	—
Obligations of state and political subdivisions	14,713	14,839	160	(34)	19,646	19,998	383	(31)
<b>Total held-to-maturity</b>	<b>164,222</b>	<b>158,106</b>	<b>160</b>	<b>(6,276)</b>	<b>151,032</b>	<b>151,032</b>	<b>619</b>	<b>(619)</b>
<b>Available-for-sale:</b>								
Securities of U.S. government agencies:								
MBS pass-through securities issued by FHLMC and FNMA	93,096	90,484	20	(2,632)	65,559	65,262	126	(423)
SBA-backed securities	41,074	40,181	—	(893)	25,979	25,982	58	(55)
CMOs issued by FNMA	19,914	19,356	4	(562)	35,340	35,125	33	(248)
CMOs issued by FHLMC	128,848	124,930	1	(3,919)	70,514	69,889	3	(628)
CMOs issued by GNMA	11,938	11,450	—	(488)	17,953	17,785	26	(194)
Debentures of government-sponsored agencies	43,470	42,914	—	(556)	12,940	12,938	3	(5)
Privately issued CMOs	367	370	3	—	1,432	1,431	1	(2)
Obligations of state and political subdivisions	75,519	73,373	41	(2,187)	98,027	97,491	298	(834)
Corporate bonds	2,506	2,513	19	(12)	6,541	6,564	26	(3)
<b>Total available-for-sale</b>	<b>416,732</b>	<b>405,571</b>	<b>88</b>	<b>(11,249)</b>	<b>334,285</b>	<b>332,467</b>	<b>574</b>	<b>(2,392)</b>
<b>Total investment securities</b>	<b>\$580,954</b>	<b>\$563,677</b>	<b>\$248</b>	<b>\$(17,525)</b>	<b>\$485,317</b>	<b>\$483,499</b>	<b>\$1,193</b>	<b>\$(3,011)</b>

The amortized cost and fair value of investment debt securities by contractual maturity at September 30, 2018 and December 31, 2017 are shown in the following table. Expected maturities may differ from contractual maturities if the issuers of the securities have the right to call or prepay obligations with or without call or prepayment penalties.

(in thousands)	September 30, 2018				December 31, 2017			
	Held-to-Maturity		Available-for-Sale		Held-to-Maturity		Available-for-Sale	
	Amortized	Fair Value	Amortized	Fair Value	Amortized	Fair Value	Amortized	Fair Value
Within one year	\$2,677	\$2,697	\$10,111	\$10,031	\$2,151	\$2,172	\$10,268	\$10,272
After one but within five years	12,476	12,438	69,230	67,972	15,577	15,791	71,576	71,237
After five years through ten years	60,422	58,041	239,939	232,532	54,641	54,554	129,723	128,954
After ten years	88,647	84,930	97,452	95,036	78,663	78,515	122,718	122,004
<b>Total</b>	<b>\$164,222</b>	<b>\$158,106</b>	<b>\$416,732</b>	<b>\$405,571</b>	<b>\$151,032</b>	<b>\$151,032</b>	<b>\$334,285</b>	<b>\$332,467</b>

Sales of investment securities and gross gains and losses are shown in the following table.

Three months ended                      Nine months ended

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

(in thousands)	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Available-for-sale:				
Sales proceeds	\$ 11,966	\$ —	—\$16,972	\$ 1,321
Gross realized gains	—	—	27	13
Gross realized losses (90 )	—	—	(106 )	(3 )

Page-14

---

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Pledged investment securities are shown in the following table.

(in thousands)	September 30, 2018	December 31, 2017
Pledged to the State of California:		
Secure public deposits in compliance with the Local Agency Security Program	\$ 97,978	\$ 107,829
Collateral for trust deposits	740	761
Total investment securities pledged to the State of California	\$ 98,718	\$ 108,590
Collateral for Wealth Management and Trust Services checking account	\$ 2,005	\$ 2,026

As part of our ongoing review of our investment securities portfolio, we reassessed the classification of certain securities issued by government sponsored agencies. During 2018 and 2017, we transferred \$27.4 million and \$129.0 million, respectively, of these securities from available-for-sale to held-to-maturity at fair value. We intend and have the ability to hold these securities to maturity. The net unrealized pre-tax loss of \$278 thousand and \$3.0 million, at the respective transfer dates, remained in accumulated other comprehensive income and are amortized over the remaining lives of the securities. Amortization of the net unrealized pre-tax losses totaled \$396 thousand and \$299 thousand for the nine months ended September 30, 2018 and 2017, respectively.

Other-Than-Temporarily Impaired ("OTTI") Debt Securities

There were 253 and 198 investment securities in unrealized loss positions at September 30, 2018 and December 31, 2017, respectively. Those securities are summarized and classified according to the duration of the loss period in the following tables:

September 30, 2018 (in thousands)	< 12 continuous months		≥ 12 continuous months		Total securities in a loss position	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity:						
MBS pass-through securities issued by FHLMC and FNMA	\$6,602	\$(225)	\$80,360	\$(4,050)	\$86,962	\$(4,275)
SBA-backed securities	8,489	(234)	—	—	\$8,489	\$(234)
CMOs issued by FNMA	11,254	(392)	—	—	11,254	(392)
CMOs issued by FHLMC	11,430	(400)	21,438	(901)	32,868	(1,301)
CMOs issued by GNMA	—	—	3,694	(40)	3,694	(40)
Obligations of state and political subdivisions	3,792	(34)	—	—	3,792	(34)
Total held-to-maturity	41,567	(1,285)	105,492	(4,991)	147,059	(6,276)
Available-for-sale:						
MBS pass-through securities issued by FHLMC and FNMA	52,821	(1,804)	20,406	(828)	73,227	(2,632)
SBA-backed securities	23,162	(893)	—	—	23,162	(893)
CMOs issued by FNMA	13,230	(383)	5,905	(179)	19,135	(562)
CMOs issued by FHLMC	87,017	(2,930)	29,702	(989)	116,719	(3,919)
CMOs issued by GNMA	10,728	(485)	485	(3)	11,213	(488)
Debentures of government-sponsored agencies	37,831	(556)	—	—	37,831	(556)
Obligations of state and political subdivisions	44,714	(785)	21,543	(1,402)	66,257	(2,187)
Corporate bonds	1,010	(12)	—	—	1,010	(12)
Total available-for-sale	270,513	(7,848)	78,041	(3,401)	348,554	(11,249)
Total temporarily impaired securities	\$312,080	\$(9,133)	\$183,533	\$(8,392)	\$495,613	\$(17,525)



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

December 31, 2017 (in thousands)	< 12 continuous months		≥ 12 continuous months		Total securities in a loss position	
	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
<b>Held-to-maturity:</b>						
Obligations of state and political subdivisions	\$3,648	\$(31)	\$—	\$—	\$3,648	\$(31)
MBS pass-through securities issued by FHLMC and FNMA	16,337	(143)	46,845	(371)	63,182	(514)
CMOs issued by FHLMC	11,066	(31)	13,824	(43)	24,890	(74)
<b>Total held-to-maturity</b>	<b>31,051</b>	<b>(205)</b>	<b>60,669</b>	<b>(414)</b>	<b>91,720</b>	<b>(619)</b>
<b>Available-for-sale:</b>						
MBS pass-through securities issued by FHLMC and FNMA	32,189	(121)	15,325	(302)	47,514	(423)
SBA-backed securities	11,028	(53)	165	(2)	11,193	(55)
CMOs issued by FNMA	26,401	(171)	5,440	(77)	31,841	(248)
CMOs issued by FHLMC	69,276	(628)	—	—	69,276	(628)
CMOs issued by GNMA	14,230	(194)	—	—	14,230	(194)
Debentures of government-sponsored agencies	2,984	(5)	—	—	2,984	(5)
Privately issued CMO's	1,310	(2)	—	—	1,310	(2)
Obligations of state and political subdivisions	52,197	(288)	19,548	(546)	71,745	(834)
Corporate bonds	3,060	(3)	—	—	3,060	(3)
<b>Total available-for-sale</b>	<b>212,675</b>	<b>(1,465)</b>	<b>40,478</b>	<b>(927)</b>	<b>253,153</b>	<b>(2,392)</b>
<b>Total temporarily impaired securities</b>	<b>\$243,726</b>	<b>\$(1,670)</b>	<b>\$101,147</b>	<b>\$(1,341)</b>	<b>\$344,873</b>	<b>\$(3,011)</b>

As of September 30, 2018, the investment portfolio included 83 investment securities that had been in a continuous unrealized loss position for twelve months or more and 170 investment securities that had been in a loss position for less than twelve months.

Securities issued by government-sponsored agencies, such as FNMA and FHLMC, have implicit credit support by the U.S. federal government. Securities issued by the SBA and GNMA have explicit credit guarantees by the U.S. federal government, which protects us from credit losses on the contractual cash flows of the securities.

Other temporarily impaired securities, including obligations of state and political subdivisions and corporate bonds, were deemed credit worthy after our internal analyses of the issuers' latest financial information, credit ratings by major credit rating agencies, and/or credit enhancements.

Based on our comprehensive analyses, we determined that the decline in the fair values of these securities was primarily driven by factors other than credit, such as changes in market interest rates and liquidity spreads subsequent to purchase. At September 30, 2018, Management determined that it did not intend to sell investment securities with unrealized losses, and it is more likely than not that we are not required to sell any of the securities with unrealized losses before recovery of their amortized cost. Therefore, we do not consider these investment securities to be other-than-temporarily impaired at September 30, 2018.

#### Non-Marketable Securities

As a member of the FHLB, we are required to maintain a minimum investment in FHLB capital stock determined by the Board of Directors of the FHLB. The minimum investment requirements can increase in the event we increase our total asset size or borrowings with the FHLB. Shares cannot be purchased or sold except between the FHLB and its members at the \$100 per share par value. We held \$11.1 million of FHLB stock recorded at cost in other assets in the consolidated statements of condition at both September 30, 2018 and December 31, 2017. The carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and they do not have a readily determinable market value. Management does not believe that the FHLB stock is

other-than-temporarily-impaired, due to FHLB's current financial condition. On October 25, 2018, FHLB announced a cash dividend to be distributed in mid-November 2018 at an annualized dividend rate of 7.00%. Cash dividends paid on FHLB capital stock are recorded as non-interest income.

As a member bank of Visa U.S.A., we hold 16,939 shares of Visa Inc. Class B common stock with a carrying value of zero, which is equal to our cost basis. These shares are restricted from resale to non-member banks of Visa U.S.A. until their conversion into Class A (voting) shares upon the termination of Visa Inc.'s Covered Litigation escrow account. Because of the restriction and the uncertainty on the conversion rate to Class A shares, these shares lack readily determinable fair value and are not classified as available-for-sale securities nor are they carried at fair value. When converting this Class B common stock to Class A common stock based on the conversion rate of 1.6298 as of September 30, 2018 and 1.6483 as of December 31, 2017, and the closing stock price of Class A shares at those respective dates, the converted value of our shares of Class B common stock would have been \$4.1 million and \$3.2 million at September 30, 2018 and December 31, 2017, respectively. The conversion rate is subject to further adjustment upon the final settlement of the covered litigation against Visa Inc. and its member banks. As such, the fair value of these Class B shares can differ significantly from their converted values. For further information, refer to Note 8, Commitments and Contingencies.

On October 25, 2018, we entered into an agreement to sell 6,500 shares of our holdings of Visa Class B common stock to a member bank of Visa U.S.A. to be settled in the fourth quarter of 2018, and the estimated net pre-tax gain from the sale is \$955 thousand.

We invest in low-income housing tax credit funds as a limited partner, which totaled \$4.8 million and \$2.1 million recorded in other assets as of September 30, 2018 and December 31, 2017, respectively. We recognized \$173 thousand and \$454 thousand of low-income housing tax credits and other tax benefits, net of \$144 thousand and \$381 thousand of amortization expense of low-income housing tax credit investment, as a component of income tax expense in the three and nine months ended September 30, 2018, respectively. As of September 30, 2018, our unfunded commitments for these low-income housing tax credit funds totaled \$3.2 million. We did not recognize any impairment losses on these low-income housing tax credit investments during the three and nine months ended September 30, 2018 or 2017, as the value of the future tax benefits exceeds the carrying value of the investments.

#### Note 5: Loans and Allowance for Loan Losses

##### Credit Quality of Loans

The following table shows outstanding loans by class and payment aging as of September 30, 2018 and December 31, 2017.

##### Loan Aging Analysis by Loan Class

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
September 30, 2018								
30-59 days past due	\$ —	\$ —	\$ —	\$ —	\$ 121	\$ —	\$ 113	\$ 234
60-89 days past due	20	—	—	—	—	—	47	67
90 days or more past due	—	—	—	—	—	—	—	—
Total past due	20	—	—	—	121	—	160	301
Current	238,751	316,467	841,493	68,739	121,122	113,383	28,615	1,728,570
Total loans <sup>3</sup>	\$ 238,771	\$ 316,467	\$ 841,493	\$ 68,739	\$ 121,243	\$ 113,383	\$ 28,775	\$ 1,728,871
Non-accrual loans <sup>2</sup>	\$ —	\$ —	\$ —	\$ —	\$ 318	\$ —	\$ 68	\$ 386
December 31, 2017								
30-59 days past due	\$ —	\$ —	\$ —	\$ —	\$ 99	\$ 255	\$ 330	\$ 684
60-89 days past due	1,340	—	—	—	—	—	—	1,340



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

90 days or more past due	—	—	—	—	307	—	—	307
Total past due	1,340	—	—	—	406	255	330	2,331
Current	234,495	300,963	822,984	63,828	132,061	95,271	27,080	1,676,682
Total loans <sup>3</sup>	\$ 235,835	\$ 300,963	\$ 822,984	\$ 63,828	\$ 132,467	\$ 95,526	\$ 27,410	\$ 1,679,013
Non-accrual loans <sup>2</sup>	\$ —	\$ —	\$ —	\$ —	\$ 406	\$ —	\$ —	\$ 406

<sup>1</sup> Our residential loan portfolio does not include sub-prime loans, nor is it our practice to underwrite loans commonly referred to as "Alt-A mortgages", the characteristics of which are loans lacking full documentation, borrowers having low FICO scores or higher loan-to-value ratios.

<sup>2</sup> Includes no purchased credit impaired ("PCI") loans at September 30, 2018. Three PCI loans with unpaid balances totaling \$131 thousand and no carrying values were not accreting interest at December 31, 2017. Amounts exclude accreting PCI loans totaling \$2.1 million at both September 30, 2018 and December 31, 2017 as we have a reasonable expectation about future cash flows to be collected and we continue to recognize accretable yield on these loans in interest income. There were no accruing loans past due more than ninety days at September 30, 2018 or December 31, 2017.

<sup>3</sup> Amounts include net deferred loan origination costs of \$704 thousand and \$818 thousand at September 30, 2018 and December 31, 2017, respectively. Amounts are also net of unaccreted purchase discounts on non-PCI loans of \$922 thousand and \$1.2 million at September 30, 2018 and December 31, 2017, respectively.

We generally make commercial loans to established small and mid-sized businesses to provide financing for their growth and working capital needs, equipment purchases and acquisitions. Management examines historical, current, and projected cash flows to determine the ability of the borrower to repay obligations as agreed. Commercial loans are made based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral and guarantor support. The cash flows of borrowers, however, may not occur as expected, and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed, such as accounts receivable and inventory, and typically include personal guarantees. We target stable businesses with guarantors who provide additional sources of repayment and have proven to be resilient in periods of economic stress.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans discussed above. We underwrite these loans to be repaid from cash flow and to be supported by real property collateral. Underwriting standards for commercial real estate loans include, but are not limited to, debt coverage and loan-to-value ratios. Furthermore, the owners of the properties guarantee substantially all of our commercial real estate loans. Conditions in the real estate markets or in the general economy may adversely affect our commercial real estate loans. In the event of a vacancy, we expect guarantors to carry the loans until they find a replacement tenant. The owner's substantial equity investment provides a strong economic incentive to continue to support the commercial real estate projects. As such, we have generally experienced a relatively low level of loss and delinquencies in this portfolio.

We generally make construction loans to developers and builders to finance construction, renovation and occasionally land acquisitions in anticipation of near-term development. These loans are underwritten after evaluation of the borrower's financial strength, reputation, prior track record, and independent appraisals. Significant events can affect the construction industry, including: the inherent volatility of real estate markets and vulnerability to delays due to weather, change orders, inability to obtain construction permits, labor or material shortages, and price changes. Estimates of construction costs and value associated with the completed project may be inaccurate. Repayment of construction loans is largely dependent on the ultimate success of the project.

Consumer loans primarily consist of home equity lines of credit, other residential loans and floating homes, along with a small number of installment loans. Our other residential loans include tenancy-in-common fractional interest loans ("TIC") located almost entirely in San Francisco County. We originate consumer loans utilizing credit score information, debt-to-income ratio and loan-to-value ratio analysis. Diversification among consumer loan types, coupled with relatively small loan amounts that are spread across many individual borrowers, mitigates risk.

We use a risk rating system to evaluate asset quality, and to identify and monitor credit risk in individual loans, and in the loan portfolio. Our definitions of "Special Mention" risk graded loans, or worse, are consistent with those used by the Federal Deposit Insurance Corporation ("FDIC"). Our internally assigned grades are as follows:

**Pass and Watch:** Loans to borrowers of acceptable or better credit quality. Borrowers in this category demonstrate fundamentally sound financial positions, repayment capacity, credit history, and management expertise. Loans in this category must have an identifiable and stable source of repayment and meet the Bank's policy regarding debt-service-coverage ratios. These borrowers are capable of sustaining normal economic, market or operational setbacks without significant financial consequences. Negative external industry factors are generally not present. The loan may be secured, unsecured or supported by non-real estate collateral for which the value is more difficult to determine and/or marketability is more uncertain. This category also includes "Watch" loans, where the primary source of repayment has been delayed. "Watch" is intended to be a transitional grade, with either an upgrade or downgrade

within a reasonable period.

Special Mention: Potential weaknesses that deserve close attention. If left uncorrected, those potential weaknesses may result in deterioration of the payment prospects for the asset. Special Mention assets do not present sufficient risk to warrant adverse classification.

Substandard: Inadequately protected by either the current sound worth and paying capacity of the obligor or the collateral pledged, if any. A Substandard asset has a well-defined weakness or weaknesses that jeopardize(s) the liquidation of the debt. Substandard assets are characterized by the distinct possibility that we will sustain some loss if such weaknesses or deficiencies are not corrected. Well-defined weaknesses include adverse trends or developments of the borrower's financial condition, managerial weaknesses and/or significant collateral deficiencies.

Page-18

---

Doubtful: Critical weaknesses that make collection or liquidation in full improbable. There may be specific pending events that work to strengthen the asset; however, the amount or timing of the loss may not be determinable. Pending events generally occur within one year of the asset being classified as Doubtful. Examples include: merger, acquisition, or liquidation; capital injection; guarantee; perfecting liens on additional collateral; and refinancing. Such loans are placed on non-accrual status and usually are collateral-dependent.

We regularly review our credits for accuracy of risk grades whenever we receive new information. Borrowers are generally required to submit financial information at regular intervals. Typically, commercial borrowers with lines of credit are required to submit financial information with reporting intervals ranging from monthly to annually depending on credit size, risk and complexity. In addition, investor commercial real estate borrowers are usually required to submit rent rolls or property income statements annually. We monitor construction loans monthly and review them on an ongoing basis. We review home equity and other consumer loans based on delinquency status. We also review loans graded “Watch” or worse, regardless of loan type, no less than quarterly.

The following table represents an analysis of the carrying amount in loans, net of deferred fees and costs and purchase premiums or discounts, by internally assigned risk grades, including PCI loans, at September 30, 2018 and December 31, 2017.

Credit Risk Profile by Internally Assigned Risk Grade

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Purchased credit-impaired	Total
September 30, 2018									
Pass	\$ 223,259	\$ 302,082	\$ 838,493	\$ 66,049	\$ 119,383	\$ 113,383	\$ 28,611	\$ 2,129	\$ 1,693,389
Special Mention	14,574	5,192	2,194	—	1,121	—	—	—	23,081
Substandard	899	7,995	—	2,690	653	—	164	—	12,401
Total loans	\$ 238,732	\$ 315,269	\$ 840,687	\$ 68,739	\$ 121,157	\$ 113,383	\$ 28,775	\$ 2,129	\$ 1,728,871
December 31, 2017									
Pass	\$ 214,636	\$ 281,104	\$ 818,570	\$ 60,859	\$ 130,558	\$ 95,526	\$ 27,287	\$ 1,325	\$ 1,629,865
Special Mention	9,318	9,284	1,850	—	—	—	—	790	21,242
Substandard	11,816	9,409	1,774	2,969	1,815	—	123	—	27,906
Total loans	\$ 235,770	\$ 299,797	\$ 822,194	\$ 63,828	\$ 132,373	\$ 95,526	\$ 27,410	\$ 2,115	\$ 1,679,013

Troubled Debt Restructuring

Our loan portfolio includes certain loans modified in a troubled debt restructuring (“TDR”), where we have granted economic concessions to borrowers experiencing financial difficulties. These concessions typically result from our loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. TDRs on non-accrual status at the time of restructure may be returned to accruing status after Management considers the borrower’s sustained repayment performance for a reasonable period, generally six months, and obtains reasonable assurance of repayment and performance.

We may remove a loan from TDR designation if it meets all of the following conditions:

- The loan is subsequently refinanced or restructured at current market interest rates and the new terms are consistent with the treatment of creditworthy borrowers under regular underwriting standards;
- The borrower is no longer considered to be in financial difficulty;
- Performance on the loan is reasonably assured; and;

Existing loan did not have any forgiveness of principal or interest.

The same Management level that approved the upgrading of the loan classification must approve the removal of TDR status. During the nine months ended September 30, 2018, one TIC loan and one home equity loan with recorded investments totaling \$247 thousand were removed from TDR designation after meeting all of the conditions noted above. There were no loans removed from TDR designation during 2017.

The following table summarizes the carrying amount of TDR loans by loan class as of September 30, 2018 and December 31, 2017.

(in thousands)

Recorded investment in Troubled Debt Restructurings <sup>1</sup>	September 30,	December 31,
	2018	2017
Commercial and industrial	\$ 1,763	\$ 2,165
Commercial real estate, owner-occupied	6,997	6,999
Commercial real estate, investor	1,831	2,171
Construction	2,690	2,969
Home equity	251	347
Other residential	986	1,148
Installment and other consumer	695	721
Total	\$ 15,213	\$ 16,520

<sup>1</sup> There were two TDR loans with recorded investments totaling \$68 thousand on non-accrual status at September 30, 2018 and no TDR loans on non-accrual status at December 31, 2017. Includes no acquired loans on TDR status as of September 30, 2018 and December 31, 2017.

The following table presents information for loans modified in a TDR during the presented periods, including the number of modified contracts, the recorded investment in the loans prior to modification, and the recorded investment in the loans at period end after being restructured. The table excludes fully charged-off TDR loans and loans modified in a TDR and subsequently paid-off during the years presented.

(dollars in thousands)	Number of Contracts Modified	Pre-Modification Outstanding Investment	Post-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment at Period End
TDRs during the three months ended September 30, 2018:				
None	—	\$ —	\$ —	\$ —
TDRs during the three months ended September 30, 2017:				
None	—	\$ —	\$ —	\$ —
TDRs during the nine months ended September 30, 2018:				
Commercial and industrial	2	\$ 254	\$ 245	\$ 235
TDRs during the nine months ended September 30, 2017:				
Installment and consumer	1	\$ 50	\$ 50	\$ 49

The two loans that were modified during the nine months ended September 30, 2018 were to the same borrower and included loan extensions and other changes in loan terms. The modification during the nine months ended September 30, 2017 primarily involved an interest rate concession and other changes to loan terms. During the first nine months of 2018 and 2017, there were no defaults on loans that had been modified in a TDR within the prior twelve-month period. We report defaulted TDRs based on a payment default definition of more than ninety days past due.

Impaired Loans

The following tables summarize information by class on impaired loans and their related allowances. Total impaired loans include non-accrual loans, accruing TDR loans and accreting PCI loans that have experienced post-acquisition declines in cash flows expected to be collected.

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
September 30, 2018								
Recorded investment in impaired loans:								
With no specific allowance recorded	\$ 304	\$ —	\$ —	\$ 2,690	\$ 318	\$ 986	\$ 113	\$ 4,411
With a specific allowance recorded	1,459	6,997	1,831	—	251	—	582	11,120
Total recorded investment in impaired loans	\$ 1,763	\$ 6,997	\$ 1,831	\$ 2,690	\$ 569	\$ 986	\$ 695	\$ 15,531
Unpaid principal balance of impaired loans	\$ 1,751	\$ 6,993	\$ 1,824	\$ 2,688	\$ 567	\$ 985	\$ 694	\$ 15,502
Specific allowance	173	228	44	—	5	—	77	527
Average recorded investment in impaired loans during the quarter ended	1,840	7,000	1,837	2,690	651	987	700	15,705
September 30, 2018								
Interest income recognized on impaired loans during the quarter ended	31	67	20	39	5	13	7	182
September 30, 2018 <sup>1</sup>								
Average recorded investment in impaired loans during the nine months ended	2,019	7,002	1,925	2,831	698	1,029	708	16,212
September 30, 2018								
Interest income recognized on impaired loans during the nine months ended	214	199	63	114	15	38	22	665
September 30, 2018 <sup>1</sup>								
Average recorded investment in impaired loans during the quarter ended	2,063	7,000	3,236	3,104	607	1,164	802	17,976
September 30, 2017								
Interest income recognized on impaired loans during the quarter ended	27	67	22	39	5	14	9	183
September 30, 2017 <sup>1</sup>								
Average recorded investment in impaired loans during the nine months ended	2,100	6,998	3,010	3,174	660	1,367	871	18,180
September 30, 2017								
Interest income recognized on impaired loans during the nine months ended	74	199	65	110	19	48	29	544
September 30, 2017 <sup>1</sup>								

<sup>1</sup> Interest income recognized on a cash basis totaling \$6 thousand and \$134 thousand during the three and nine months ended September 30, 2018 was primarily related to the pay-off of three non-accrual commercial PCI loans. No interest income on impaired loans was recognized on a cash basis during the three and nine months ended September 30, 2017.

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
----------------	---------------------------	--	----------------------------------	--------------	-------------	-------------------	--------------------------------	-------

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

December 31, 2017

Recorded investment in impaired loans:

With no specific allowance recorded	\$ 309	\$ —	\$ —	\$ 2,689	\$ 406	\$ 995	\$ 46	\$ 4,445
With a specific allowance recorded	1,856	6,999	2,171	280	347	153	675	12,481
Total recorded investment in impaired loans	\$ 2,165	\$ 6,999	\$ 2,171	\$ 2,969	\$ 753	\$ 1,148	\$ 721	\$ 16,926
Unpaid principal balance of impaired loans	\$ 2,278	\$ 6,993	\$ 2,168	\$ 2,963	\$ 750	\$ 1,147	\$ 720	\$ 17,019
Specific allowance	\$ 50	\$ 188	\$ 159	\$ 7	\$ 6	\$ 1	\$ 102	\$ 513

Management monitors delinquent loans continuously and identifies problem loans, generally loans graded Substandard or worse, loans on non-accrual status and loans modified in a TDR, to be evaluated individually for impairment. Generally, the recorded investment in impaired loans is net of any charge-offs from estimated losses related to specifically identified impaired loans when they are deemed uncollectible. There were no charged-off amounts on impaired loans at September 30, 2018 or December 31, 2017. In addition, the recorded investment in impaired loans is net of purchase discounts or premiums on acquired loans and deferred fees and costs. At September 30, 2018 and December 31, 2017, unused commitments to extend credit on impaired loans, including performing loans to borrowers whose terms have been modified in TDRs, totaled \$950 thousand and \$935 thousand, respectively.

Page-21

---



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

The following tables disclose activity in the allowance for loan losses ("ALLL") and the recorded investment in loans by class, as well as the related ALLL disaggregated by impairment evaluation method.

Allowance for Loan Losses Rollforward for the Period

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
Three months ended September 30, 2018									
Beginning balance	\$ 2,597	\$ 2,339	\$ 7,390	\$ 508	\$ 952	\$ 746	\$ 325	\$ 956	\$ 15,813
Provision (reversal)	(245)	83	46	157	(39)	35	5	(42)	—
Charge-offs	—	—	—	—	—	—	—	—	—
Recoveries	4	—	—	—	—	—	—	—	4
Ending balance	\$ 2,356	\$ 2,422	\$ 7,436	\$ 665	\$ 913	\$ 781	\$ 330	\$ 914	\$ 15,817
Three months ended September 30, 2017									
Beginning balance	\$ 3,932	\$ 2,082	\$ 6,065	\$ 411	\$ 981	\$ 509	\$ 340	\$ 912	\$ 15,232
Provision (reversal)	612	(56)	33	217	21	33	(5)	(855)	—
Charge-offs	(5)	—	—	—	—	—	(1)	—	(6)
Recoveries	21	—	—	—	—	—	1	—	22
Ending balance	\$ 4,560	\$ 2,026	\$ 6,098	\$ 628	\$ 1,002	\$ 542	\$ 335	\$ 57	\$ 15,248

Allowance for Loan Losses Rollforward for the Period

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
Nine months ended September 30, 2018									
Allowance for loan losses:									
Beginning balance	\$ 3,654	\$ 2,294	\$ 6,475	\$ 681	\$ 1,031	\$ 536	\$ 378	\$ 718	\$ 15,767
Provision (reversal)	(1,308)	128	961	(16)	(118)	245	(88)	196	—
Charge-offs	(3)	—	—	—	—	—	(2)	—	(5)
Recoveries	13	—	—	—	—	—	42	—	55
Ending balance	\$ 2,356	\$ 2,422	\$ 7,436	\$ 665	\$ 913	\$ 781	\$ 330	\$ 914	\$ 15,817
Nine months ended September 30, 2017									
Allowance for loan losses:									
Beginning balance	\$ 3,248	\$ 1,753	\$ 6,320	\$ 781	\$ 973	\$ 454	\$ 372	\$ 1,541	\$ 15,442
Provision (reversal)	1,509	273	(222)	(153)	29	88	(40)	(1,484)	—
Charge-offs	(289)	—	—	—	—	—	(3)	—	(292)
Recoveries	92	—	—	—	—	—	6	—	98
Ending balance	\$ 4,560	\$ 2,026	\$ 6,098	\$ 628	\$ 1,002	\$ 542	\$ 335	\$ 57	\$ 15,248



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Allowance for Loan Losses and Recorded Investment in Loans

(dollars in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unaffiliated	Total	
September 30, 2018										
Ending ALLL related to loans collectively evaluated for impairment	\$2,183	\$2,194	\$7,392	\$665	\$908	\$781	\$253	\$914	\$15,290	
Ending ALLL related to loans individually evaluated for impairment	173	228	44	—	5	—	77	—	527	
Ending ALLL related to PCI loans	—	—	—	—	—	—	—	—	—	
Ending balance	\$2,356	\$2,422	\$7,436	\$665	\$913	\$781	\$330	\$914	\$15,817	
Recorded Investment:										
Collectively evaluated for impairment	\$236,969	\$308,272	\$838,856	\$66,049	\$120,588	\$112,397	\$28,080	\$—	\$1,711,211	
Individually evaluated for impairment	1,763	6,997	1,831	2,690	569	986	695	—	15,531	
PCI loans	39	1,198	806	—	86	—	—	—	2,129	
Total	\$238,771	\$316,467	\$841,493	\$68,739	\$121,243	\$113,383	\$28,775	\$—	\$1,728,871	
Ratio of allowance for loan losses to total loans	0.99	%0.77	%0.88	%0.97	%0.75	%0.69	%1.15	%NM	0.91	%
Allowance for loan losses to non-accrual loans	NM	NM	NM	NM	287	%NM	485	%NM	4,098	%
NM - Not Meaningful										

Allowance for Loan Losses and Recorded Investment in Loans

(dollars in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unaffiliated	Total
December 31, 2017									
Ending ALLL related to loans collectively evaluated for impairment	\$3,604	\$2,106	\$6,316	\$674	\$1,025	\$535	\$276	\$718	\$15,254
Ending ALLL related to loans individually evaluated for impairment	50	188	159	7	6	1	102	—	513

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Ending ALLL related to purchased credit-impaired loans	—	—	—	—	—	—	—	—	—
Ending balance	\$3,654	\$2,294	\$6,475	\$681	\$1,031	\$536	\$378	\$718	\$15,767
Recorded Investment:									
Collectively evaluated for impairment	\$233,605	\$292,798	\$820,023	\$60,859	\$131,620	\$94,378	\$26,689	\$—	\$1,659,972
Individually evaluated for impairment	2,165	6,999	2,171	2,969	753	1,148	721	—	16,926
Purchased credit-impaired	65	1,166	790	—	94	—	—	—	2,115
Total	\$235,835	\$300,963	\$822,984	\$63,828	\$132,467	\$95,526	\$27,410	\$—	\$1,679,013
Ratio of allowance for loan losses to total loans	1.55	%0.76	%0.79	%1.07	%0.78	%0.56	%1.38	%NM	0.94
Allowance for loan losses to non-accrual loans	NM	NM	NM	NM	254	%NM	NM	NM	3,883
NM - Not Meaningful									

Purchased Credit-Impaired Loans

Acquired loans are considered credit-impaired if there is evidence of significant deterioration of credit quality since origination and it is probable, at the acquisition date, that we will be unable to collect all contractually required payments receivable. Management has determined certain loans purchased in our three bank acquisitions to be PCI loans based on credit indicators such as nonaccrual status, past due status, loan risk grade, loan-to-value ratio, etc. Revolving credit agreements (e.g., home equity lines of credit and revolving commercial loans) are not considered PCI loans as cash flows cannot be reasonably estimated.

The following table reflects the unpaid principal balance and related carrying value of PCI loans.

PCI Loans (in thousands)	September 30, 2018		December 31, 2017	
	Unpaid Principal Balance	Carrying Value	Unpaid Principal Balance	Carrying Value
Commercial and industrial	\$ 106	\$ 39	\$ 276	\$ 65
Commercial real estate, owner occupied	1,259	1,198	1,297	1,166
Commercial real estate, investor	1,041	806	1,064	790
Home equity	215	86	231	94
Total purchased credit-impaired loans	\$ 2,621	\$ 2,129	\$ 2,868	\$ 2,115

The activities in the accretable yield, or income expected to be earned over the remaining lives of the PCI loans were as follows:

Accretable Yield (in thousands)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Balance at beginning of period	\$ 1,059	\$ 1,306	\$ 1,254	\$ 1,476
Accretion	(63)	(76)	(258)	(246)
Balance at end of period	\$ 996	\$ 1,230	\$ 996	\$ 1,230

#### Pledged Loans

Our FHLB line of credit is secured under terms of a blanket collateral agreement by a pledge of certain qualifying loans with unpaid principal balances of \$1,031.5 million and \$887.9 million at September 30, 2018 and December 31, 2017, respectively. In addition, we pledge a certain residential loan portfolio, which totaled \$85.2 million and \$67.6 million at September 30, 2018 and December 31, 2017, respectively, to secure our borrowing capacity with the Federal Reserve Bank ("FRB"). Also, see Note 6, Borrowings.

#### Related Party Loans

The Bank has, and expects to have in the future, banking transactions in the ordinary course of its business with directors, officers, principal shareholders and their businesses or associates. These transactions, including loans, are granted on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with persons not related to us. Likewise, these transactions do not involve more than the normal risk of collectability or present other unfavorable features. Related party loans totaled \$11.3 million at September 30, 2018 compared to \$11.9 million at December 31, 2017. In addition, undisbursed commitments to related parties totaled \$9.1 million at September 30, 2018 and December 31, 2017.

#### Note 6: Borrowings

**Federal Funds Purchased** – The Bank had unsecured lines of credit with correspondent banks for overnight borrowing totaling \$92.0 million at September 30, 2018 and \$100.4 million at December 31, 2017. In general, interest rates on these lines approximate the federal funds target rate. We had no overnight borrowings under these credit facilities at September 30, 2018 or December 31, 2017.

**Federal Home Loan Bank Borrowings** – As of September 30, 2018 and December 31, 2017, the Bank had lines of credit with the FHLB totaling \$616.2 million and \$538.9 million, respectively, based on eligible collateral of certain loans. There were no FHLB overnight borrowings at September 30, 2018 or December 31, 2017.

Federal Reserve Line of Credit – The Bank has a line of credit with the FRBSF secured by certain residential loans. At September 30, 2018 and December 31, 2017, the Bank had borrowing capacity under this line totaling \$64.4 million and \$52.1 million, respectively, and had no outstanding borrowings with the FRBSF.

As part of an acquisition, Bancorp assumed two subordinated debentures due to NorCal Community Bancorp Trusts I and II (the "Trusts"), established for the sole purpose of issuing trust preferred securities on September 22, 2003 and December 29, 2005, respectively. The subordinated debentures were recorded at fair values totaling \$4.95 million at acquisition date with contractual values totaling \$8.2 million. The difference between the contractual balance and the fair value at acquisition date is accreted into interest expense over the lives of the debentures. Accretion on the subordinated debentures totaled \$92 thousand and \$117 thousand in the nine months ended September 30, 2018

and 2017, respectively. Bancorp has the option to defer payment of the interest on the subordinated debentures for a period of up to five years, as long as there is no default on the subordinated debentures. In the event of interest deferral, dividends to Bancorp common stockholders are prohibited. The trust preferred securities were sold and issued in private transactions pursuant to an exemption from registration under the Securities Act of 1933, as amended. Bancorp has guaranteed, on a subordinated basis, distributions and other payments due on trust preferred securities totaling \$8.0 million issued by the Trusts, which have identical maturity, repricing, and payment terms as the subordinated debentures.

The following table summarizes the contractual terms of the subordinated debentures due to the Trusts as of September 30, 2018:

(in thousands)

Subordinated debentures due to NorCal Community Bancorp Trust I on October 7, 2033 with interest payable quarterly, based on 3-month LIBOR plus 3.05%, repricing quarterly (5.39% as of September 30, 2018), redeemable, in whole or in part, on any interest payment date	\$4,124
Subordinated debentures due to NorCal Community Bancorp Trust II on March 15, 2036 with interest payable quarterly, based on 3-month LIBOR plus 1.40%, repricing quarterly (3.73% as of September 30, 2018), redeemable, in whole or in part, on any interest payment date	4,124
Total	\$8,248

On October 5, 2018, Bancorp redeemed in full the subordinated debentures due to NorCal Community Bancorp Trust I resulting in \$916 thousand in accelerated accretion, which will have a one-time impact on net interest income in the fourth quarter of 2018, but will not have a material impact on our capital ratios.

#### Note 7: Stockholders' Equity

##### Dividend and Stock Split

On October 22, 2018, the Bancorp declared a \$0.35 per share cash dividend, payable on November 8, 2018 to shareholders of record at the close of business on November 1, 2018. Additionally, Bancorp announced a 2:1 stock split, payable on November 27, 2018, to shareholders of record at the close of business on November 9, 2018. See Note 1, Basis of Presentation, for the pro forma effect of the stock split on reported earnings per share for the periods presented.

##### Share-Based Payments

The fair value of stock options as of the grant date is recorded as stock-based compensation expense in the consolidated statements of comprehensive income over the requisite service period, which is generally the vesting period, with a corresponding increase in common stock. Stock-based compensation also includes compensation expense related to the issuance of restricted stock awards. The fair value of the restricted stock awards on the grant date, which equals the intrinsic value, is recorded as compensation expense over the requisite service period with a corresponding increase in common stock as the shares vest. Stock option and restricted stock awards issued in 2018 include a retirement eligibility clause whereby the requisite service period is satisfied at the retirement eligibility date. For those awards, we accelerate stock-based compensation if the award holder is eligible to retire. However, retirement eligibility does not affect the legal vesting schedule of the awards.

Performance-based stock awards (restricted stock awards) are issued to a selected group of employees. Stock award vesting is contingent upon the achievement of pre-established long-term performance goals set by the Compensation Committee of the Board of Directors. Performance is measured over a three-year period and the stock awards cliff vest. These performance-based stock awards were granted at a maximum opportunity level, and based on the

achievement of the pre-established goals, the actual payouts can range from 0% to 200% of the target award. For performance-based stock awards, an estimate is made of the number of shares expected to vest based on the probability that the performance criteria will be achieved to determine the amount of compensation expense to be recognized. The estimate is re-evaluated quarterly and total compensation expense is adjusted for any change in the current period.

In addition, we record excess tax benefits (deficiencies) resulting from the exercise of non-qualified stock options, the disqualifying disposition of incentive stock options and vesting of restricted stock awards as income tax benefits



(expense) in the consolidated statements of comprehensive income with a corresponding decrease (increase) to current taxes payable.

The holders of unvested restricted stock awards are entitled to dividends on the same per-share ratio as holders of common stock. Tax benefits on dividends paid on unvested restricted stock awards are recorded as tax benefits in the consolidated statements of comprehensive income with a corresponding decrease to current taxes payable.

Under the 2017 Equity Plan, stock options may be net settled by a reduction in the number of shares otherwise deliverable upon exercise in satisfaction of the exercise payment and applicable tax withholding requirements. During the nine months ended September 30, 2018, option holders exchanged 20,981 shares totaling \$1.5 million at a weighted-average price of \$71.35 for cashless stock option exercises and tax withholdings upon vesting of performance-based stock awards. During the nine months ended September 30, 2017, option holders exchanged 11,938 shares totaling \$782 thousand at a weighted-average price of \$65.50 for cashless stock option exercises. Shares exchanged under net settlement arrangements are available for future grants under the 2017 Equity Plan.

#### Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

We early adopted ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, in the first quarter of 2018 and reclassified \$638 thousand from AOCI to retained earnings. This amount represents the stranded income tax effects related to the unrealized loss on available-for-sale securities in AOCI on the date of the enactment of the Tax Cuts and Jobs Act of 2017. For more information regarding ASU No. 2018-02, refer to Note 2, Accounting Standards Adopted in 2018.

#### Share Repurchase Program

On April 23, 2018, Bancorp announced that its Board of Directors approved a Share Repurchase Program under which Bancorp may repurchase up to \$25.0 million of its outstanding common stock through May 1, 2019.

Under the Share Repurchase Program, Bancorp may purchase shares of its common stock through various means such as open market transactions, including block purchases, and privately negotiated transactions. The number of shares repurchased and the timing, manner, price and amount of any repurchases will be determined at Bancorp's discretion. Factors include, but are not limited to, stock price, trading volume and general market conditions, along with Bancorp's general business conditions. The program may be suspended or discontinued at any time and does not obligate Bancorp to acquire any specific number of shares of its common stock.

As part of the Share Repurchase Program, Bancorp entered into a trading plan adopted in accordance with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The 10b5-1 trading plan permits common stock to be repurchased at times that might otherwise be prohibited under insider trading laws or self-imposed trading restrictions. The 10b5-1 trading plan is administered by an independent broker and is subject to price, market volume and timing restrictions.

During the nine months ended September 30, 2018, Bancorp purchased 17,943 shares for a total amount of \$1.5 million.

#### Note 8: Commitments and Contingencies

##### Financial Instruments with Off-Balance Sheet Risk

## Edgar Filing: Bank of Marin Bancorp - Form 10-Q

We make commitments to extend credit in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit in the form of loans or through standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because various commitments will expire without being fully drawn, the total commitment amount does not necessarily represent future cash requirements.

Our credit loss exposure is equal to the contractual amount of the commitment in the event of nonperformance by the borrower. We use the same credit underwriting criteria for all credit exposure. The amount of collateral obtained, if

Page-26

---

deemed necessary by us, is based on Management's credit evaluation of the borrower. Collateral types pledged may include accounts receivable, inventory, other personal property and real property.

The contractual amount of undrawn loan commitments and standby letters of credit not reflected in the consolidated statements of condition are as follows:

(in thousands)	September 30, December 31,	
	2018	2017
Commercial lines of credit	\$ 228,932	\$ 224,370
Revolving home equity lines	189,353	177,678
Undisbursed construction loans	51,624	35,322
Personal and other lines of credit	10,783	11,758
Standby letters of credit	2,636	4,074
Total commitments and standby letters of credit	\$ 483,328	\$ 453,202

We record an allowance for losses on these off-balance sheet commitments based on an estimate of probabilities of the utilization of these commitments according to our historical experience on different types of commitments and expected loss. The allowance for losses on off-balance sheet commitments totaled \$958 thousand as of September 30, 2018 and December 31, 2017, which is recorded in interest payable and other liabilities in the consolidated statements of condition.

#### Operating Leases

We rent certain premises under long-term, non-cancelable operating leases expiring at various dates through the year 2032. Most of the leases contain certain renewal options and escalation clauses. At September 30, 2018, the approximate minimum future commitments payable under non-cancelable contracts for leased premises are as follows:

(in thousands)	2018	2019	2020	2021	2022	Thereafter	Total
Operating leases	\$ 1,106	\$ 4,198	\$ 3,758	\$ 2,138	\$ 1,330	\$ 2,904	\$ 15,434

Rent expense included in occupancy expense totaled \$1.1 million and \$997 thousand for the three months ended September 30, 2018 and 2017, respectively. Rent expense totaled \$3.5 million and \$3.0 million for the nine months ended September 30, 2018 and 2017, respectively.

#### Litigation Matters

We may be party to legal actions that arise from time to time during the normal course of business. We believe, after consultation with legal counsel, that litigation contingent liability, if any, would not have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

The Bank is responsible for a proportionate share of certain litigation indemnifications provided to Visa U.S.A. ("Visa") by its member banks in connection with Visa's lawsuits related to anti-trust charges and interchange fees ("Covered Litigation"). Our proportionate share of the litigation indemnification liability does not change or transfer upon the sale of our Class B Visa shares to member banks. Visa established an escrow account to pay for settlements or judgments in the Covered Litigation. Under the terms of the U.S. retrospective responsibility plan, when Visa funds the litigation escrow account, it triggers a conversion rate reduction of the Class B common stock to shares of Class A common stock, effectively reducing the aggregate value of the Class B common stock held by Visa's member banks like us.

In 2012, Visa had reached a \$4.0 billion interchange multidistrict litigation class settlement agreement with plaintiffs representing a class of U.S. retailers. On September 17, 2018, Visa signed an amended settlement agreement with the class action plaintiffs of the U.S. interchange multidistrict litigation that superseded the 2012 settlement agreement. Pursuant to the amended settlement agreement, Visa deposited an additional \$600 million into the litigation escrow account, increasing the escrow account balance to \$1.5 billion. The escrow balance, combined with funds previously deposited with the court, are expected to cover all settlement payment obligations. According to Visa's Form 10-Q filed on July 27, 2018, it had reached settlement agreements with individual merchants representing 51% of the Visa-branded payment card sales volume of merchants who opted out of the 2012 settlement agreement.

The outcome of the Covered Litigation affects the conversion rate of Visa Class B common stock held by us to Visa Class A common stock, as discussed above and in Note 4, Investment Securities. The final conversion rate might change depending on the final settlement payments, and the full effect on member banks is still uncertain. Litigation is ongoing and until the court approval process is complete, there is no assurance that Visa will resolve the claims as contemplated by the settlement agreement and additional lawsuits may arise. However, until the escrow account is fully depleted and the conversion rate of Class B to Class A common stock is reduced to zero, no future cash settlement payments are required by the member banks, such as us, on the Covered Litigation. Therefore, we are not required to record any indemnification liabilities related to the Covered Litigation.

#### Note 9: Derivative Financial Instruments and Hedging Activities

We have entered into interest rate swap agreements, primarily as an interest rate risk management strategy, in order to mitigate the changes in the fair value of specified long-term fixed-rate loans (or firm commitments to enter into long-term fixed-rate loans) caused by changes in interest rates. These hedges allow us to offer long-term fixed-rate loans to customers without assuming the interest rate risk of a long-term asset. Converting our fixed-rate interest payments to floating-rate interest payments, generally benchmarked to the one-month U.S. dollar LIBOR index, protects us against changes in the fair value of our loans associated with fluctuating interest rates.

Our credit exposure, if any, on interest rate swap asset positions is limited to the fair value (net of any collateral pledged to us) and interest payments of all swaps by each counterparty. Conversely, when an interest rate swap is in a liability position exceeding a certain threshold, we may be required to post collateral to the counterparty in an amount determined by the agreements. Collateral levels are monitored and adjusted on a regular basis for changes in interest rate swap values.

As of September 30, 2018, we had five interest rate swap agreements, which are scheduled to mature in June 2031, October 2031, July 2032, August 2037 and October 2037. All of our derivatives are designated hedging instruments and are accounted for as fair value hedges. The notional amounts of the interest rate contracts are equal to the notional amounts of the hedged loans. Our interest rate swap payments are settled monthly with counterparties. Accrued interest on the swaps totaled \$4 thousand and \$8 thousand as of September 30, 2018 and December 31, 2017, respectively.

The following table presents the notional amount and fair value of our derivatives designated as hedging instruments:

(in thousands)	Derivative Assets		Derivative Liabilities	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Fair value hedges:				
Interest rate contracts notional amount	\$8,988	\$ 4,019	\$9,156	\$ 14,810
Interest rate contracts fair value <sup>1</sup>	\$436	\$ 74	\$163	\$ 740

<sup>1</sup> See Note 3, Fair Value of Assets and Liabilities, for valuation methodology.

The following table presents the carrying amount and associated cumulative basis adjustment related to the application of fair value hedge accounting that is included in the carrying amount of hedged assets as of September 30, 2018:

(in thousands)	Carrying Amounts of Hedged Assets	Cumulative Amount of Fair Value Hedging Adjustment Included in the
----------------	-----------------------------------	--

		Carrying Amount of the Hedged Loans	
Loans	\$ 17,651	\$ (493	)

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

The following table presents the net gains (losses) recognized in interest income on loans on the consolidated statements of comprehensive income related to our derivatives designated as fair value hedges:

Three months ended	
(in September 30,	September 30,
thousands)	2017
Increase	
in	
value	
of	\$ 222
designated	\$ 25
interest	
rate	
swaps	
Payment	
on	
interest	(\$ 32 )
rate	
swaps	
Decrease	
in	
value	
of	\$(231)
hedged	
loans	
Decrease	
in	
value	
of	\$(4 )
yield	
maintenance	
agreement	
Net	
loss	
on	
fair	
value	
hedged	(\$ 15 )
relationships	
recognized	
in	
interest	
income	
Nine months ended	
(in September 30,	September 30,
thousands)	2017
Increase	\$ 39
in	
value	
of	\$ 7

designated  
interest  
rate  
swaps  
Payment  
on  
interest rate swaps  
of \$(127) \$ (261 )  
rate  
swaps  
(Decrease)  
increase  
in  
value of \$(924) \$ 35  
of  
hedged  
loans  
Decrease  
in  
value  
of \$(11 ) \$ (11 )  
yield  
maintenance  
agreement  
Net  
loss  
on  
fair  
value  
hedged relationships  
of \$(123) \$ (230 )  
relationships  
recognized  
against  
interest  
income

Our derivative transactions with counterparties are under International Swaps and Derivative Association (“ISDA”) master agreements that include “right of set-off” provisions. “Right of set-off” provisions are legally enforceable rights to offset recognized amounts and there may be an intention to settle such amounts on a net basis. We do not offset such financial instruments for financial reporting purposes.

The following table shows information on financial instruments that are eligible for offset in the consolidated statements of condition.

Offsetting of Financial Assets and Derivative Assets

	Gross Amounts of Recognized Assets <sup>1</sup>	Gross Offset in the Statements of Condition	Net Assets Presented in the Statements of Condition <sup>1</sup>	Gross Amounts Not Offset in the Financial Instruments Received	Net Cash Collateral Amount
(in thousands)					

September 30, 2018



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Derivatives by Counterparty:

Counterparty A	\$ 436	\$	-\$ 436	\$ (163 )	\$	-\$ 273
----------------	--------	----	---------	-----------	----	---------

December 31, 2017

Derivatives by Counterparty:

Counterparty A	\$ 74	\$	-\$ 74	\$ (74 )	\$	-\$ —
----------------	-------	----	--------	----------	----	-------

<sup>1</sup> Amounts exclude accrued interest totaling less than \$1 thousand at both September 30, 2018 and December 31, 2017.

Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)	Gross Amounts of Recognized Liabilities <sup>2</sup>	Gross Offset in the Statements of Condition <sup>2</sup>	Net Amounts of Liabilities Presented in the Statements of Condition <sup>2</sup>	Gross Amounts Not Offset in the Statements of Financial Condition		Net Amount
				Cash Collateral Placed	Instruments	

September 30, 2018

Derivatives by Counterparty:

Counterparty A	\$ 163	\$	-\$ 163	\$(163)	\$	—
----------------	--------	----	---------	---------	----	---

December 31, 2017

Derivatives by Counterparty:

Counterparty A	\$ 740	\$	-\$ 740	\$(74 )	\$(666 )	—
----------------	--------	----	---------	---------	----------	---

<sup>2</sup> Amounts exclude accrued interest totaling \$3 thousand and \$8 thousand at September 30, 2018 and December 31, 2017, respectively.

For more information on how we account for our interest rate swaps, refer to Note 1 to the Consolidated Financial Statements included in our 2017 Form 10-K filed with the SEC on March 14, 2018.

Note 10: Acquisition

On November 21, 2017, we completed the merger of Bank of Napa, N.A. (OTCQB: BNNP), to enhance our market presence in Napa, California. Bank of Napa was a national bank with two branch offices serving Napa. The acquisition added \$134.7 million in loans, \$249.9 million in deposits and \$75.5 million in investment securities to Bank of Marin as of the acquisition date. Bank of Napa shareholders received 0.307 shares of Bancorp common stock for each

share of Bank of Napa common stock outstanding. We have accounted for the acquisition of Bank of Napa as a business combination under the acquisition method of accounting. The assets acquired and liabilities assumed, both tangible and intangible, were recorded at their fair values as of the acquisition date in accordance with ASC 805, Business Combinations. The acquisition was treated as a "reorganization" within the definition of section 368(a) of the Internal Revenue Code and is generally considered tax-free for U.S. federal income tax purposes.

The Bank of Napa acquisition resulted in \$23.7 million in goodwill, which represents the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. Goodwill mainly reflects expected value created through the combined operations of Bank of Napa and Bank of Marin, which we evaluate for impairment annually. We determined that the fair value of our traditional community banking activities (provided through our branch network) exceeded the carrying amount of the bank-level reporting unit. The goodwill is not deductible for tax purposes.

The core deposit intangible represents the estimated future benefits of acquired deposits and is booked separately from the related deposits. We recorded a core deposit intangible asset of \$4.4 million from the Bank of Napa acquisition on November 21, 2017, of which \$56 thousand was amortized in 2017 and \$381 thousand was amortized in the first nine months of 2018. The core deposit intangible is amortized on an accelerated basis over an estimated ten-year life, and is evaluated periodically for impairment. No impairment loss was recognized as of September 30, 2018.

Acquisition-related expenses are recognized as incurred and continue until all systems have been converted and operational functions become fully integrated. Bank of Marin Bancorp incurred acquisition-related expenses in the consolidated statements of comprehensive income for the three and nine months ended September 30, 2018 as follows:

(in thousands)	Three months ended		Nine months ended	
	September		September	
	30, 2018	30, 2017	30, 2018	30, 2017
Data processing <sup>1</sup>	\$ 43	\$ —	\$ 598	\$ —
Professional services	46	449	172	458
Personnel severance	—	—	141	—
Other	—	46	43	46
Total	\$ 89	\$ 495	\$ 954	\$ 504

<sup>1</sup> Primarily relates to Bank of Napa's core processing system contract termination and deconversion fees.

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

Management's discussion of the financial condition and results of operations, which is unaudited, should be read in conjunction with the related consolidated financial statements in this Form 10-Q and with the audited consolidated financial statements and accompanying notes included in our 2017 Annual Report on Form 10-K. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

### Forward-Looking Statements

This discussion of financial results includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "1933 Act") and Section 21E of the Securities Exchange Act of 1934, as amended, (the "1934 Act"). Those sections of the 1933 Act and 1934 Act provide a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about their financial performance so long as they provide meaningful, cautionary statements identifying important factors that could cause actual results to differ significantly from projected results.

Our forward-looking statements include descriptions of plans or objectives of Management for future operations, products or services, and forecasts of revenues, earnings or other measures of economic performance. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include the words "believe," "expect," "intend," "estimate" or words of similar meaning, or future or conditional verbs preceded by "will," "would," "should," "could" or "may."

Forward-looking statements are based on Management's current expectations regarding economic, legislative, and regulatory issues, and the successful integration of acquisitions that may affect our earnings in future periods. A number of factors, many of which are beyond Management's control, could cause future results to vary materially from current Management expectations. Such factors include, but are not limited to, general economic conditions and the economic uncertainty in the United States and abroad, including changes in interest rates, deposit flows, real estate values, and expected future cash flows on loans and securities; costs or effects of acquisitions; competition; changes in accounting principles, policies or guidelines; changes in legislation or regulation (including the Tax Cuts and Jobs Act of 2017); natural disasters (such as the 2017 wildfires in our area); adverse weather conditions; and other economic, competitive, governmental, regulatory and technological factors (including external fraud and cyber-security threats) affecting our operations, pricing, products and services.

Important factors that could cause results or performance to materially differ from those expressed in our prior forward-looking statements are detailed in the Risk Factors section of this Form 10-Q and in Item 1A. Risk Factors section of our 2017 Form 10-K as filed with the SEC, copies of which are available from us at no charge. Forward-looking statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events.

### Critical Accounting Policies and Estimates

Critical accounting policies are those that are both important to the portrayal of our financial condition and results of operations and require Management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and imprecise. There have been no material changes to our critical accounting policies, which include: Allowance for Loan Losses, Other-than-temporary Impairment of Investment Securities, Accounting for Income Taxes, and Fair Value Measurements. For a detailed discussion, refer to Note 1 to the Consolidated Financial Statements included in our 2017 Form 10-K filed with the SEC on March 14, 2018 and Note 2, Recently Adopted and Issued Accounting Standards, to the Consolidated

Financial Statements in this Form 10-Q.

Page-31

---

## Executive Summary

Earnings in the third quarter of 2018 totaled \$8.7 million, compared to \$5.1 million in the third quarter of 2017. Diluted earnings per share were \$1.23 in the third quarter of 2018, compared to \$0.83 in the same quarter a year ago. Year-to-date earnings totaled \$23.0 million compared to \$14.9 million in the same period last year. Diluted earnings per share were \$3.27 and \$2.41 in the nine months ended September 30, 2018 and 2017, respectively.

The following are highlights of our operating and financial performance for the periods presented:

Pre-tax net income in the third quarter of 2018 was up \$4.0 million from the third quarter of 2017. Higher average balances of both loans and non-interest bearing deposits and higher yields across earning asset categories favorably impacted earnings in the current quarter. Reported net interest margin was 3.91% in the third quarter of 2018, compared to 3.63% in the same quarter last year.

Return on assets was 1.38% for the quarter ended September 30, 2018, compared to 0.95% for the quarter ended September 30, 2017. Return on equity was 11.20% for the quarter ended September 30, 2018, compared to 8.37% for the quarter ended September 30, 2017.

All capital ratios are well above regulatory requirements for a well-capitalized institution. The total risk-based capital ratio for Bancorp was 15.3% at September 30, 2018, compared to 14.9% at December 31, 2017.

The Board of Directors declared a cash dividend of \$0.35 per share, a \$0.03 increase from the prior quarter. This represents the 54th consecutive quarterly dividend paid by Bank of Marin Bancorp. The dividend is payable on November 8, 2018, to shareholders of record at the close of business on November 1, 2018.

In order to further enhance liquidity in Bank of Marin Bancorp (BMRC) stock and expand diversification in the investor base, the Board of Directors announced a 2:1 stock split payable on November 27, 2018, to shareholders of record at the close of business on November 9, 2018.

To reduce our funding costs, on October 5, 2018, Bancorp early-redeemed one of the two subordinated debentures assumed as part of the 2013 acquisition of NorCal Community Bancorp. The unaccreted purchase discount of \$916 thousand has been accelerated and will have a one-time impact on net interest income in the fourth quarter of 2018, but will not have a material impact on our capital ratios.

Loans totaled \$1,728.9 million at September 30, 2018, compared to \$1,679.0 million at December 31, 2017. New loan volume of \$165.8 million in the first nine months of 2018 was partially offset by payoffs of \$120.8 million, and combined with changes in lines of credit utilization and amortization on existing loans, resulted in the net increase of \$49.9 million.

Strong credit quality remains a cornerstone of the Bank's consistent performance. Non-accrual loans totaled \$386 thousand, or 0.02% of the loan portfolio at September 30, 2018, compared to \$406 thousand, or 0.02% at December 31, 2017. Classified loans totaled \$12.4 million at September 30, 2018, compared to \$27.9 million at December 31, 2017. The decrease in classified loans is primarily due to two borrowing relationships whose risk grades were upgraded from substandard to special mention in the second quarter of 2018. Accruing loans past due 30 to 89 days totaled \$301 thousand at September 30, 2018, compared to \$1.9 million at December 31, 2017. There was no provision for either loan losses or off-balance sheet commitments recorded in the first nine months of 2018.

Total deposits increased \$64.2 million in the first nine months of 2018 to \$2,212.8 million at September 30, 2018.

Non-interest bearing deposits represented 50.2% of total deposits, and the annualized cost of total deposits for the first nine months of 2018 was 0.09%.

Looking forward into 2018, we believe that our core values - relationship banking, disciplined fundamentals and commitment to the communities that we serve - will continue to drive the success of the Bank. By building strong relationships in vibrant markets, we are able to grow our loan portfolio and deposit franchise organically. Disciplined fundamentals ensure that our credit quality remains high, our deposit base is reasonably priced, and our operations are highly efficient, all of which contribute to profitability and net interest margin expansion. Our success helps us to attract the most qualified professionals in the marketplace.

Our strong liquidity and capital supports our organic growth as well as acquisitions. This gives us a great deal of flexibility as we seek opportunities that add value to the Company.

Page-32

---

## RESULTS OF OPERATIONS

Highlights of the financial results are presented in the following tables:

(dollars in thousands)	September 30, 2018	December 31, 2017		
Selected financial condition data:				
Total assets	\$2,545,715	\$2,468,154		
Loans, net	1,713,054	1,663,246		
Deposits	2,212,846	2,148,670		
Borrowings	5,831	5,739		
Stockholders' equity	308,603	297,025		
Asset quality ratios:				
Allowance for loan losses to total loans	0.91%	0.94	%	
Allowance for loan losses to non-accrual loans	41.00	x 38.88x		
Non-accrual loans to total loans	0.02%	0.02	%	
Capital ratios:				
Equity to total assets ratio	12.12	% 12.03	%	
Tangible common equity to tangible assets <sup>1</sup>	10.90	% 10.70	%	
Total capital (to risk-weighted assets)	15.29	% 14.91	%	
Tier 1 capital (to risk-weighted assets)	14.45	% 14.04	%	
Tier 1 capital (to average assets)	11.74	% 12.13	%	
Common equity Tier 1 capital (to risk weighted assets)	14.16	% 13.75	%	

(dollars in thousands, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Selected operating data:				
Net interest income	\$23,539	\$ 18,788	\$68,272	\$ 54,713
Non-interest income	2,236	2,066	6,716	6,277
Non-interest expense <sup>2</sup>	13,971	13,036	44,561	38,678
Net income <sup>2</sup>	8,680	5,132	22,960	14,866
Net income per common share:				
Basic	\$1.25	\$ 0.84	\$3.31	\$ 2.43
Diluted	\$1.23	\$ 0.83	\$3.27	\$ 2.41
Performance and other financial ratios:				
Return on average assets	1.38%	0.95%	1.24%	0.96%
Return on average equity	11.20%	8.37%	10.17%	8.35%
Tax-equivalent net interest margin <sup>3</sup>	3.97%	3.77%	3.91%	3.80%
Efficiency ratio	54.20%	62.51%	59.42%	63.42%
Cash dividend payout ratio on common stock <sup>4</sup>	25.60%	34.52%	27.79%	34.16%

<sup>1</sup> Tangible common equity to tangible assets is considered to be a meaningful non-GAAP financial measure of capital adequacy and is useful for investors to assess Bancorp's ability to absorb potential losses. Tangible common equity includes common stock, retained earnings and unrealized gains (losses) on available-for sale securities, net of tax, less goodwill and intangible assets of \$35.9 million and \$36.6 million at September 30, 2018 and December 31, 2017, respectively. Tangible assets exclude goodwill and intangible assets.

<sup>2</sup> Includes merger-related costs totaling \$89 thousand and \$954 thousand for the three and nine months ended September 30, 2018.

<sup>3</sup> Tax-equivalent net interest margin is computed by dividing taxable equivalent net interest income, which is adjusted for taxable equivalent income on tax-exempt loans and securities based on Federal statutory rate of 21 percent in 2018

and 35 percent in 2017, by total average interest-earning assets.

<sup>4</sup> Calculated as dividends on common shares divided by basic net income per common share.



## Net Interest Income

Net interest income is the difference between the interest earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and other interest-bearing liabilities. Net interest income is impacted by changes in general market interest rates and by changes in the amounts and composition of interest-earning assets and interest-bearing liabilities. Interest rate changes can create fluctuations in the net interest income and/or margin due to an imbalance in the timing of repricing and maturity of assets and liabilities. We manage interest rate risk exposure with the goal of minimizing the impact of interest rate volatility on net interest income. For more information, refer to Item 3. Quantitative and Qualitative Disclosure about Market Risk in this Form 10-Q.

Net interest margin is expressed as net interest income divided by average interest-earning assets. Net interest rate spread is the difference between the average rate earned on total interest-earning assets and the average rate incurred on total interest-bearing liabilities. Both of these measures are reported on a taxable-equivalent basis. Net interest margin is the higher of the two because it reflects interest income earned on assets funded with non-interest-bearing sources of funds, which include demand deposits and stockholders' equity.

## Average Statements of Condition and Analysis of Net Interest Income

The following table compares interest income, average interest-earning assets, interest expense, and average interest-bearing liabilities for the periods presented. The table also presents net interest income, net interest margin and net interest rate spread for each period reported.

	Three months ended September 30, 2018			Three months ended September 30, 2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
(dollars in thousands)						
<b>Assets</b>						
Interest-bearing due from banks <sup>1</sup>	\$79,674	\$400	1.96 %	\$125,846	\$406	1.26 %
Investment securities <sup>2, 3</sup>	558,741	3,624	2.59 %	400,659	2,294	2.29 %
Loans <sup>1, 3, 4</sup>	1,715,295	20,504	4.68 %	1,500,167	17,228	4.49 %
Total interest-earning assets <sup>1</sup>	2,353,710	24,528	4.08 %	2,026,672	19,928	3.85 %
Cash and non-interest-bearing due from banks	41,316			45,009		
Bank premises and equipment, net	7,866			8,430		
Interest receivable and other assets, net	86,039			60,622		
Total assets	\$2,488,931			\$2,140,733		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing transaction accounts	\$134,293	\$58	0.17 %	\$96,504	\$24	0.10 %
Savings accounts	179,429	18	0.04 %	171,187	17	0.04 %
Money market accounts	609,821	337	0.22 %	560,486	133	0.09 %
Time accounts including CDARS	132,588	130	0.39 %	140,736	138	0.39 %
Overnight borrowings <sup>1</sup>	112	1	2.06 %	—	—	— %
Subordinated debentures <sup>1</sup>	5,815	125	8.43 %	5,682	111	7.63 %
Total interest-bearing liabilities	1,062,058	669	0.25 %	974,595	423	0.17 %
Demand accounts	1,101,288			909,900		
Interest payable and other liabilities	18,022			13,055		
Stockholders' equity	307,563			243,183		
Total liabilities & stockholders' equity	\$2,488,931			\$2,140,733		
Tax-equivalent net interest income/margin <sup>1</sup>		\$23,859	3.97 %		\$19,505	3.77 %
Reported net interest income/margin <sup>1</sup>		\$23,539	3.91 %		\$18,788	3.63 %

Tax-equivalent net interest rate spread

3.83%

3.68%

Page-34

---

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

(dollars in thousands)	Nine months ended September 30, 2018			Nine months ended September 30, 2017		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
<b>Assets</b>						
Interest-bearing due from banks <sup>1</sup>	\$82,304	\$1,088	1.74 %	\$70,947	\$623	1.16 %
Investment securities <sup>2, 3</sup>	555,414	10,512	2.52 %	407,798	7,011	2.29 %
Loans <sup>1, 3, 4</sup>	1,697,093	59,475	4.62 %	1,488,771	50,317	4.46 %
Total interest-earning assets <sup>1</sup>	2,334,811	71,075	4.01 %	1,967,516	57,951	3.88 %
Cash and non-interest-bearing due from banks	42,488			43,140		
Bank premises and equipment, net	8,188			8,420		
Interest receivable and other assets, net	87,403			59,593		
Total assets	\$2,472,890			\$2,078,669		
<b>Liabilities and Stockholders' Equity</b>						
Interest-bearing transaction accounts	\$148,141	\$158	0.14 %	\$97,458	\$74	0.10 %
Savings accounts	179,543	54	0.04 %	165,212	48	0.04 %
Money market accounts	601,896	789	0.18 %	539,560	360	0.09 %
Time accounts including CDARS	142,563	426	0.40 %	144,559	423	0.39 %
Overnight borrowings <sup>1</sup>	115	2	1.92 %	—	—	— %
Subordinated debentures <sup>1</sup>	5,785	362	8.25 %	5,645	328	7.65 %
Total interest-bearing liabilities	1,078,043	1,791	0.22 %	952,434	1,233	0.17 %
Demand accounts	1,074,778			874,995		
Interest payable and other liabilities	18,127			13,151		
Stockholders' equity	301,942			238,089		
Total liabilities & stockholders' equity	\$2,472,890			\$2,078,669		
Tax-equivalent net interest income/margin <sup>1</sup>		\$69,284	3.91 %		\$56,718	3.80 %
Reported net interest income/margin <sup>1</sup>		\$68,272	3.86 %		\$54,713	3.67 %
Tax-equivalent net interest rate spread			3.79 %			3.71 %

<sup>1</sup> Interest income/expense is divided by actual number of days in the period times 360 days to correspond to stated interest rate terms, where applicable.

<sup>2</sup> Yields on available-for-sale securities are calculated based on amortized cost balances rather than fair value, as changes in fair value are reflected as a component of stockholders' equity. Investment security interest is earned on 30/360 day basis monthly.

<sup>3</sup> Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 21 percent in 2018 and 35 percent in 2017.

<sup>4</sup> Average balances on loans outstanding include non-performing loans. The amortized portion of net loan origination fees is included in interest income on loans, representing an adjustment to the yield.

#### Analysis of Changes in Tax-Equivalent Net Interest Income

The following table presents the effects of changes in average balances (volume) or changes in average rates on tax-equivalent net interest income for the years indicated. Volume variances are equal to the increase or decrease in average balances multiplied by prior period rates. Rate variances are equal to the increase or decrease in rates multiplied by prior period average balances. Mix variances are attributable to the change in yields or rates multiplied by the change in average balances.



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

(in thousands)	Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017				Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017				
	Volume	Yield/Rate	Mix	Total	Volume	Yield/Rate	Mix	Total	
Interest-bearing due from banks	\$(149)	\$ 226		\$(83)	\$(6)	\$100	\$ 315	\$50	\$465
Investment securities <sup>1</sup>	905	305	120	1,330	2,538	707	256	3,501	
Loans <sup>1</sup>	2,471	704	101	3,276	7,041	1,856	261	9,158	
Total interest-earning assets	3,227	1,235	138	4,600	9,679	2,878	567	13,124	
Interest-bearing transaction accounts	9	18	7	34	39	30	15	84	
Savings accounts	1	—	—	1	4	2	—	6	
Money market accounts	12	177	15	204	42	348	39	429	
Time accounts, including CDARS	(8)	)—	—	(8)	) (6)	)9	—	3	
Overnight borrowings	—	—	1	1	—	—	2	2	
Subordinated debentures	3	11	—	14	8	25	1	34	
Total interest-bearing liabilities	17	206	23	246	87	414	57	558	
Changes in tax-equivalent net interest income	\$3,210	\$ 1,029	\$115	\$4,354	\$9,592	\$ 2,464	\$510	\$12,566	

<sup>1</sup> Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the federal statutory rate of 21% in 2018 and 35% in 2017.

#### Third Quarter of 2018 Compared to Third Quarter of 2017

Net interest income totaled \$23.5 million in the third quarter of 2018, compared to \$18.8 million in the same quarter a year ago. The \$4.7 million increase was primarily due to the \$327.0 million increase in average earning assets from both the Bank of Napa acquisition and organic growth. Higher yields across asset categories also positively impacted interest income for the current quarter.

The reported net interest margin was 3.91% in the third quarter of 2018, compared to 3.63% in the same quarter of the previous year. The 28 basis points increase compared to the third quarter of 2017 is related to higher yields on earning assets, partially offset by a minimal increase in rates on deposit accounts and subordinated debentures.

#### First Nine Months of 2018 Compared to First Nine Months of 2017

Net interest income totaled \$68.3 million in the nine months ended September 30, 2018, compared to \$54.7 million for the same period in 2017. The \$13.6 million increase primarily relates to a \$367.3 million increase in average earning assets compared to 2017. Additionally, the higher yield on loans, investment securities, and interest-bearing cash positively impacted interest income.

The reported net interest margin was 3.86% in the first nine months of 2018, compared to 3.67% in the same period of 2017. The 19 basis points increase compared to the first nine months of 2017 is related to higher yields on earning assets, partially offset by a decrease in higher yielding loans as a percentage of total earning assets.

#### Market Interest Rates

Market interest rates are, in part, based on the target federal funds interest rate (the interest rate banks charge each other for short-term borrowings) implemented by the Federal Reserve Open Market Committee ("FOMC"). Actions by the FOMC to increase the target federal funds rate by 25 basis points in December 2015, December 2016, March 2017, June 2017, December 2017, March 2018, June 2018 and September 2018, have positively impacted yields on our rate sensitive interest-earning assets. The increase in September 2018, to the current target range for the federal

funds rate of 2.00% to 2.25%, was the eighth rate hike since 2008. If interest rates continue to rise, we anticipate that our net interest income will increase. While short-term interest rates have risen and improved the Bank's yields on prime-rate adjustable assets, longer-term rates that influence competitive pricing for fixed-rate lending activities have moved to a lesser degree.

Impact of Acquired Loans on Net Interest Margin

Early payoffs or prepayments of our acquired loans with significant unamortized purchase discount/premium could result in volatility in our net interest margin. As our acquired loans from prior acquisitions continue to pay off, we expect the accretion income from these loans to continue to decline. Accretion and gains on payoffs of purchased loans are recorded in interest income and the positive affect on our net interest margin for the third quarter and first nine months of 2018 and 2017 were as follows:

	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
(dollars in thousands)	Dollar Basis point impact to net interest margin	Dollar Basis point impact to net interest margin	Dollar Basis point impact to net interest margin	Dollar Basis point impact to net interest margin
Accretion on PCI loans	\$631 bps	\$76 2 bps	\$258 1 bps	\$246 2 bps
Accretion on non-PCI loans	\$411 bps	\$132 3 bps	\$273 2 bps	\$460 3 bps
Gains on pay-offs of PCI loans	\$6 0 bps	\$— 0 bps	\$135 1 bps	\$84 1 bps

Provision for Loan Losses

Management assesses the adequacy of the allowance for loan losses quarterly based on several factors including growth of the loan portfolio, analysis of probable losses in the portfolio, historical loss experience and the current economic climate. While loss recoveries and provisions for loan losses charged to expense increase the allowance, actual losses on loans reduce the allowance.

Impaired loan balances totaled \$15.5 million at September 30, 2018 and \$16.9 million at December 31, 2017, with specific valuation allowances of \$527 thousand and \$513 thousand for the same respective dates. Classified assets (loans with substandard or doubtful risk grades) decreased to \$12.4 million at September 30, 2018, from \$27.9 million at December 31, 2017. The decrease in classified loans is primarily due to two borrowing relationships whose risk grades were upgraded from substandard to special mention in the second quarter of 2018. There were no loans with doubtful risk grades at September 30, 2018 or December 31, 2017.

There was no provision for loan losses recorded in the three and nine months ended September 30, 2018 and 2017. The two classified borrowing relationships that were upgraded in the second quarter (mentioned above) reduced the calculated general allowance for loan losses. This reduction was primarily offset by general allowances resulting from loan growth and refinement of certain loan concentration qualitative factors, and an increase in specific reserves related to a loan that was modified as a troubled debt restructuring in the second quarter. Net recoveries in the third quarter of 2018 totaled \$4 thousand compared to \$16 thousand in the same quarter a year ago. Net recoveries totaled \$50 thousand in the nine months ended September 30, 2018, compared to net charge-offs of \$194 thousand for the same period in 2017.

The ratio of loan loss reserves to total loans was 0.91% at September 30, 2018, compared to 0.94% at December 31, 2017. Non-accrual loans totaled \$386 thousand, or 0.02% of total loans, at September 30, 2018, compared to \$406 thousand, or 0.02%, at December 31, 2017.

For more information, refer to Note 5 to the Consolidated Financial Statements in this Form 10-Q.





## Non-interest Income

The following table details the components of non-interest income.

(dollars in thousands)	Three months ended		Amount Increase (Decrease)	Percent Increase (Decrease)	
	September 30, 2018	September 30, 2017			
Service charges on deposit accounts	\$475	\$ 438	\$ 37	8.4	%
Wealth Management and Trust Services	490	539	(49 )	(9.1 )	%
Debit card interchange fees, net	402	390	12	3.1	%
Merchant interchange fees, net	99	88	11	12.5	%
Earnings on bank-owned life insurance	227	209	18	8.6	%
Dividends on FHLB stock	194	177	17	9.6	%
Losses on investment securities, net	(90 )	—	(90 )	NM	
Other income	439	225	214	95.1	%
Total non-interest income	\$2,236	\$ 2,066	\$ 170	8.2	%

(dollars in thousands)	Nine months ended		Amount Increase (Decrease)	Percent Increase (Decrease)	
	September 30, 2018	September 30, 2017			
Service charges on deposit accounts	\$1,407	\$ 1,337	\$ 70	5.2	%
Wealth Management and Trust Services	1,493	1,546	(53 )	(3.4 )	%
Debit card interchange fees, net	1,158	1,146	12	1.0	%
Merchant interchange fees, net	297	296	1	0.3	%
Earnings on bank-owned life insurance	685	628	57	9.1	%
Dividends on FHLB stock	582	585	(3 )	(0.5 )	%
(Losses) gains on investment securities, net	(79 )	10	(89 )	(890.0 )	%
Other income	1,173	729	444	60.9	%
Total non-interest income	\$6,716	\$ 6,277	\$ 439	7.0	%

NM - Not Meaningful

## Third Quarter of 2018 Compared to Third Quarter of 2017

Non-interest income increased by \$170 thousand in the third quarter of 2018 to \$2.2 million, compared to \$2.1 million in the same quarter a year ago. The increase in other income was primarily due to an increase in fees on one-way deposits placed into deposit networks as a result of the rising market interest rate environment. The decrease in Wealth Management and Trust Services income was primarily due to the loss of assets under management resulting from the distribution of large estates and trusts.

## First Nine Months of 2018 Compared to First Nine Months of 2017

Non-interest income increased by \$439 thousand in the first nine months to \$6.7 million, compared to \$6.3 million in the same period a year ago. The increase in other income was due to the reasons mentioned above.

Non-interest Expense

The following table details the components of non-interest expense.

(dollars in thousands)	Three months ended		Amount Increase (Decrease)	Percent Increase (Decrease)	
	September 30, 2018	September 30, 2017			
Salaries and related benefits	\$8,069	\$ 7,344	\$ 725	9.9	%
Occupancy and equipment	1,444	1,364	80	5.9	%
Depreciation and amortization	532	489	43	8.8	%
Federal Deposit Insurance Corporation insurance	186	167	19	11.4	%
Data processing	950	946	4	0.4	%
Professional services	727	801	(74)	(9.2)	%
Directors' expense	173	175	(2)	(1.1)	%
Information technology	262	179	83	46.4	%
Provision for losses on off-balance sheet commitments	—	100	(100)	(100.0)	%
Other non-interest expense					
Core deposit intangible amortization	230	118	112	94.9	%
Advertising	118	155	(37)	(23.9)	%
Other expense	1,280	1,198	82	6.8	%
Total other non-interest expense	1,628	1,471	157	10.7	%
Total non-interest expense	\$13,971	\$ 13,036	\$ 935	7.2	%

(dollars in thousands)	Nine months ended		Amount Increase (Decrease)	Percent Increase (Decrease)	
	September 30, 2018	September 30, 2017			
Salaries and related benefits	\$25,402	\$ 22,106	\$ 3,296	14.9	%
Occupancy and equipment	4,462	4,063	399	9.8	%
Depreciation and amortization	1,625	1,433	192	13.4	%
Federal Deposit Insurance Corporation insurance	568	490	78	15.9	%
Data processing	3,354	2,848	506	17.8	%
Professional services	2,836	1,845	991	53.7	%
Directors' expense	530	557	(27)	(4.8)	%
Information technology	795	563	232	41.2	%
Provision for losses on off-balance sheet commitments	—	57	(57)	(100.0)	%
Other non-interest expense					
Core deposit intangible amortization	691	354	337	95.2	%
Advertising	426	359	67	18.7	%
Other expense	3,872	4,003	(131)	(3.3)	%
Total other non-interest expense	4,989	4,716	273	5.8	%
Total non-interest expense	\$44,561	\$ 38,678	\$ 5,883	15.2	%

NM - Not Meaningful

Third Quarter of 2018 Compared to Third Quarter of 2017

Non-interest expense increased by \$935 thousand to \$14.0 million in the third quarter of 2018, compared to \$13.0 million in the same quarter a year ago. The increase was primarily due to higher salaries and benefits related to the addition of Bank of Napa employees, merit increases and filling open positions. Additionally, we amortized \$127 thousand in the third quarter of 2018 of the core-deposit intangible ("CDI") that arose from the Bank of Napa

acquisition. There was no provision for losses on off-balance sheet commitments in the third quarter of 2018, compared to a \$100 thousand reversal of the provision in the third quarter of 2017. Occupancy and equipment expenses increased primarily due to the addition of two branches from the Bank of Napa acquisition.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Non-interest expense increased by \$5.9 million to \$44.6 million in the nine months ended September 30, 2018, compared to \$38.7 million in the same period a year ago. The increase was primarily due to higher salaries and benefits related to the addition of Bank of Napa employees, merit increases and filling open positions, as well as higher stock-based compensation related to awards granted in 2018 with certain participants meeting retirement eligibility requirements. Professional services increased due to \$1.1 million in consulting expenses related to core processing contract negotiations that will result in future technology cost savings. The increase also relates to \$954 thousand in acquisition expenses in the nine months ended September 30, 2018 (\$598 thousand in data processing, \$172 thousand in professional services, \$141 thousand in personnel severance and \$43 thousand in other expenses) compared to \$504 thousand in the same period last year (\$458 thousand in professional services and \$46 thousand in other expenses). Additionally, higher occupancy and equipment expenses related to rent for the two acquired branches from Bank of Napa and the amortization of \$381 thousand of the core-deposit intangible ("CDI") that arose from the Bank of Napa acquisition also contributed to the increase.

Provision for Income Taxes

The provision for income taxes for the third quarter of 2018 totaled \$3.1 million at an effective tax rate of 26.5%, compared to \$2.7 million at an effective tax rate of 34.4% in the same quarter last year. The provision for income taxes for the nine months ended September 30, 2018 totaled \$7.5 million at an effective tax rate of 24.5%, compared to \$7.4 million at an effective tax rate of 33.4% for the same period in 2017. The declines for the 2018 periods compared to the prior year periods reflect the reduction in the federal corporate income tax rate from 35% to 21% related to the enactment of the Tax Cuts and Jobs Act of 2017 that was signed into law on December 22, 2017, effective January 1, 2018. Income tax provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income, and adjusted for the effects of all permanent differences between income for tax and financial reporting purposes (such as earnings on tax exempt loans and municipal securities, BOLI, and low-income housing tax credits) as well as transactions with discrete tax effects (such as the exercise of stock options, the disqualifying dispositions of incentive stock options and vesting of restricted stock awards). The resulting reduction in the federal statutory rate was partially offset by the effect of the higher level of expected pre-tax income in 2018 and elimination or reductions to the deductibility of certain meals, entertainment, parking and transportation expenses due to the Tax Cuts and Jobs Act of 2017. We expect the effective tax rate for the nine months ended September 30, 2018 to be indicative of the effective tax rate for the year, not including the effect of discrete items described above.

We file a consolidated return in the U.S. Federal tax jurisdiction and a combined return in the State of California tax jurisdiction. There were no ongoing federal or state income tax examinations at the issuance of this report. At September 30, 2018, neither the Bank nor Bancorp had accruals for interest nor penalties related to unrecognized tax benefits.

FINANCIAL CONDITION SUMMARY

At September 30, 2018, assets totaled \$2,545.7 million, an increase of \$77.6 million when compared to \$2,468.2 million at December 31, 2017. Excess cash was mainly deployed into investment securities and new loans during the first nine months of 2018 as discussed below.

Investment Securities

The investment securities portfolio totaled \$569.8 million at September 30, 2018, an increase of \$86.3 million from December 31, 2017. The increase reflects year-to-date purchases of investment securities that are either issued or

guaranteed by the US government totaling \$176.6 million, which were offset by paydowns, maturities and sales totaling \$78.8 million, amortization of premiums net of accretion of discounts totaling \$2.2 million, and a \$9.4 million net increase in unrealized losses on available-for-sale securities. During the second quarter of 2018, as part of our ongoing review of our investment securities portfolio, we reassessed the classification of certain securities issued by government sponsored agencies and transferred \$27.4 million of these securities from available-for-sale to held-to-maturity at fair value. We maintain liquidity to support our future loan growth by holding investment securities averaging less than 5 years duration and cash earning 2.20% at the Federal Reserve Bank as of September 30, 2018.

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

The following table summarizes our investment in obligations of state and political subdivisions at September 30, 2018 and December 31, 2017.

(dollars in thousands)	September 30, 2018			December 31, 2017		
	Amortized Cost	Fair Value	% of Total State and Political Subdivisions	Amortized Cost	Fair Value	% of Total State and Political Subdivisions
<b>Within California:</b>						
General obligation bonds	\$ 14,528	\$ 14,364	16.1 %	\$ 19,634	\$ 19,678	16.7 %
Revenue bonds	9,341	9,324	10.3	11,660	11,776	9.9
Tax allocation bonds	5,423	5,441	6.0	6,099	6,234	5.2
Total within California	29,292	29,129	32.4	37,393	37,688	31.8
<b>Outside California:</b>						
General obligation bonds	53,029	51,244	58.8	68,890	68,454	58.5
Revenue bonds	7,911	7,839	8.8	11,390	11,346	9.7
Total outside California	60,940	59,083	67.6	80,280	79,800	68.2
Total obligations of state and political subdivisions	\$ 90,232	\$ 88,212	100.0 %	\$ 117,673	\$ 117,488	100.0 %

The portion of the portfolio outside the state of California is distributed among twenty states. Of the total investment in obligations of state and political subdivisions, the largest concentrations outside California are Washington (12.2%), Texas (11.4%), and Minnesota (8.9%). Revenue bonds, both within and outside California, primarily consist of bonds relating to essential services (such as public improvements, transportation and utilities) and school district bonds.

Investments in states, municipalities and political subdivisions are subject to an initial pre-purchase credit assessment and ongoing monitoring. Key considerations include:

- The soundness of a municipality's budgetary position and stability of its tax revenues
- Debt profile and level of unfunded liabilities, diversity of revenue sources, taxing authority of the issuer
- Local demographics/economics including unemployment data, largest taxpayers and local employers, income indices and home values
- For revenue bonds, the source and strength of revenue for municipal authorities including the obligor's financial condition and reserve levels, annual debt service and debt coverage ratio, and credit enhancement (such as insurer's strength and collateral in escrow accounts)
- Credit ratings by major credit rating agencies

#### Loans

Loans increased by \$49.9 million and totaled \$1,728.9 million at September 30, 2018, compared to \$1,679.0 million at December 31, 2017. New loan originations in the first nine months of 2018 of \$165.8 million were primarily in commercial real estate, including both owner-occupied and investor-owned, spread throughout our markets, and tenancy-in-common fractional interest loans. Loan pay-offs totaled \$52.0 million in the third quarter and \$120.8 year-to-date. Year-to-date payoffs were slightly higher than 2017 and were due to a variety of reasons, primarily asset sales and refinancing activities.

#### Liabilities

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

During the first nine months of 2018, total liabilities increased by \$66.0 million to \$2,237.1 million. Deposits increased \$64.2 million in the first nine months of 2018, primarily due to fluctuations from large commercial clients' operational cash flows. Non-interest bearing deposits increased \$95.8 million in the first nine months of 2018 to \$1,109.9 million, or 50.2% of total deposits at September 30, 2018, compared to 47.2% at December 31, 2017.

## Capital Adequacy

We are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements as set forth in the following tables can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on our consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and the Bank's prompt corrective action classification are also subject to qualitative judgments by the regulators about components of capital, risk weightings and other factors.

Management reviews capital ratios on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet our anticipated future needs. For all periods presented, the Bank's ratios exceed the regulatory definition of "well capitalized" under the regulatory framework for prompt corrective action and Bancorp's ratios exceed the required minimum ratios to be considered a well-capitalized bank holding company. In addition, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action as of June 30, 2018. There are no conditions or events since that notification that Management believes have changed the Bank's categories and we expect the Bank to remain well capitalized for prompt corrective action purposes.

In July 2013, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency ("Agencies") finalized regulatory capital rules known as "Basel III." The rules became effective beginning January 2015, and will be fully phased-in by January 2019. The guidelines, among other things, changed the minimum capital requirements of banks and bank holding companies, by increasing the Tier 1 capital to risk-weighted assets ratio to 6%, and introduced a new requirement to maintain a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%. By 2019, when fully phased in, the rules will require further increases to certain minimum capital requirements and a capital conservation buffer of an additional 2.5% of risk-weighted assets.

We have modeled our ratios under the fully phased-in Basel III rules, and based on present facts and the recently announced \$25 million share repurchase program, we do not expect that we will be required to raise additional capital as a result of the fully phased-in rules.

The Bancorp's and Bank's capital adequacy ratios as of September 30, 2018 and December 31, 2017 are presented in the following tables. Bancorp's Tier 1 capital includes the subordinated debentures, which are not included at the Bank level. We continued to build capital in 2018 through the accumulation of net income. Our Share Repurchase Program announced on April 23, 2018 may affect future capital levels, as described in Item 1. Note 7, Stockholders Equity, of this Form 10-Q.

Capital Ratios for Bancorp (dollars in thousands)	Actual Ratio		Adequately Capitalized Threshold <sup>1</sup>		Ratio to be a Well Capitalized Bank Holding Company	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2018						
Total Capital (to risk-weighted assets)	\$ 306,006	15.29 %	\$ 197,693	9.87 %	\$ 200,195	10.00 %
Tier 1 Capital (to risk-weighted assets)	\$ 289,231	14.45 %	\$ 157,654	7.87 %	\$ 160,156	8.00 %
Tier 1 Capital (to average assets)	\$ 289,231	11.74 %	\$ 8,528	4.00 %	\$ 23,160	5.00 %
Common Equity Tier 1 (to risk-weighted assets)	\$ 283,400	14.16 %	\$ 27,625	6.37 %	\$ 30,127	6.50 %
December 31, 2017						
Total Capital (to risk-weighted assets)	\$ 287,435	14.91 %	\$ 78,323	9.25 %	\$ 92,782	10.00 %
Tier 1 Capital (to risk-weighted assets)	\$ 270,710	14.04 %	\$ 39,767	7.25 %	\$ 54,225	8.00 %



Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Tier 1 Capital (to average assets) \$270,710 12.13% ≥ \$9,285 ≥ 4.00% ≥ \$11,607 ≥ 5.00%

Common Equity Tier 1 (to risk-weighted assets) \$265,119 13.75% ≥ \$10,849 ≥ 5.75% ≥ \$25,308 ≥ 6.50%

<sup>1</sup> The adequately capitalized threshold includes the capital conservation buffer that was effective January 1, 2016.

These ratios are not reflected on a fully phased-in basis, which will occur in January 2019.

Page-42

---

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

Capital Ratios for the Bank (dollars in thousands)	Actual Ratio		Adequately Capitalized Threshold <sup>1</sup>		Ratio to be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2018						
Total Capital (to risk-weighted assets)	\$274,656	13.72%	\$97,646	9.87%	\$200,147	10.00%
Tier 1 Capital (to risk-weighted assets)	\$257,881	12.88%	\$57,616	7.87%	\$60,118	8.00%
Tier 1 Capital (to average assets)	\$257,881	10.47%	\$8,508	4.00%	\$23,135	5.00%
Common Equity Tier 1 (to risk-weighted assets)	\$257,881	12.88%	\$27,594	6.37%	\$30,096	6.50%
December 31, 2017						
Total Capital (to risk-weighted assets)	\$283,885	14.73%	\$78,281	9.25%	\$92,737	10.00%
Tier 1 Capital (to risk-weighted assets)	\$267,160	13.86%	\$39,734	7.25%	\$54,189	8.00%
Tier 1 Capital (to average assets)	\$267,160	11.97%	\$9,275	4.00%	\$11,593	5.00%
Common Equity Tier 1 (to risk-weighted assets)	\$267,160	13.86%	\$10,824	5.75%	\$25,279	6.50%

<sup>1</sup> The adequately capitalized threshold includes the capital conservation buffer that was effective January 1, 2016. These ratios are not reflected on a fully phased-in basis, which will occur in January 2019.

### Liquidity

The goal of liquidity management is to provide adequate funds to meet loan demand and to fund operating activities and deposit withdrawals. We accomplish this goal by maintaining an appropriate level of liquid assets and formal lines of credit with the FHLB, FRBSF and correspondent banks that enable us to borrow funds as discussed in Note 6 to the Consolidated Financial Statements in ITEM 1 of this report. Our Asset Liability Management Committee ("ALCO"), which is comprised of independent Bank directors and the President and Chief Executive Officer, is responsible for approving and monitoring our liquidity targets and strategies. ALCO has adopted a contingency funding plan that provides early detection of potential liquidity issues in the market or the Bank and institutes prompt responses that may prevent or alleviate a potential liquidity crisis. Management monitors liquidity daily and regularly adjusts our position based on current and future liquidity needs. We also have relationships with third party deposit networks and can adjust the placement of our deposits via reciprocal or one-way sales, as part of our cash management strategy.

We obtain funds from the repayment and maturity of loans, deposit inflows, investment security maturities and paydowns, federal funds purchases, FHLB advances, other borrowings, and cash flow from operations. Our primary uses of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificates of deposit, repayment of borrowings and dividends to common stockholders.

The most significant factor in our daily liquidity position has been the level of customer deposits. We attract and retain new deposits, which depends upon the variety and effectiveness of our customer account products, service and convenience, and rates paid to customers, as well as our financial strength. The cash cycles of some of our large commercial depositors may cause short-term fluctuations in their deposit balances held with us.

At September 30, 2018 our liquid assets, which included unencumbered available-for-sale securities and cash, totaled \$496.4 million, a decrease of \$5.6 million from December 31, 2017. Our cash and cash equivalents decreased \$60.8 million from December 31, 2017. Significant uses of liquidity during the first nine months of 2018 were \$176.6 million in investment securities purchased, \$50.3 million in loan originations and advances, net of repayments, \$6.4 million in cash dividends paid on common stock to our shareholders, and \$1.3 million in common stock repurchases. Significant sources of liquidity during the first nine months of 2018 included \$78.8 million in paydowns, maturities and sales of investment securities, an increase in deposits of \$64.2 million, and \$31.3 million net cash provided by operating activities. Refer to the Consolidated Statement of Cash Flows in this Form 10-Q for additional information on our sources and uses of liquidity. Management anticipates that our current strong liquidity position and core deposit base will provide adequate liquidity to fund our operations.

Undrawn credit commitments, as discussed in Note 8 to the Consolidated Financial Statements in this Form 10-Q, totaled \$483.3 million at September 30, 2018. These commitments, to the extent used, are expected to be funded primarily through the repayment of existing loans, deposit growth and liquid assets. Over the next twelve months, \$83.2 million of time deposits will mature. We expect new deposits to replace these funds. Our emphasis on local deposits combined with our equity position, provides a very stable funding base.

Since Bancorp is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to Bancorp without advance regulatory approval is restricted to the lesser of the Bank's retained earnings or the amount of the Bank's net profits from the previous three fiscal years less the amount of dividends paid during that period. The primary uses of funds for Bancorp are shareholder dividends and ordinary operating expenses. Bancorp held \$31.3 million of cash at September 30, 2018, which is deemed sufficient to cover Bancorp's operational needs, share repurchases, early redemption of subordinated debentures, and cash dividends to shareholders through the end of 2018. Management anticipates that there will be sufficient earnings at the Bank to provide dividends to Bancorp to meet its funding requirements for the near future.

### ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

Market risk is defined as the risk of loss arising from an adverse change in the market value (or prices) of financial instruments. A significant form of market risk is interest rate risk, which is inherent in our investment, borrowing, lending and deposit gathering activities. The Bank manages interest rate sensitivity to minimize the exposure of our net interest margin, earnings, and capital to changes in interest rates. Interest rate changes can create fluctuations in the net interest margin due to an imbalance in the timing of repricing or maturity of assets or liabilities.

We expect our net interest margin to increase if rates go up, primarily due to our cash earning the Federal Funds rate, adjustable rate loans and our significant non-interest bearing deposit base. Our net interest income remains most vulnerable to a falling interest rate environment.

To mitigate interest rate risk, the structure of the Consolidated Statement of Condition is managed with the objective of correlating the effects of interest rate changes on loans and investments with those of deposits and borrowings. The asset liability management policy sets limits on the acceptable amount of change to net interest income and economic value of equity under a variety of interest rate scenarios.

From time to time, we enter into interest rate swap contracts to mitigate the changes in the fair value of specified long-term fixed-rate loans and firm commitments to enter into long-term fixed-rate loans caused by changes in interest rates. See Note 9 to the Consolidated Financial Statements in this Form 10-Q.

ALCO and the Board of Directors review our exposure to interest rate risk at least quarterly. We use simulation models to measure interest rate risk and to evaluate strategies to improve profitability. A simplified static statement of condition is prepared on a quarterly basis as a starting point, using instrument level data of our actual loans, investments, borrowings and deposits as inputs. If potential changes to net equity value and net interest income resulting from hypothetical interest rate changes are not within the limits established by the Board of Directors, Management may adjust the asset and liability mix to bring the risk position within approved limits or take other actions. At September 30, 2018, interest rate risk was within policy guidelines established by ALCO and the Board.

One set of interest rates modeled and evaluated against flat interest rates is a series of immediate parallel shifts in the yield curve. These are provided in the following table as an example rather than an expectation of likely interest rate movements.

Page-44

---

Immediate Changes in Interest Rates (in basis points)	Estimated Change in Net Interest Income in Year 1, as percent of Net Interest Income	Estimated Change in Net Interest Income in Year 2, as percent of Net Interest Income	
up 400	(0.3	)% 8.4	%
up 300	—	% 6.6	%
up 200	—	% 4.5	%
up 100	0.3	% 3.1	%
down 100	(6.0	)% (10.1	)%

Interest rate sensitivity is a function of the repricing characteristics of our assets and liabilities. The Bank runs a combination of scenarios and sensitivities in its attempt to capture the range of interest rate risk including the simulations mentioned above. As with any simulation model or other method of measuring interest rate risk, limitations are inherent in the process and dependent on assumptions. For example, if we choose to pay interest on certain business deposits that are currently non-interest bearing, causing these deposits to become rate sensitive in the future, we would become less asset sensitive than the model currently indicates. Assets and liabilities may react differently to changes in market interest rates in terms of both timing and responsiveness to market rate movements. Further, the actual rates and timing of prepayments on loans and investment securities, and the behavior of depositors, could vary significantly from the assumptions applied in the various scenarios.

#### ITEM 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

Bank of Marin Bancorp and its subsidiary (the "Company") conducted an evaluation under the supervision and with the participation of our Management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 (the "Act")) as of the end of the period covered by this report. The term disclosure controls and procedures means controls and other procedures that are designed to ensure that information we are required to disclose in the reports that we file or submit under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit under the Act is accumulated and communicated to our Management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

##### Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2018, there were no significant changes that materially affected, or are reasonably likely to affect, our internal control over financial reporting. The term internal control over financial reporting, as defined by Rule 15d-15(f) of the Act, is a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.



PART II OTHER INFORMATION

ITEM 1 Legal Proceedings

Refer to Note 12 to the Consolidated Financial Statements in Item 8 of our 2017 Form 10-K and Note 8 to the Consolidated Financial Statements in this Form 10-Q.

ITEM 1A Risk Factors

There have been no material changes from the risk factors previously disclosed in our 2017 Form 10-K. Refer to "Risk Factors" in Item 1A of our 2017 Form 10-K, pages 10 through 20.

ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

On April 23, 2018, Bancorp announced that its Board of Directors approved a Share Repurchase Program under which Bancorp may repurchase up to \$25.0 million of its outstanding common stock through May 1, 2019. For additional information, refer to Note 7 to the Consolidated Financial Statements in this Form 10-Q.

From April 23, 2018 to September 30, 2018, Bancorp purchased 17,943 at an average price of \$85.76 and a total cost of \$1.5 million. The following table reflects purchases under the Share Repurchase Program for the periods presented.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value That May yet Be Purchased Under the Program
April 23-30, 2018	—	\$ —	—	\$ 25,000
May 1-31, 2018	1,398	74.06	1,398	24,896
June 1-30, 2018	—	—	—	24,896
July 1-31, 2018	—	—	—	24,896
August 1-31, 2018	4,444	88.85	4,444	24,501
September 1-30, 2018	12,101	85.98	12,101	23,460
Total	17,943	\$ 85.76	17,943	

ITEM 3 Defaults upon Senior Securities

None.

ITEM 4 Mine Safety Disclosures

Not applicable.

ITEM 5 Other Information

None.





Edgar Filing: Bank of Marin Bancorp - Form 10-Q

ITEM 6 Exhibits

The following exhibits are filed as part of this report or hereby incorporated by references to filings previously made with the SEC.

Exhibit Number	Exhibit Description	Incorporated by Reference				
		Form	File No.	Exhibit	Filing Date	
2.01	<u>Agreement to Merger and Plan of Reorganization with Bank of Napa, dated July 31, 2017</u>	8-K	001-33572	2.1	August 2, 2017	
3.01	<u>Articles of Incorporation, as amended</u>	10-Q	001-33572	3.01	November 7, 2007	
3.02	<u>Bylaws</u>	10-Q	001-33572	3.02	May 9, 2011	
3.02a	<u>Bylaw Amendment</u>	8-K	001-33572	3.03	July 6, 2015	
4.01	<u>Rights Agreement, dated July 6, 2017</u>	8-A12B	001-33572	4.1	July 7, 2017	
10.01	<u>Employee Stock Ownership Plan</u>	S-8	333-218274	4.1	May 26, 2017	
10.02	<u>2017 Employee Stock Purchase Plan</u>	S-8	333-221219	4.1	October 30, 2017	
10.03	<u>2017 Equity Plan</u>	S-8	333-227840	4.1	October 15, 2018	
10.04	<u>2010 Director Stock Plan</u>	S-8	333-167639	4.1	June 21, 2010	
10.05	<u>Form of Indemnification Agreement for Directors and Executive Officers, dated August 9, 2007</u>	10-Q	001-33572	10.06	November 7, 2007	
10.06	<u>Form of Employment Agreement, dated January 23, 2009</u>	8-K	001-33572	10.1	January 26, 2009	
10.07	<u>2010 Annual Individual Incentive Compensation Plan</u>	8-K	001-33572	99.1	October 21, 2010	
10.08	<u>Salary Continuation Agreement for executive officer Russell Colombo, Chief Executive Officer, dated January 1, 2011</u>	8-K	001-33572	10.1	January 6, 2011	
10.09	<u>Salary Continuation Agreement for executive officer Peter Pelham, Director of Retail Banking, dated January 1, 2011</u>	8-K	001-33572	10.4	January 6, 2011	
10.10	<u>Salary Continuation Agreement for executive officer Tani Girton, Chief Financial Officer, dated October 18, 2013</u>	8-K	001-33572	10.2	November 4, 2014	
10.11	<u>Salary Continuation Agreement for executive officer Elizabeth Reizman, Chief Credit Officer, dated July 20, 2014</u>	8-K	001-33572	10.3	November 4, 2014	
10.12	<u>Salary Continuation Agreement for executive officer Timothy Myers, Executive Vice President and Commercial Banking Manager, dated May 28, 2015</u>	8-K	001-33572	10.4	June 2, 2015	
10.13	<u>2007 Form of Change in Control Agreement</u>	8-K	001-33572	10.1	October 31, 2007	
11.01	<u>Earnings Per Share Computation - included in Note 1 to the Consolidated Financial Statements</u>					Filed
31.01	<u>Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>					Filed

Edgar Filing: Bank of Marin Bancorp - Form 10-Q

31.02	<u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed
32.01	<u>Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002</u>	Filed
101.01*	XBRL Interactive Data File	Furnished

\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

---

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Bank of Marin Bancorp  
(registrant)

November 6, 2018 /s/ Russell A. Colombo  
Date Russell A. Colombo  
President &  
Chief Executive Officer  
(Principal Executive Officer)

November 6, 2018 /s/ Tani Girton  
Date Tani Girton  
Executive Vice President &  
Chief Financial Officer  
(Principal Financial Officer)

November 6, 2018 /s/ Cecilia Situ  
Date Cecilia Situ  
First Vice President &  
Manager of Finance & Treasury  
(Principal Accounting Officer)