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Bank of Marin Bancorp
Form 10-K
March 11, 2011

BANK OF MARIN BANCORP

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

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

For the fiscal year ended: December 31, 2010
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
(State or other jurisdiction of incorporation)

20-8859754
(IRS Employer Identification No.)

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

94947
(Zip Code)

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

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

None

Securities registered pursuant to section 12(g) of the Act:

Common Stock, No Par Value,
and attached Share Purchase Rights
(Title of each class)

NASDAQ Capital Market
(Name of each exchange on which registered)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes £ No T

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes

No

Note – checking the box above will not relieve any registrant required to file reports pursuant to section 13 or 15(d) of the Exchange Act from their obligations under these sections.

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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 T

No F

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes F

No F

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this form 10-K or any amendment to this Form 10-K. F

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer F

Accelerated filer T

Non-accelerated filer F

Smaller reporting company F

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

Yes F No T

As of June 30, 2010, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting and non-voting common equity held by non-affiliates, based upon the closing price per share of the registrant's common stock as reported by the NASDAQ, was approximately \$163 million. For the purpose of this response, directors and officers of the Registrant are considered the affiliates at that date.

As of February 28, 2011 there were 5,300,685 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 17, 2011 are incorporated by reference into Part III.

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PART I

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 may include descriptions of plans or objectives of Management for future operations, products or services, and forecasts of our 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 such as "will," "would," "should," "could" or "may."

Forward-looking statements are based on Management's current expectations regarding economic, legislative, and regulatory issues that may impact 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's expectations. Such factors include, but are not limited to, general economic conditions, the current financial turmoil in the United States and abroad, changes in interest rates, deposit flows, real estate values and competition; changes in accounting principles, policies or guidelines; changes in legislation or regulation; and other economic, competitive, governmental, regulatory and technological factors affecting our operations, pricing, products and services. These and other important factors are detailed in Item 1A Risk Factors section of this report. 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.

ITEM 1.

BUSINESS

Bank of Marin (the "Bank") was incorporated in August 1989, received its charter from the California Superintendent of Banks (now the California Department of Financial Institutions or "DFI") and commenced operations in January 1990. The Bank is an insured bank under the Federal Deposit Insurance Act ("FDIC"). On July 1, 2007 (the "Effective Date"), a bank holding company reorganization was completed whereby Bank of Marin Bancorp ("Bancorp") became the parent holding company for the Bank, the sole and wholly-owned subsidiary of Bancorp. On the Effective Date, each outstanding share of Bank of Marin common stock was converted into one share of Bank of Marin Bancorp common stock. Bancorp assumed the ticker symbol BMRC, which was formerly used by the Bank. Prior to the Effective Date, the Bank filed reports and proxy statements with the FDIC pursuant to Sections 12 of the Securities Exchange Act of 1934 (the "1934 Act"). Upon formation of the holding company, Bancorp became subject to regulation under the Bank Holding Company Act of 1956, as amended, which subjects Bancorp to Federal Reserve Board reporting and examination requirements.

References in this report to "Bancorp" mean Bank of Marin Bancorp, parent holding company for the Bank. References to "we," "our," "us" mean the holding company and the Bank that are consolidated for financial reporting purposes.

Virtually all of our business is conducted through Bancorp's sole subsidiary, the Bank, which is headquartered in Novato, California. As of December 31, 2010, we operated through sixteen offices in San Francisco, Marin and

Sonoma counties with a strong focus on supporting the local community. As discussed in Note 19 to the Consolidated Financial Statements in Item 8 of this report, in February 2011, we expanded our community banking footprint to Napa County through an FDIC-assisted acquisition of certain assets and assumption of certain liabilities of the former Charter Oak Bank. Our customer base is made up of business and personal banking relationships from the communities near the branch office locations. Our business banking focus is on small to medium-sized businesses, professionals and not-for-profit organizations.

We offer a broad range of commercial and retail deposit and lending programs designed to meet the needs of our target markets. Our loan products include commercial loans and lines of credit, construction financing, consumer loans, and home equity lines of credit. Merchant card services are available for our customers in retail businesses. Through a third party vendor, we offer a proprietary Visa® credit card product combined with a rewards program to our customers, as well as a Business Visa® program for business and professional customers. We also offer cash management sweep to business clients through a third party vendor.

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We offer a variety of personal and business checking and savings accounts, and a number of time deposit alternatives, including time certificates of deposit, Individual Retirement Accounts (“IRAs”), Health Savings Accounts, and Certificate of Deposit Account Registry Service (“CDARS®”). CDARS® is a network through which we offer full FDIC insurance coverage in excess of the regulatory maximum by placing deposits in multiple banks participating in the network. We also offer remote deposit capture, direct deposit of payroll, social security and pension checks, fraud prevention services including an insurance protected Identity Theft Prevention Program and image lockbox services. A valet deposit pick-up service is available to our professional and business clients. Automatic teller machines (“ATM’s”) are available at each branch location.

Our ATM network is linked to the PLUS and NYCE networks. In January 2009, we began offering free access to a network of nation-wide surcharge-free ATM’s called MoneyPass. We also offer our depositors 24-hour access to their accounts by telephone and through our internet banking products available to personal and business account holders.

We offer Wealth Management and Trust Services (“WMTS”) which include customized investment portfolio management, financial planning, trust administration, estate settlement and custody services, and advice of charitable giving. We also offer 401(k) plan services to small and medium businesses through a third party vendor.

We offer branch-based Private Banking as a natural extension of our services. Our Private Banking includes deposit services and loans, as well as a full range of banking services.

We do not directly offer international banking services, but do make such services available to our customers through other financial institutions with whom we have correspondent banking relationships.

We hold no patents, licenses (other than licenses required by the appropriate banking regulatory agencies), franchises or concessions. The Bank has registered the service marks "The Spirit of Marin", the words “Bank of Marin”, the Bank of Marin logo, and the Bank of Marin tagline “Committed to your business and our community” with the United States Patent & Trademark Office. In addition, Bancorp has registered the service marks for the words “Bank of Marin Bancorp” and for the Bank of Marin Bancorp logo with the United States Patent & Trademark Office.

All service marks registered by Bancorp or the Bank are registered on the United States Patent & Trademark Office Principal Register, with the exception of the words "Bank of Marin Bancorp" which is registered on the United States Patent & Trademark Office Supplemental Register.

Market Area

Our primary market area reaches from Sonoma County to San Francisco and lies between the Pacific Ocean on the west and San Francisco Bay to the east. See also Note 19 to the Consolidated Financial Statements in Item 8 of this report regarding our subsequent expansion into Napa County in February 2011. Our customer base is made up of business and personal banking relationships from the communities near the branch office locations.

We attract deposit relationships from individuals, merchants, small to medium-sized businesses, not-for-profit organizations and professionals who live and/or work in the communities comprising our market areas. As of December 31, 2010, approximately 82% of our deposits are in Marin and southern Sonoma counties, and approximately 56% of our deposits are from businesses and 44% are from individuals.

Competition

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The banking business in California generally, and in our market area specifically, is highly competitive with respect to attracting both loan and deposit relationships. The increasingly competitive environment is impacted by changes in regulation, interest rate environment, technology and product delivery systems, and the consolidation among financial service providers. The banking industry is seeing extreme competition for quality loans. Larger banks are seeking to expand lending to small businesses, which are traditionally community bank customers. The Marin County market area is dominated by two major nation-wide banks, each of which has more branch offices than us in the defined service area. Additionally, there are several thrifts, credit unions and other independent banks.

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As of June 30, 2010, the latest data available shows 89 banking offices with \$8.8 billion in total deposits served the Marin County market. As of that same date, there were approximately 3 thrift offices in Marin with \$0.6 billion in total deposits. We have the largest business core deposit market share, representing 24.3% of business core deposits in Marin County¹. A significant driver of our franchise value is the growth and stability of our checking and savings deposits, which are a low cost funding source for our loan portfolio. We have also gained overall deposit market share in our primary market area in 2010¹. The four financial institutions with the greatest deposit market share in Marin County are Wells Fargo Bank, Bank of America, Bank of Marin, and Westamerica Bank with deposit market shares of 26.0% and 17.9%, 9.9%, and 8.6%, respectively¹.

In the southern Sonoma County area of Petaluma, there are approximately 25 banking and thrift offices with \$1.5 billion in total deposits as of June 30, 2010. Compared with our share of 4.5%, the four banking institutions with the greatest overall market share, Wells Fargo Bank, Bank of America, Bank of the West, and First Community Bank had deposit market shares in Petaluma of 28.7%, 15.6%, 9.3%, and 8.9%, respectively¹.

We also compete for depositors' funds with money market mutual funds and with non-bank financial institutions such as brokerage firms and insurance companies. Among the competitive advantages held by some of these non-bank financial institutions are their ability to finance extensive advertising campaigns, and to allocate investment assets to regions of California or other states with areas of highest demand and, therefore, often higher yield.

Nationwide banks have the competitive advantages of national advertising campaigns and technology infrastructure to achieve economies of scale. Large commercial banks also have substantially greater lending limits and have the ability to offer certain services which are not offered directly by us.

In order to compete with the numerous, and often larger, financial institutions in our primary market area, we use, to the fullest extent possible, the flexibility and rapid response capabilities which are accorded by our independent status. Our competitive advantages also include an emphasis on personalized services, community involvement, philanthropic giving, local promotional activities and personal contacts. The commitment and dedication of our organizers, directors, officers and staff have also contributed greatly to our success in competing for business.

Employees

At December 31, 2010, we employed 203 full-time equivalent (“FTE”) staff. The actual number of employees, including part-time employees, at year-end 2010 included 4 executive officers, 77 other corporate officers and 142 staff. None of our employees are presently represented by a union or covered by a collective bargaining agreement. We believe that our employee relations are good. We have been recognized as one of the “Best Places to Work in the San Francisco Bay Area” by the San Francisco Business Times and the “Best Places to Work” by North Bay Business Journal.

SUPERVISION AND REGULATION

Bank holding companies and banks are extensively regulated under both federal and state law. The following discussion summarizes certain significant laws, rules and regulations affecting Bancorp and the Bank.

Bank Holding Company Regulation

Upon formation of the bank holding company on July 1, 2007, we became subject to regulation under the Bank Holding Company Act of 1956, as amended (“BHCA”) which subjects Bancorp to Federal Reserve Board reporting and examination requirements. Under the Federal Reserve Board’s regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks.

1 Based on the latest available FDIC deposit market share data as of June 30, 2010.

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The BHCA regulates the activities of holding companies including acquisitions, mergers and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities.

Bank Regulation

Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole. These regulations affect our lending practices, consumer protections, capital structure, investment practices and dividend policy.

As a state chartered bank, we are subject to regulation and examination by the DFI. We are also subject to regulation, supervision and periodic examination by the FDIC. If, as a result of an examination of the Bank, the FDIC or the DFI should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of our operations are unsatisfactory, or that we have violated any law or regulation, various remedies are available to those regulators including issuing a "cease and desist" order, restricting our growth or removing officers and directors.

Dividends

The payment of cash dividends by the Bank to Bancorp is subject to restrictions set forth in the California Financial Code (the "Code"). Prior to any distribution from the Bank to Bancorp, a calculation is made to ensure compliance with the provisions of the Code and to ensure that the Bank remains within capital guidelines set forth by the DFI and the FDIC. As the Bank made a \$28 million distribution to Bancorp in March 2009 in connection with Bancorp's repurchase of preferred stock discussed in Note 9 to the Consolidated Financial Statements in Item 8 of this report, distributions from the Bank to Bancorp are subject to advance regulatory approval from the DFI for three years beginning in 2010. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to Bancorp to meet its funding requirements for the foreseeable future. See also Note 9 to the Consolidated Financial Statements, under the heading "Dividends" in Item 8 of this report.

FDIC Insurance Assessments

Our deposits are insured by the FDIC to the maximum amount permitted by law, which is currently \$250,000 per depositor. The 2010 enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") made the deposit insurance coverage permanent at the \$250,000 level retroactive to January 1, 2008. The Dodd-Frank act also provides depositors at all FDIC-insured institutions with unlimited deposit insurance coverage on traditional checking accounts that do not pay interest and Interest on Lawyers Trust Accounts beginning December 31, 2010 through the end of 2012.

During 2009 and 2010, we elected to participate in the Temporary Transaction Account Guarantee Program, which provided full deposit insurance coverage to non-interest bearing transaction accounts (including low-interest negotiable order of withdrawal accounts and interest on lawyer trust accounts), by paying a 10 basis point surcharge on the non-interest bearing transaction accounts over \$250,000 through December 31, 2009, and a 15 basis point surcharge through December 31, 2010, when the program ended.

Effective April 1, 2009, the FDIC revised its risk-based insurance assessment system, effectively increasing the overall assessment rate. The revised base assessment rates for banks in the best risk category range from twelve to sixteen cents annually for every \$100 of domestic deposits held. In addition, the FDIC also imposed a one-time special Deposit Insurance assessment of five basis points on all insured institutions' total assets minus Tier 1 capital at June 30, 2009 in order to replenish the Deposit Insurance Fund. On November 12, 2009, the FDIC finalized a Deposit

Insurance Fund restoration plan that required banks to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. Under the plan, banks were assessed through 2010 according to the risk-based premium schedule adopted in April 2009.

On February 7, 2010, as required by the Dodd-Frank Act, the FDIC approved a rule that changes the FDIC insurance assessment base from adjusted domestic deposits to a bank's average consolidated total assets minus average tangible equity, defined as Tier 1 capital. Since the new base is larger than the current base, the new rule lowers assessment rates to between 2.5 and 9 basis points on the broader base for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. The change will be effective beginning with the second quarter of 2011 and payable at the end of September 2011. The new rule is expected to lower our FDIC insurance by more than 30%. Since we have a solid core deposit base and do not rely heavily on borrowings and brokered deposits, the benefit of the lower assessment rate (which is expected to drop by half for us) will significantly outweigh the effect of a wider assessment base.

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The following discussion summarizes certain significant laws, rules and regulations affecting both Bancorp and the Bank

Community Reinvestment Act

We are subject to the provisions of the Community Reinvestment Act (“CRA”), under which all banks and thrifts have a continuing and affirmative obligation, consistent with safe and sound operations, to help meet the credit needs of their entire communities, including low and moderate income neighborhoods. The act requires a depository institution’s primary federal regulator, in connection with its examination of the institution, to assess the institution’s record in meeting the requirements in CRA. The regulatory agency’s assessment of the institution’s record is made available to the public. The record is taken into consideration when the institution establishes a new branch that accepts deposits, relocates an office, applies to merge or consolidate, or expands into other activities. CRA performance is evaluated by the FDIC under the intermediate small bank requirements. The FDIC’s last CRA and consumer compliance examination performed on us was completed on May 7, 2009 with a rating of “Satisfactory,” which is the highest rating possible.

Anti Money–Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 require banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and “know your customer” standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. We have extensive controls in place to comply with these requirements.

Privacy and Data Security

The Gramm-Leach Bliley Act (“GLBA”) of 1999 imposes requirements on financial institutions with respect to consumer privacy. The GLBA generally prohibits disclosure of consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. The GLBA also directs federal regulators, including the FDIC, to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to “opt out” of having non-public customer information disclosed to third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal of information that is no longer needed. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Consumer Protection Regulations

Our lending activities are subject to a variety of statutes and regulations designed to protect consumers, including the Fair Credit Reporting Act, Equal Credit Opportunity Act, the Fair Housing Act, and the Truth-in-Lending Act. Our deposit operations are also subject to laws and regulations that protect consumer rights including Funds Availability, Truth in Savings, and Electronic Funds Transfers. Additional rules govern check writing ability on certain interest earning accounts and prescribe procedures for complying with administrative subpoenas of financial records. Additionally, the provision of the Federal Reserve Regulation E has been changed effective July 1, 2010. It puts restrictions on institutions assessing overdraft fees on consumer’s accounts relating to electronic funds transfers. As a

result, our overdraft fee income has been negatively impacted.

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Restriction on Transactions between Member Banks and their Affiliates

Transactions between Bancorp and the Bank are quantitatively and qualitatively restricted under Sections 23A and 23B of the Federal Reserve Act and Federal Reserve Regulation W. Section 23A places restrictions on the Bank's "covered transactions" with Bancorp, including loans and other extensions of credit, investments in the securities of, and purchases of assets from Bancorp. Section 23B requires that certain transactions, including all covered transactions, be on market terms and conditions. Federal Reserve Regulation W combines statutory restrictions on transactions between the Bank and Bancorp with Board interpretations in an effort to simplify compliance with Sections 23A and 23B.

Capital Requirements

The Federal Reserve and the FDIC have adopted risk-based capital guidelines for bank holding companies and banks. Bancorp's ratios exceed the required minimum ratios for capital adequacy purposes and the Bank meets the definition for well capitalized. Undercapitalized depository institutions may be subject to significant restrictions. Payment of interest and principal on subordinated debt of the Bank could be restricted or prohibited, with some exceptions, if the Bank were categorized as "critically undercapitalized" under applicable FDIC regulations. For further information on risk-based capital, see Note 16 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Sarbanes-Oxley Act of 2002

We are subject to the requirements of the Sarbanes-Oxley Act of 2002 which implemented legislative reforms intended to address corporate and accounting improprieties.

Emergency Economic Stabilization Act of 2009 (the "EESA")

In response to the financial crisis affecting the banking system and financial markets and going concern threats of investment banks and other financial institutions, on October 3, 2008, the EESA was signed into law, which gave the U.S. Treasury the authority to, among other things, inject \$700 billion capital into the market to stabilize the financial industry. Pursuant to the EESA, the U.S. Treasury also purchased senior preferred shares from the largest nine financial institutions in the nation and the other financial institutions in a program known as the Treasury Capital Purchase Program ("TCPP") that was carved out of the Troubled Asset Relief Program ("TARP"). As a result of our participation in the TCPP, we were subject to restrictions on executive compensation and limitations on dividends and stock repurchases from December 5, 2008 to March 31, 2009, the period that the preferred stock issued to the U.S. Treasury was outstanding.

The American Recovery and Reinvestment Act of 2009 (the "Recovery Act")

The Recovery Act was signed into law on February 17, 2009 in an effort, among other things, to jumpstart the U.S. economy, prevent job losses, expand educational opportunities, and provide affordable health care and tax relief. Among the various measures in the Recovery Act, it imposes further restriction on executive compensation and corporate expenditure limits of recipients of the TCPP funds, while allowing them to repurchase the preferred stock at liquidation amount without regard to the original TCPP transaction terms. See Note 9 to the Consolidated Financial Statements in Item 8 of this report for discussion regarding our repurchase of preferred stock issued under the TCPP.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, a landmark financial reform bill comprised of massive volume of new rules and restrictions that will impact banks going forward. It includes key provisions aimed at preventing a repeat of the 2008 financial crisis and a new process for winding down failing, systemically important institutions in a manner as close to a controlled bankruptcy as possible. The Act includes other key provisions as follows:

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(1) The Act establishes a new Financial Stability Oversight Council to monitor systemic financial risks. The Board of Governors of the Federal Reserve (“Fed”) are given extensive new authorities to impose strict controls on large bank holding companies with total consolidated assets equal to or in excess of \$50 billion and systemically significant nonbank financial companies to limit the risk they might pose for the economy and to other large interconnected companies. The Fed can also take direct control of troubled financial companies that are considered systemically significant.

The Act restricts the amount of trust preferred securities (“TPS”) that may be considered as Tier 1 Capital. For bank holding companies below \$15 billion in total assets, TPS issued before May 19, 2010 will be grandfathered, so their status as Tier 1 capital does not change. Beginning January 1, 2013, bank holding companies above \$15 billion in assets will have a three-year phase-in period to fill the capital gap caused by the disallowance of the TPS issued before May 19, 2010. However going forward, TPS will be disallowed as Tier 1 capital.

(2) The Act creates a new process to liquidate failed financial firms in an orderly manner, including giving the FDIC broader authority to operate or liquidate a failing financial company.

(3) The Act also establishes a new independent Federal regulatory body for consumer protection within the Federal Reserve System known as the Bureau of Consumer Financial Protection (the "Bureau"), which will assume responsibility for most consumer protection laws (except the Community Reinvestment Act). It will also be in charge of setting appropriate consumer banking fees and caps. The Office of Comptroller of the Currency will continue to have authority to preempt state banking and consumer protection laws if these laws "prevent or significantly" interfere with the business of banking.

(4) The Act effects changes in the FDIC assessment as discussed in section “FDIC Insurance Assessments” above.

(5) The Act places certain limitations on investment and other activities by depository institutions, holding companies and their affiliates, including comprehensive regulation of all over-the-counter derivatives.

The impact of the Act on our banking operations is still uncertain due to the massive volume of new rules still subject to adoption and interpretation.

Available Information

On our internet web site, www.bankofmarin.com, we post the following filings as soon as reasonably practicable after they are filed with or furnished to the SEC: Annual Report on Form 10-K, Proxy Statement for the Annual Meeting of Shareholders, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934. The text of the Code of Ethical Conduct for Bancorp and the Bank is also included on the website. All such filings on our website are available free of charge. This website address is for information only and is not intended to be an active link, or to incorporate any website information into this document. In addition, copies of our filings are available by requesting them in writing or by phone from:

Corporate Secretary
Bank of Marin
504 Redwood Blvd., Suite 100
Novato, CA 94947
415-763-4523

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BANK OF MARIN BANCORP

ITEM 1A.

RISK FACTORS

An investment in our common stock is subject to risks inherent to our business. The material risks and uncertainties that Management believes may affect our business are described below. Before making an investment decision, investors should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing our business. Additional risks and uncertainties that Management is not aware of or focused on or that Management currently deems immaterial may also impair business operations. This report is qualified in its entirety by these risk factors.

If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected.

Our Earnings are Significantly Influenced by General Business and Economic Conditions

We are operating in an uncertain economic environment. While the economic recession ended in 2009 and there are signs of economic conditions improving, the persistent high unemployment rate, weak business and consumer spending, and the U.S. budget deficit underline that the economy remains very fragile. Economic recovery is expected to be slow and long. The housing market is not expected to recover soon amid a bleak job market. Business activity across a wide range of industries and regions is greatly affected. Local and state governments are in difficulty due to the reduction in sales taxes resulting from the lack of consumer spending and property taxes resulting from declining property values. Financial institutions continue to be affected by the contraction of the real estate market, elevated foreclosure rates, high unemployment rates and a stricter regulatory environment. While our service area has not experienced the same degree of challenge in unemployment as other areas², the effects of these issues have trickled down to households and businesses in our markets. There can be no assurance that the recent economic improvement is sustainable and credit worthiness of our borrowers will not deteriorate.

Continued declines in real estate values and home sale volumes, financial stress on borrowers, including job losses, and customers' inability to pay debt could adversely affect our financial condition and results of operations in the following aspects:

- Demand for our products and services may decline
- Low cost or non-interest bearing deposits may decrease
- Collateral for our loans, especially real estate, may decline further in value
- Loan delinquencies, problem assets and foreclosures may increase

Our deposit growth level has outpaced our loan growth recently, which leads to excess liquidity earning a less favorable yield. As the economy is still fragile, consumers are wary of their debts and are reducing their borrowing activities. We have noticed a decrease in loan demand due to an unfavorable economic climate and intensified competition for creditworthy borrowers, all of which could impact our ability to generate profitable loans.

² Based on the latest available labor market information from Employment Development Department. Preliminary December 2010 results show that the unemployment rate in Marin County was the lowest in California at 7.9% and in Sonoma County at 10.0%, compared to the state of California at 12.3%.

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Nonperforming Assets Take Significant Time To Resolve And Adversely Affect Our Results Of Operations And Financial Condition.

Our nonperforming assets have been maintained at a manageable level historically. As discussed in Note 19 to the Consolidated Financial Statements in Item 8 of this report, we acquired certain assets of the failed Charter Oak Bank on February 18, 2011. The acquisition may expose us to credit issues of acquired assets, which may become nonperforming in the future.

Nonperforming assets may adversely affect our net income in various ways. Until economic and market conditions improve, we expect to continue to incur additional losses relating to nonperforming assets. We do not record interest income on non-accrual loans, thereby adversely affecting our income and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related loan to the then fair market value of the collateral, which may result in a loss. While we have tried to reduce our problem assets through workouts, restructurings and otherwise, decreases in the value of these assets, or the underlying collateral, or in these borrowers' performance or financial conditions, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of nonperforming assets requires significant commitments of time from management, which can be detrimental to the performance of other responsibilities. There can be no assurance that we will not experience further increases in nonperforming loans in the future.

Recently Enacted Legislation and Other Measures Undertaken by the Government May not Help Stabilize the U.S. Financial System and The Impact of New Financial Reform Legislation is Yet to be Determined

As discussed in Item 1, Section captioned "Supervision and Regulation" above, in 2010, President Obama signed into law a landmark financial reform bill—the Dodd-Frank Act. The current rules and interpretations being considered under the Dodd-Frank Act may change banking statutes and the operating environment of Bancorp and the Bank in substantial and unpredictable ways, and could increase the cost of doing business, decrease our revenues, limit or expand permissible activities or affect the competitive balance depending upon whether or how regulations are implemented. We may be forced to invest significant management attention and resources to make any necessary changes related to the Dodd-Frank Act and any regulations promulgated there under. The ultimate effect of the changes would have on the financial condition or results of operations of Bancorp or the Bank is uncertain at this time.

The actual impact of the recently enacted legislation and such related measures undertaken to alleviate the aftermaths of the credit crisis is unknown. The capital and credit markets have experienced volatility and disruption at an unprecedented level in the past few years. In some cases, the markets have produced downward pressure on credit availability for certain issuers without regard to those issuers' underlying financial strength. If the recent years' disruption and volatility return, there can be no assurance that we will not experience an adverse effect on our ability to access credit or capital.

In addition to changes resulting from the Dodd-Frank Act, recent proposals published by the Basel Committee on Banking Supervision, if adopted, could lead to significantly higher capital requirements, higher capital charges and more restrictive leverage and liquidity ratios. On September 12, 2010, the Basel Committee announced an agreement on additional capital reforms that increases required Tier 1 capital and minimum Tier 1 common equity capital and requires banks to maintain an additional capital conservation buffer during times of economic prosperity. If adopted, it could restrict our ability to grow or require us to raise additional capital. As a result, it may affect the result of our financial condition, or business' prospects in the future.

The Recent Repeal of Federal Prohibitions on Payment of Interest on Demand Deposits Could Increase Our Interest Expense

The Dodd-Frank Act has lifted the prohibitions on payment of interest on demand deposits. Beginning on July 21, 2011, financial institutions can start paying interest on demand deposits in an effort to compete for deposits. Although we do not know what interest rates will be offered by our competitors, we would increase our interest expense and interest rate sensitivity and experience an overall decrease in the net interest margin if we were to offer interest on demand deposits to attract or retain customers. As a result, it may affect the result of our financial condition, or business' prospects in the future.

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We May Experience Unfavorable Outcomes with Growth

We seek to expand our franchise safely and consistently. A successful growth strategy requires us to manage multiple aspects of the business simultaneously, such as following adequate loan underwriting standards, balancing loan and deposit growth without increasing interest rate risk or compressing our net interest margin, maintaining sufficient capital, and recruiting, training and retaining qualified professionals. We have recently expanded into Santa Rosa and plan to expand to the town of Sonoma through a new branch opening. These new markets may have characteristics unfamiliar to us. We also expect significant increase in non-interest expenses associated with new branches with a lag in profitability.

Our growth strategy also includes merger and acquisition opportunities that either enhance our market presence or have potential for improved profitability through financial management, economies of scale or expanded services. As discussed in Note 19 to the Consolidated Financial Statement in Item 8 of this report, we acquired certain assets and certain liabilities of Napa-based Charter Oak Bank on February 18, 2011 through an FDIC-assisted transaction. While FDIC-assisted acquisitions provide attractive opportunities in part due to loans purchased at significant discounts, acquiring other banks or branches involves risks such as exposure to potential asset quality issues of the target company, potential disruption to our normal business activities and diversion of Management's time and attention due to integration and conversion efforts. If we pursue our growth strategy too aggressively and fail to execute integration properly, we may not be able to achieve expected synergies or other anticipated benefits.

Interchange Reimbursement Fees and Related Practices Have Been Receiving Significant Legal and Regulatory Scrutiny, and the Resulting Regulations Could Have a Significant Impact on Interchange Fees We Earn

The Dodd-Frank Act includes provisions that will regulate the debit interchange rates and certain other network industry practices (the "Durbin Amendment"). In addition, the Federal Reserve now has the power to regulate network fees to the extent necessary to prevent evasion of the new rules on interchange rates. The Federal Reserve has proposed rules to restrict interchange fees on debit cards to about 12 cents per transaction for institutions with \$10 billion or more in assets. Interchange represents a transfer of value between the financial institutions participating in a payments network such as Visa and NYCE, in which we participate. In connection with transactions initiated with cards in a payments system, interchange reimbursement fees are typically paid to issuers, the financial institutions such as us that issue debit cards to cardholders. They are typically paid by owners, the financial institutions that offer network connectivity and payment acceptance services to merchants.

In January 2010, Visa announced that it will implement a two-tiered pricing system for debit interchange -- one for banks with more than \$10 billion in assets, and one for all those under the \$10 billion threshold. However, it may still not alleviate the negative consequences that the Durbin amendment and the Federal Reserve's proposed rules will have for banks of all sizes and consumers. Despite the statutory attempt to separate out smaller banks from the price controls embodied in the Durbin amendment, the marketplace may drive business to the lowest cost option. Merchants may switch to lower-cost cards and accounts of larger institutions, applying downward pressure on the fees paid to small institutions to compete. Community banks such as us may ultimately be harmed as a result. We may be forced to charge lower fees to customers, affecting our profitability. Owners of networks in which we do not participate could elect to charge higher discount rates to merchants, leading merchants not to accept cards for payment, or to steer Visa cardholders to alternate payment systems, hence reducing our transaction volumes.

Negative Conditions Affecting Real Estate May Harm Our Business

Concentration of our lending activities in the California real estate sector could negatively impact our results of operations if the adverse changes in the real estate market in our lending area intensify. Although we do not offer

traditional first mortgages, nor have sub-prime or Alt-A residential loans or significant amount of securities backed by such loans in the portfolio, we are not immune from the effect of the set-back of the real estate market. Approximately 86% of our loans were secured by real estate at December 31, 2010, of which 65% were secured by commercial real estate and the remaining 21% by residential real estate. Real estate valuations are impacted by demand, and demand is driven by factors such as employment; when unemployment rises, demand drops. The unemployment rate has stayed at an elevated level since 2009. Most of the properties that secure our loans are located within Marin and Sonoma Counties. While we have seen improvement in real estate sales statistics³ after a few years of falling prices, there is no guarantee that the recent trend will continue.

³ Based on the latest available real estate information from Keegan & Coppin Company, Inc.

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Loans secured by commercial real estate include those secured by small office buildings, owner-user office/warehouses, mixed-use residential/commercial properties and retail properties. In 2010, office vacancy rates in Marin County have fallen slightly from 26.3% to 25.7%, while industrial and retail rates have risen slightly from approximately 4% to 6%⁴. In Sonoma County, vacancy rates are generally higher than in Marin County: the rate of industrial, retail, and office vacancies decreased from 15.5%, 9.2%, and 24.8% in 2009 to 13.9%, 8.5%, and 22.3% in 2010, respectively⁴. There can be no assurance that the companies or properties securing our loans will generate sufficient cash flows to allow the borrowers to make full and timely loan payments to us.

In late 2006, Federal banking regulators issued final guidance regarding commercial real estate lending to address a concern that rising commercial real estate lending concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the investor commercial real estate market. This guidance suggests that institutions that are potentially exposed to significant commercial real estate concentration risk will be subject to increased regulatory scrutiny. Institutions that have experienced rapid growth in commercial real estate lending, have notable exposure to a specific type of commercial real estate lending, or are approaching or exceed certain supervisory criteria that measure an institution's commercial real estate portfolio against its capital levels, may be subject to such increased regulatory scrutiny. Although regulators have not notified us of any concern, there is no assurance that we will not be subject to additional scrutiny in the future.

We are Subject to Interest Rate Risk

Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors outside our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System, which regulates the supply of money and credit in the United States. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and interest we pay on deposits and borrowings, but could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of our mortgage-backed securities portfolio. Our portfolio of securities is subject to interest rate risk and will generally decline in value if market interest rates increase, and generally increase in value if market interest rates decline. Our mortgage-backed security portfolio is also subject to prepayment risk in a low interest rate environment.

In response to the recessionary state of the national economy, the gloomy housing market and the volatility of financial markets, the Federal Open Market Committee of the Federal Reserve Board ("FOMC") started a series of decreases in Federal funds target rate with seven decreases in 2008, bringing the target rate to a historically low range of 0% to 0.25% through December 2010.

In the current environment of historically low interest rates, it is imperative for us to mitigate exposure to potential increases in interest rates. If interest rates rise by more than 100 basis points, we anticipate that net interest income will rise assuming no additional deposit rate sensitivity. However, it may still take several upward market rate movements for variable rate loans at floors to move above their floor rates. Further, a rise in index rates leads to lower debt service coverage of variable rate loans if the borrower's operating cash flow doesn't also rise. This creates a leveraged paradox of an improving economy (leading to higher interest rates), but lower credit quality as short-term rates move up faster than the cash flow or income of the borrowers. Higher interest rates may also depress loan demand, making it more difficult for us to grow loans.

4 Median price for single-family re-sales homes were up 3.3% in Marin County and 3.2% in Sonoma County in 2010.

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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 manage interest rate risk exposure with the goal of minimizing the impact of interest rate volatility on the net interest margin. Although we believe we have implemented effective asset and liability management strategies, any substantial, prolonged low interest rate environment could have an adverse effect on our financial condition and results of operations. See the sections captioned “Net Interest Income” in Management’s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and Quantitative and Qualitative Disclosures about Market Risk in Item 7A of this report for further discussion related to management of interest rate risk.

We are Subject to Significant Credit Risk and Loan Losses May Exceed Our Allowance for Loan Losses in the Future

We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, that represents Management’s best estimate of probable losses that may be incurred within the existing portfolio of loans. The level of the allowance reflects Management’s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality and present economic, political and regulatory conditions. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Further, we generally rely on appraisals of the collateral or comparable sales data to determine the level of specific reserve and/or the charge-off amount on certain collateral dependent loans. Inaccurate assumptions in the appraisals or an inappropriate choice of the valuation techniques may lead to an inadequate level of specific reserve or charge-offs.

Changes in economic conditions affecting borrowers, new information regarding existing loans and their collateral, identification of additional problem loans and other factors, may require an increase in our allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs. In addition, if charge-offs in future periods exceed the allowance for loan losses, we will need to record additional provision for loan losses. Any increases in the allowance for loan losses will result in an adverse impact on net income and capital.

We Face Intense Competition with Other Financial Institutions to Attract and Retain Banking Customers

We are facing significant competition for customers from other banks and financial institutions located in the markets we serve. We compete with commercial banks, saving banks, credit unions, non-bank financial services companies and other financial institutions operating within or near our serving areas. Many of our non-bank competitors are not subject to the same extensive regulations as ours, thus, are able to offer greater flexibility in competing for business. We anticipate intense competition will be continued for the coming year due to the recent consolidation of many financial institutions and more changes in legislature, regulation and technology.

Going forward, we may see tighter competition in the industry as banks seek to take market share in the most profitable customer segments, particularly the small business segment and the mass-affluent segment, which offers a rich source of deposits as well as more profitable and less risky customer relationships. Further, with the rebound of the equity markets, our deposit customers may perceive alternative investment opportunities as providing superior expected returns. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts such as online virtual banks and non-bank service providers. The current low interest rate environment could increase such transfers of deposits to higher yielding deposits or other investments. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. When our customers move money into higher yielding deposits or in favor of alternative investments, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

We also compete with nationwide and regional banks much larger than our size, which may be able to benefit from economies of scale through their wider branch network, national advertising campaigns and sophisticated technology infrastructure.

We intend to seek additional deposits by continuing to establish and strengthen our personal relationships with our existing customers and by offering deposit products that are competitive with those offered by other financial institutions in our markets. If these efforts are unsuccessful, we may need to fund our asset growth through borrowings, other non-core funding or public offerings of our common stock which could be leveraged. Increased debt would further increase our leverage, reduce our borrowing capacity and increase our reliance on non-core funds and counterparties' credit availability. A public offering may have a dilutive effect on earnings per share and share ownership.

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Our Ability to Access Markets for Funding and Acquire and Retain Customers Could be Adversely Affected by the Deterioration of Other Financial Institutions or the Financial Service Industry's Reputation.

Reputation risk is the risk to liquidity, earnings and capital arising from negative publicity regarding the financial services industry. The financial services industry continues to be featured in negative headlines about their roles in the past global and national credit crisis and the resulting stabilization legislation enacted by the U.S. federal government. These reports can be damaging to the industry's image and potentially erode consumer confidence in insured financial institutions. Recent bank failures in California, including in our own markets, have had a negative impact and additional failures are expected. In addition, our ability to engage in routine funding and other transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems, losses of depositor, creditor and counterparty confidence and could lead to losses or defaults by us or by other institutions. We could experience increases in deposits and assets as a direct or indirect result of other banks' difficulties or failure, which would increase the capital we need to support such growth or we could experience severe and unexpected decreases in deposits which could adversely impact our liquidity and heighten regulatory concern.

Bancorp and the Bank are Subject to Extensive Government Regulation and Supervision

Bancorp and the Bank are subject to extensive federal and state governmental supervision, regulation and control. Holding company regulations affect the range of activities in which Bancorp is engaged. Banking regulations affect the Bank's lending practices, capital structure, investment practices and dividend policy among other controls. Future legislative changes or interpretations may also alter the structure and competitive relationship among financial institutions.

The historic disruptions in the financial marketplace over the past few years have prompted the Obama administration to reform the financial market regulation. This proposed reform includes additional regulations over consumer financial products, bond rating agencies and the creation of a regime for regulating systemic risk across all types of financial service firms. In light of recent economic conditions as well as regulatory and congressional criticism, further restrictions on financial service companies may adversely impact our results of operations and financial condition, as well as increase our compliance risk.

Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policies, and procedures, or ethical standards set forth by regulators. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of our clients may be ambiguous or untested. This risk exposes Bancorp and the Bank to potential fines, civil money penalties, payment of damages and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and an inability to enforce contracts.

For further information on supervision and regulation, see the section captioned "Supervision and Regulation" in Item 1 above.

Bancorp Relies on Dividends from the Bank to Pay Cash Dividends to Shareholders

Bancorp is a separate legal entity from its subsidiary, the Bank. Bancorp receives substantially all of its revenue from the Bank in the form of dividends, which is Bancorp's principal source of funds to pay cash dividends to Bancorp's

common shareholders. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to Bancorp. In the event that the Bank is unable to pay dividends to Bancorp, Bancorp may not be able to pay dividends to its shareholders. As a result, it could have an adverse effect on Bancorp's stock price and investment value.

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Under federal law, capital distributions from the Bank would become prohibited, with limited exceptions, if the Bank were categorized as "undercapitalized" under applicable Federal Reserve or FDIC regulations. In addition, as a California bank, the Bank is subject to state law restrictions on the payment of dividends. Distributions from the Bank to Bancorp are subject to advance regulatory approval for three years beginning in 2010. For further information on the distribution limit from the Bank to Bancorp, see the section captioned "Bank Regulation" in Item 1 above and "Dividends" in Note 9 to the Consolidated Financial Statements in Item 8 below.

The Trading Volume of Bancorp's Common Stock is Less than That of Other Larger Financial Services Companies

Our common stock is listed on the NASDAQ's Capital Market. Our trading volume is less than that of nationwide or regional financial institutions. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence of willing buyers and sellers of common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant trades of our stock in a given time, or the expectations of these trades, could cause the stock price to be more volatile.

Failure of Correspondent Banks and Counterparties May Affect our Liquidity

In the past few years, the financial services industry in general was materially and adversely affected by the credit crises. We have witnessed failure of banks in the industry in recent years and the trend is expected to continue. We rely on our correspondent banks for lines of credit. We also have two correspondent banks as counterparties in our derivative transactions (see Note 15 to the Consolidated Financial Statements). While we continually monitor the financial health of our correspondent banks and we have diverse sources of liquidity, should any one of our correspondent banks become financially impaired, our available credit may decline and/or they may be unable to honor their commitments.

Unexpected Early Termination of Our Interest Rate Swap Agreements May Impact Our Earnings

We have entered into interest-rate swap agreements, primarily as an asset/liability management strategy, in order 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. These hedges allow us to offer long-term fixed rate loans to customers without assuming the interest rate risk of a long-term asset by swapping our fixed-rate interest stream for a floating-rate interest stream. In the event of default by the borrowers on our hedged loans, we may have to terminate these designated interest-rate swap agreements early, resulting in severe prepayment penalties charged by our counterparties. On the other hand, when these interest-rate swap agreements are in an asset position, we are subject to the credit risk of our counterparties, who may default on the interest-rate swap agreements, leaving us vulnerable to interest rate movements.

Securities May Lose Value due to Credit Quality of the Issuers

We hold securities issued and/or guaranteed by Federal National Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("FHLMC"). In 2008, the U.S. Government placed both FNMA and FHLMC under conservatorship. Starting in December 2008, the U.S. Government also began purchasing mortgage-backed securities ("MBS") issued by FNMA. Further, in December 2009, the U.S. Treasury also announced unlimited capital support for FNMA and FHLMC for the next three years. As a result, the MBS issued by FNMA and FHLMC has experienced an increase in fair value and our available-for-sale security portfolio has benefitted from this government support. However, the Obama administration released its report to Congress on reforming the housing-finance market on February 11, 2011. The proposal would wind down FNMA and FHLMC and incrementally shrink the government's

housing-finance footprint by, among other things, gradually increasing the firms' guarantee pricing, reducing their conforming loan limits, and phasing in a 10-percent down-payment requirement. When the U.S. Government starts selling the MBS securities issued by FNMA and FHLMC, when the government support is phased-out or completely withdrawn, or if either the FNMA or FHLMC comes under further financial stress or deteriorates in their credit worthiness, the fair value of our securities issued or guaranteed by these entities could be negatively affected.

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We also invest in obligations of state and political subdivisions, some of which are experiencing financial difficulties in part due to loss of property tax from falling home values and declines in sales tax revenues from a reduction in retail activities. The 2009 federal stimulus funds that flowed out to state governments across the country is running down and is expected to drop to \$89.4 billion for 2011, \$23.3 billion in 2012 and \$14.3 billion in 2013. State and political subdivisions are expected to undergo further financial stress due to the reduced federal funding. While we seek to minimize our exposure by diversifying geographic location of our portfolio and investing in investment grade securities, there is no guarantee that the issuers will remain financially sound to be current with their payments on these debentures.

Deterioration of Credit Quality or Insolvency of Insurance Companies May Impede our Ability to Recover Losses

The recent financial crisis has led certain major insurance companies to the verge of bankruptcy. We have property, casualty and financial institution risk coverage underwritten by several insurance companies, who may not avoid the insolvency risk permeating in the insurance industry. In addition, some of our investment in obligations of state and political subdivisions is insured by several insurance companies. While we closely monitor credit ratings of our insurers and insurers of our municipality securities, and we are poised to make quick changes if needed, we cannot predict an unexpected inability to honor commitments. We also invest in bank-owned life insurance policies on certain members of senior management, which may lose value in the event of the carriers' insolvency. In the event that our bank-owned life insurance policy carriers' credit ratings fall below investment grade, we may exchange policies underwritten by them to another carrier at a cost charged by the original carrier, or we may terminate the policies which may result in adverse tax consequences.

Our loan portfolio is also primarily secured by properties located in earthquake or fire-prone zones. In the event of a disaster that causes pervasive damage to the region in which we operate, not only the Bank, but also the loan collateral may suffer losses not recovered by insurance.

We Rely on Technology and Continually Encounter Technological Change

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology will enable efficiency and meeting customer's changing needs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to retain and compete for customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact of the long-term aspect our business and, in turn, our financial condition and results of operations.

We May Experience a Breach in Security

Our business requires the secure handling of sensitive client information. We also rely heavily on communications and information systems to conduct our business. A breach of security in the Bank, at our vendors or customers, or widely publicized breaches of other financial institutions could significantly harm our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability. While we have systems and procedures designed to prevent security breaches, we cannot be certain that advances in criminal capabilities, physical system or network break-ins or inappropriate access will not compromise or breach the technology protecting our networks or proprietary client information.

We Rely on Third-Party Vendors for Important Aspects of Our Operation

We depend on the accuracy and completeness of information provided by certain key vendors, including but not limited to, data processing, payroll processing, technology support, investment security safekeeping and accounting. Our ability to operate, as well as the our financial condition and results of operations, could be negatively affected in the event of an interruption of an information system, an undetected error, or in the event of a natural disaster whereby certain vendors are unable to maintain business continuity.

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We May Not Be Able To Attract and Retain Key Employees

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities engaged by us can be intense and we may not be able to hire skilled people or retain them. We do not currently have non-competitive agreements with any of our senior officers. The unexpected loss of services of key personnel could have a material adverse impact on our business because of the skills, knowledge of our market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Severe Weather, Natural Disasters or Other Climate Change Related Matters Could Significantly Impact Our Business

Our primary market is located in an earthquake-prone zone in northern California. Other severe weather or disasters, such as severe rainstorms, wildfire or flood, could interrupt our business operations unexpectedly. Climate-related physical changes and hazards could also pose credit risks for us. For example, our borrowers may have collateral properties located in coastal areas at risk to rise in sea level. The properties pledged as collateral on our loan portfolio could also be damaged by tsunamis, floods, earthquake or wildfires and thereby the recoverability of our loan could be impaired. A number of factors affect our credit losses, including the extent of damage to the collateral, the extent of damage not covered by insurance, the extent to which unemployment and other economic conditions caused by the natural disaster adversely affect the ability of borrowers to repay their loans, and the cost of collection and foreclosure to us. Lastly, there could be increased insurance premiums and deductibles, or a decrease in the availability of coverage, due to severe weather-related losses. The ultimate impact on our business of a natural disaster, whether or not caused by climate change, is difficult to predict.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease our corporate headquarters building, which houses our primary loan production, operations, and administrative offices, in Novato, California. We also lease other branch or office facilities within our primary market areas in the cities of Corte Madera, San Rafael, Novato, Sausalito, Mill Valley, Greenbrae, Petaluma, Santa Rosa, Sonoma, Napa and San Francisco, California. We consider our properties to be suitable and adequate for our present needs. For additional information on properties, see Notes 5 and 13 to the Consolidated Financial Statements included in Item 8 of this Form 10-K.

ITEM 3. LEGAL PROCEEDINGS

There are no pending, or to Management's knowledge any threatened, material legal proceedings to which we are a party, or to which any of our properties are subject. There are no material legal proceedings to which any director, any nominee for election as a director, any executive officer, or any associate of any such director, nominee or officer is a party adverse to us.

We are responsible for our proportionate share of certain litigation indemnifications provided to Visa U.S.A. by its member banks in connection with lawsuits related to anti-trust charges and interchange fees. For further details, see Note 13 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

ITEM 4. REMOVED AND RESERVED

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BANK OF MARIN BANCORP

PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

Bancorp common stock trades on the NASDAQ Capital Market under the symbol BMRC. At February 28, 2011, 5,300,685 shares of Bancorp's common stock, no par value, were outstanding and held by approximately 2,300 holders of record. The following table sets forth, for the periods indicated, the range of high and low sales prices of Bancorp's common stock.

Calendar Quarter	2010		2009	
	High	Low	High	Low
1st Quarter	\$ 33.60	\$ 29.19	\$ 24.44	\$ 17.01
2nd Quarter	\$ 36.14	\$ 30.80	\$ 29.25	\$ 21.10
3rd Quarter	\$ 35.50	\$ 30.08	\$ 33.81	\$ 26.55
4th Quarter	\$ 36.00	\$ 31.69	\$ 35.75	\$ 30.20

The table below shows cash dividends paid to common shareholders on a quarterly basis in the last two fiscal years.

Calendar Quarter	Per Share	2010		2009	
		Dollars	Per Share	Dollars	Per Share
1st Quarter	\$ 0.15	\$ 785,000	\$ 0.14	\$ 722,000	
2nd Quarter	\$ 0.15	\$ 787,000	\$ 0.14	\$ 724,000	
3rd Quarter	\$ 0.15	\$ 789,000	\$ 0.14	\$ 730,000	
4th Quarter	\$ 0.16	\$ 844,000	\$ 0.15	\$ 784,000	

For additional information regarding our ability to pay dividends, see discussion in Note 9 to the Consolidated Financial Statement, under the heading "Dividends," in Item 8 of this report.

During the first nine months of 2008, Bancorp repurchased 88,316 shares at an average price of \$28.55, plus commissions, for a total cost of \$2.5 million. In September 2008, the repurchases were discontinued to preserve capital during a time of extreme economic turbulence.

There were no purchases made by or on behalf of Bancorp or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Bancorp's common stock during the fourth quarter of 2010.

On July 2, 2007, Bancorp executed a shareholder rights agreement ("Rights Agreement") designed to discourage takeovers that involve abusive tactics or do not provide fair value to shareholders. Refer to Exhibit 4.1 to Registration Statement on Form 8-A12B filed with the Securities and Exchange Commission on July 2, 2007.

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Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information as of December 31, 2010, with respect to equity compensation plans. All plans have been approved by the shareholders.

	(A)	(B)	(C)
	Shares to be issued upon exercise of outstanding options	Weighted average price of outstanding options	Shares available for future issuance (Excluding shares in column A)
Equity compensation plans approved by shareholders	317,804	1 \$ 29.27	499,584

1 Represents shares of common stock issuable upon exercise of outstanding options under the Bank of Marin 1990 Stock Option Plan, the Bank of Marin 1999 Stock Option Plan and the Bank of Marin Bancorp 2007 Equity Plan.

2 Represents shares of common stock available for future grants under the 2007 Equity Plan and the 2010 Director Share Plan.

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BANK OF MARIN BANCORP

Stock Price Performance Graph

The following graph, provided by Keefe, Bruyette, & Woods, Inc., shows a comparison of cumulative total shareholder return on our common stock during the five fiscal years ended December 31, 2010 compared to Russell 2000 Stock index and peer group index of other financial institutions. We have been part of the Russell 2000 index since July 2009. The comparison assumes \$100 was invested on December 31, 2005 in our common stock and all of the dividends were reinvested. The performance graph represents past performance and should not be considered to be an indication of future performance. Ticker symbol BMRC represents the common stock of Bank of Marin Bancorp subsequent to its formation July 1, 2007 and represents the common stock of Bank of Marin for periods prior to the formation of the bank holding company.

	2005	2006	2007	2008	2009	2010
BMRC	100	111	90	74	101	108
Peer Group1	100	109	69	35	21	23
Russell 2000	100	118	117	77	98	125

1BMRC Peer Group represents public California banks with assets between \$500 million to \$2 billion as of December 31, 2010: FMCB, EXSR, AMBZ, BOCH, BBNK, CVCY, FNRN, FNBG, UBFO, SAEB, CWBC, SWBC, CUNB, AMRB, OVLY, PFCF, FCAL, HTBK, HEOP, NOVB, PMBC, PPBI, PFBC, RCBC, BSRR. The peer group composite index is weighted by market capitalization and reinvests dividends on the ex-date and adjusts for stock splits, if applicable.

Source: Company Reports, FactSet, and SNL

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BANK OF MARIN BANCORP

ITEM 6. SELECTED FINANCIAL DATA

As of For the Year Ended December 31, (Dollars in thousands, except per share data)	2010	2009	2008	2007	2006	2009/2010 % change	
At December 31							
Total assets	\$1,208,150	\$1,121,672	\$1,049,557	\$933,901	\$876,578	7.7	%
Total loans	941,400	917,748	890,544	724,878	719,778	2.6	%
Total deposits	1,015,739	944,061	852,290	834,642	736,697	7.6	%
Total stockholders' equity	121,920	109,051	125,546	87,774	89,525	11.8	%
Equity-to-asset ratio	10.1	% 9.7	% 12.0	% 9.4	% 10.2	% 3.8	%
For year ended December 31							
Net interest income	\$54,909	\$52,567	\$48,359	\$42,742	\$41,733	4.5	%
Provision for loan losses	5,350	5,510	5,010	685	1,266	-2.9	%
Non-interest income	5,521	5,182	5,356	5,718	3,972	6.5	%
Non-interest expense	33,357	31,696	28,677	27,673	25,891	5.2	%
Net income	13,552	12,765	12,150	12,324	11,883	6.2	%
Net income per share (diluted)	2.55	2.19	2.31	2.31	2.11	16.4	%
Cash dividend payout ratio on common stock 1	23.6	% 25.8	% 23.9	% 21.4	% 20.8	% -8.5	%

1 Calculated as dividends on common share divided by basic net income per common share.

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ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
7. OPERATIONS

The following discussion of financial condition as of December 31, 2010 and 2009 and results of operations for each of the years in the three-year period ended December 31, 2010 should be read in conjunction with our consolidated financial statements and related notes thereto, included in Part II Item 8 of this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances.

Forward-Looking Statements

The disclosures set forth in this item are qualified by important factors detailed in Part I captioned Forward-Looking Statements and Item 1A captioned Risk Factors of this report and other cautionary statements set forth elsewhere in the report.

Executive Summary

We reported record annual earnings of \$13.6 million in 2010, an increase of \$787 thousand, or 6.2% from \$12.8 million a year ago. Earnings growth reflects a lower level of credit losses, continued focus on cost controls, and growth in interest earning assets. Our continued focus on responsible community banking fundamentals and our strong customer relationships has led to higher deposits, a core funding source for our loan portfolio. Deposit growth in 2010 was substantial at \$71.7 million, or 7.6%, over a year ago without compromising our pricing discipline. Demand deposits grew \$51.6 million or 22.4% over a year ago and comprised 27.8% of total deposits at December 31, 2010.

Diluted earnings per share for the year ended December 31, 2010 totaled \$2.55, up \$0.36 from \$2.19 in the prior year. 2009 diluted earnings per share were reduced by \$0.25 related to Bancorp's participation and withdrawal from the TCPP and \$0.06 related to an FDIC special assessment, as discussed later.

We are committed to actively lend with a focus in our local community. Total loans reached \$941.4 million at December 31, 2010, representing an increase of \$23.7 million, or 2.6%, over December 31, 2009. This growth primarily reflects growth in our San Francisco and Santa Rosa markets and represents an increase in commercial real estate loans, partially offset by decreases in construction and commercial loans.

Our focus on prudent lending standards, proactive management of credit risk and discipline in operating within markets that we know have kept our loan losses to a minimal level. Non-accrual loans totaled \$12.9 million, or 1.37% of the Bank's loan portfolio at December 31, 2010, compared to \$11.6 million or 1.26% a year ago. Accruing loans past due 30 to 89 days decreased to \$352 thousand at December 31, 2010 from \$835 thousand a year ago.

The provision for loan losses totaled \$5.4 million and \$5.5 million in 2010 and 2009, respectively. The allowance for loan losses of \$12.4 million totaled 1.32% of loans at December 31, 2010 compared to \$10.6 million or 1.16% at December 31, 2009. The increase in the allowance for loan losses as a percentage of loans reflects a higher level of non-performing loans and the related specific reserves. Net charge-offs in 2010 decreased to \$3.6 million in 2010 from \$4.8 million in 2009, and primarily related to construction loans secured by real property where the value of collateral has declined. Net loans charged off in 2010 represent 0.38% of average loans compared to 0.53% in 2009.

On March 31, 2009, Bancorp repurchased all 28,000 shares of outstanding preferred stock issued in December 2008 under the TCPP program. We determined that continued participation in the TCPP was not in the best interest of our common shareholders, customers or our employees, and it would impede our ability to compete after the U.S.

government's actions, interpretations, and commentary regarding various aspects of the TCPP program. The warrant issued to the U.S. Treasury to purchase 154,242 shares of our common stock remains outstanding.

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After the repurchase of the preferred stock under the TCPP, we continued to grow our capital during 2009 and 2010. The total risk-based capital ratio for Bancorp at December 31, 2010 totaled 13.3% compared to 12.3% at December 31, 2009, exceeding industry standards for being well-capitalized.

The tax-equivalent net interest margin was 4.95% in 2010 compared to 5.17% in 2009. Decreases in the tax-equivalent net interest margin were primarily due to lower yields on investment securities (as a result of increased prepayments and lower yields on recent purchases) and a shift in the relative composition of interest-earning assets from higher-yielding loans to lower-yielding cash held at the Federal Reserve Bank and other short-term investments. The excess liquidity from deposit inflows has not been deployed fully into higher yielding loans as the banking industry as a whole is experiencing challenges with loan demand from qualified borrowers.

The largest factors likely to affect our net interest margin in 2011 will be our ability to generate profitable loans to creditworthy borrowers, as well as our responsiveness to competitive pricing on loans and deposits in our market. In the current environment of historically low short-term interest rates, it is imperative for us to continue to mitigate exposure to potential increases in interest rates. If interest rates increase, we anticipate that net interest income will rise. The increase in interest income from asset repricing may be partially offset by deposit rate sensitivity. Additionally, it may take several upward market rate movements for variable rate loans at floors to move above the floor rates. As such, if interest rates increase by less than 100 basis points, we anticipate little impact on our net interest income. Further, we expect loan demand to continue to be challenging due to the uncertain economic climate and the intensifying competition for creditworthy borrowers, both of which could lead to loan rate concession pressure and could impact our ability to generate profitable loans.

As discussed in Note 19, the Bank acquired certain assets and assumed certain liabilities of Napa-based Charter Oak Bank on February 18, 2011. This transaction was completed under a modified whole-bank purchase and assumption agreement with the FDIC without loss share. At December 31, 2010, Charter Oak Bank reported gross loans totaling \$107.0 million and deposits totaling \$105.3 million. The purchase price reflects an asset discount of \$19.8 million and no deposit premium. Loans at the former Charter Oak Bank's book values totaling approximately \$28.5 million as of the bid valuation date (October 18, 2010) were retained by the FDIC. The excluded loans mainly represent loans delinquent more than sixty days or more as of the bid valuation date and certain types of land and construction loans. Balances are subject to change based upon the activities between the bid valuation date and the purchase date. The assets acquired and liabilities assumed are also subject to fair value adjustments in accordance with FASB ASC 805, Business Combinations upon finalizing the valuation process.

We have also expanded our community banking footprint into Sonoma County. On October 14, 2010, the Bank opened a loan production office in Santa Rosa, which will be converted to a full service commercial banking office in the second quarter of 2011. In addition, in December 2010, the Bank signed a lease for a branch in downtown Sonoma. This office is expected to open by mid-summer 2011.

We expect our non-interest expenses to continue to increase in 2011 as we continue our expansion into Sonoma and Napa counties. We expect that these strategic initiatives will contribute to our profitability in the long term.

Critical Accounting Policies

Critical accounting policies are those that are both most 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.

Management has determined the following five accounting policies to be critical: Allowance for Loan Losses, Other-than-temporary Impairment of Investment Securities, Share-Based Payment, Accounting for Income Taxes and Fair Value Measurements.

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Allowance for Loan Losses

Allowance for loan losses is based upon estimates of loan losses and is maintained at a level considered adequate to provide for probable losses inherent in the outstanding loan portfolio. The allowance is increased by provisions charged to expense and reduced by net charge-offs. In periodic evaluations of the adequacy of the allowance balance, Management considers our past loan loss experience by type of credit, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, current economic conditions and other factors. We formally assess the adequacy of the allowance for loan losses on a quarterly basis. These assessments include the periodic re-grading of loans based on changes in their individual credit characteristics including delinquency, seasoning, recent financial performance of the borrower, economic factors, changes in the interest rate environment, and other factors as warranted. Loans are initially graded when originated. They are reviewed as they are renewed, when there is a new loan to the same borrower and/or when identified facts demonstrate heightened risk of default. Confirmation of the quality of our grading process is obtained by independent reviews conducted by outside consultants specifically hired for this purpose and by periodic examination by various bank regulatory agencies. Management monitors delinquent loans continuously and identifies problem loans to be evaluated individually for impairment testing. For loans that are determined impaired, formal impairment measurement is performed at least quarterly on a loan-by-loan basis.

Our method for assessing the appropriateness of the allowance includes specific allowances for identified problem loans, an allowance factor for categories of credits, and allowances for changing environmental factors (e.g., portfolio trends, concentration of credit, growth, economic factors). Allowances for identified problem loans are based on specific analysis of individual credits. Loss estimation factors for loan categories are based on an analysis of local economic factors applicable to each loan category, including consideration of the Bank's historical charge-off history. Allowances for changing environmental factors are Management's best estimate of the probable impact these changes have had on the loan portfolio as a whole.

Other-than-temporary Impairment of Investment Securities

At each financial statement date, we assess whether declines in the fair value of held-to-maturity and available-for-sale securities below their costs are deemed to be other than temporary. We consider, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Evidence evaluated includes, but is not limited to, the remaining payment terms of the instrument and economic factors that are relevant to the collectability of the instrument, such as: current prepayment speeds, the current financial condition of the issuer(s), industry analyst reports, credit ratings, credit default rates, interest rate trends and the value of any underlying collateral. Credit-related other-than-temporary-impairment results in a charge to earnings and the corresponding establishment of a new cost basis for the security. Non-credit-related other-than-temporary impairment results in a charge to other comprehensive income, net of applicable taxes, and the corresponding establishment of a new cost basis for the security. The other-than-temporary impairment recognized in other comprehensive income for debt securities classified as held-to-maturity is accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows.

Share-Based Payment

We recognize all share-based payments, including stock options and non-vested restricted common shares, as an expense in the statement of income based on the grant-date fair value of the award with a corresponding increase to

common stock.

We determine the fair value of stock options at the grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, the exercise price, the expected dividend yield, stock price volatility and the risk-free interest rate over the expected life of the option. The Black-Scholes model requires the input of highly subjective assumptions, including the expected life of the stock-based award (derived from historical data on employee exercise and post-vesting employment termination behavior) and stock price volatility (based on the historical volatility of the common stock). The estimates used in the model involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded stock-based compensation expense could have been materially different from that reflected in these financial statements. The fair value of non-vested restricted common shares generally equals the stock price at grant date. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those share-based awards expected to vest. If our actual forfeiture rate is materially different from the estimate, the share-based compensation expense could be materially different.

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Accounting for Income Taxes

Income taxes reported in the financial statements are computed based on an asset and liability approach. We recognize the amount of taxes payable or refundable for the current year, and deferred tax assets and liabilities for the expected future tax consequences that have been recognized in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We record net deferred tax assets to the extent it is more likely than not that they will be realized. In evaluating our ability to recover the deferred tax assets, Management considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In projecting future taxable income, Management develops assumptions including the amount of future state and federal pretax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates being used to manage the underlying business. Bancorp files consolidated federal and combined state income tax returns.

We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. For tax positions that meet the more-likely-than-not threshold, we may recognize only the largest amount of tax benefit or least amount of tax expense that is greater than fifty percent likely of being realized upon ultimate settlement with the taxing authority. Management believes that all of our tax positions taken meet the more-likely-than-not recognition threshold. To the extent tax authorities disagree with these tax positions, our effective tax rates could be materially affected in the period of settlement with the taxing authorities.

Fair Value Measurements

We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Securities available for sale, derivatives, and loans held for sale, if any, are recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record certain assets at fair value on a non-recurring basis, such as certain impaired loans held for investment and securities held to maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

We have established and documented a process for determining fair value. We maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. Whenever there is no readily available market data, Management uses its best estimate and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these financial statements. For detailed information on our use of fair value measurements and our related valuation methodologies, see Note 10 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

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RESULTS OF OPERATIONS

Overview

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

(Dollars in thousands, except per share data)	As of and for the years ended					
	December 31,		2009		2008	
	2010		2009		2008	
For the period:						
Net income	\$13,552		\$12,765		\$12,150	
Net income per share						
Basic	\$2.59		\$2.21		\$2.34	
Diluted	\$2.55		\$2.19		\$2.31	
Return on average equity	11.67	%	11.46	%	12.73	%
Return on average assets	1.14	%	1.16	%	1.28	%
Common stock dividend payout ratio	23.55	%	25.79	%	23.93	%
Efficiency ratio	55.20	%	54.89	%	53.39	%
At period end:						
Book value per common share	\$23.05		\$20.85		\$19.14	
Total assets	\$1,208,150		\$1,121,672		\$1,049,557	
Total loans	\$941,400		\$917,748		\$890,554	
Total deposits	\$1,015,739		\$944,061		\$852,290	
Loan-to-deposit ratio	92.68	%	97.21	%	104.49	%

Summary of Quarterly Results of Operations

Table 1 sets forth the quarterly results of operations for 2010 and 2009:

Table 1 Summarized Statement of Income

(Dollars in thousands, unaudited)	2010 Quarters Ended				2009 Quarters Ended			
	Dec. 31	Sept. 30	Jun. 30	Mar. 31	Dec. 31	Sept. 30	Jun. 30	Mar. 31
Interest income	\$15,364	\$15,601	\$15,505	\$14,887	\$15,204	\$15,116	\$14,837	\$14,577
Interest expense	1,305	1,636	1,748	1,759	1,814	1,780	1,804	1,769
Net interest income	14,059	13,965	13,757	13,128	13,390	13,336	13,033	12,808
Provision for loan losses	1,050	1,400	1,350	1,550	2,525	1,100	700	1,185
Net interest income after provision for loan losses	13,009	12,565	12,407	11,578	10,865	12,236	12,333	11,623
Non-interest income	1,360	1,307	1,505	1,349	1,341	1,331	1,273	1,237
Non-interest expense	8,037	8,507	8,591	8,222	7,763	7,776	8,600	7,557
Income before provision for income taxes	6,332	5,365	5,321	4,705	4,443	5,791	5,006	5,303
	2,424	2,006	1,983	1,758	1,641	2,190	1,873	2,074

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Provision for income taxes								
Net income	\$3,908	\$3,359	\$3,338	\$2,947	\$2,802	\$3,601	\$3,133	\$3,229
Preferred stock dividends and accretion								
	---	---	---	---	---	---	---	\$(1,299)
Net income available to common stockholders								
	\$3,908	\$3,359	\$3,338	\$2,947	\$2,802	\$3,601	\$3,133	\$1,930
Net income per common share								
Basic	\$0.74	\$0.64	\$0.64	\$0.56	\$0.54	\$0.69	\$0.61	\$0.38
Diluted	\$0.73	\$0.63	\$0.63	\$0.56	\$0.53	\$0.68	\$0.60	\$0.37

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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 margin due to an imbalance in the timing of repricing or maturity of assets or liabilities. We manage interest rate risk exposure with the goal of minimizing the impact of interest rate volatility on net interest margin.

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.

Table 2, Distribution of Average Statements of Condition and Analysis of Net Interest Income, compares interest income and average interest-earning assets with interest expense and average interest-bearing liabilities for the three years ended December 31, 2010, 2009 and 2008. The table also indicates net interest income, net interest margin and net interest rate spread for each period presented.

Table 2 Distribution of Average Statements of Condition and Analysis of Net Interest Income

Average Statements of Condition and Analysis of Net Interest Income

(Dollars in thousands; unaudited)	2010			2009			2008			
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate	
Assets										
Interest-bearing due from banks (1)	\$43,028	\$143	0.33 %	\$164	\$1	0.60 %	\$---	\$---	---	%
Federal funds sold	3,049	2	0.07	1,752	4	0.23	4,212	138	3.22	
Investment securities										
U.S. Government agencies (2)	91,869	3,234	3.52	70,268	3,304	4.70	72,606	3,555	4.90	
Corporate CMOs and other (2)	13,675	593	4.34	7,397	506	6.84	6,124	273	4.46	
Obligations of state and political subdivisions (3)	30,893	1,741	5.64	29,221	1,677	5.74	19,541	1,106	5.66	
Loans and banker's acceptances (1) (3) (4)	929,755	56,542	6.00	910,456	55,071	5.97	798,369	54,475	6.82	
Total interest-earning assets (1)	1,112,269	62,255	5.52	1,019,258	60,563	5.86	900,852	59,547	6.61	
	34,383			46,954			21,990			

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Cash and non-interest-bearing due from banks									
Bank premises and equipment, net	8,259			8,140			8,354		
Interest receivable and other assets, net									
	31,262			26,041			17,325		
Total assets	\$ 1,186,173			\$ 1,100,393			\$ 948,521		
Liabilities and Stockholders' Equity									
Interest-bearing									
transaction accounts	\$ 98,168	\$ 110	0.11 %	\$ 90,159	\$ 115	0.13 %	\$ 78,672	\$ 344	0.44 %
Savings accounts	51,738	104	0.20	45,944	94	0.20	40,238	300	0.75
Money market accounts	390,575	2,467	0.63	391,571	3,235	0.83	390,383	6,610	1.69
CDARS® time accounts	71,432	842	1.18	51,248	721	1.41	9,039	200	2.21
Other time accounts	124,631	1,495	1.20	97,924	1,541	1.57	83,735	2,466	2.95
Overnight borrowings (1)	2	---	0.29	10,659	28	0.26	15,629	295	1.89
FHLB fixed-rate advances	55,000	1,281	2.33	53,794	1,253	2.33	14,440	306	2.12
Subordinated debenture (1)	5,000	149	2.94	5,000	180	3.55	5,000	296	5.92
Total interest-bearing liabilities									
	796,546	6,448	0.81	746,299	7,167	0.96	637,136	10,817	1.70
Demand accounts	263,742			232,502			208,320		
Interest payable and other liabilities									
	9,791			9,873			7,624		
Stockholders' equity									
	116,094			111,359			95,441		
Total liabilities & stockholders' equity									
	\$ 1,186,173			\$ 1,100,033			\$ 948,521		
Tax-equivalent net interest									
income/margin (1)		\$ 55,807	4.95 %		\$ 53,396	5.17 %		\$ 48,730	5.41 %
Reported net interest									
income/margin		\$ 54,909	4.87 %		\$ 52,567	5.09 %		\$ 48,359	5.37 %
Tax-equivalent net interest rate spread									
			4.71 %			4.90 %			4.91 %

(1) 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.

(2) 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.

(3) Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 35 percent.

(4) 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.

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2010 Compared with 2009:

Tax equivalent net interest income totaled \$55.8 million and \$53.4 million for the years ended December 31, 2010 and 2009, respectively. The \$2.4 million or 4.5% increase was due to an increase in volume of interest-earning assets, offset by the effect of lower yields on investment securities.

Average interest-earning assets increased \$93.0 million, or 9.1%, in 2010 compared to 2009. This included increases in average interest-bearing due from banks of \$42.9 million, average investment securities of \$29.6 million and average loan growth of \$19.3 million. In October 2010, we opened our Santa Rosa loan production office, which is expected to position the Bank for additional loan growth, particularly in commercial and industrial loans.

The tax-equivalent net interest margin decreased to 4.95% in 2010, down twenty-two basis points from 2009. The decrease in the tax-equivalent net interest margin was primarily due to lower yields on investment securities (as a result of increased prepayments and lower yields on recent additions) and a shift in the relative composition of interest-earning assets from higher-yielding loans to lower-yielding interest-bearing due from banks. The excess liquidity from deposit inflows has not yet been deployed into funding new loans, as the banking industry as a whole is experiencing challenges with loan demand and the competition for qualified borrowers intensified. The net interest spread decreased nineteen basis points from the same period last year for the same reasons.

The average balance of interest-bearing liabilities increased \$50.2 million, or 6.7%, in 2010 compared to 2009. The increases are pervasive in all categories of deposit accounts except money market accounts, with the most significant increase in time deposits (including CDARS®), which increased \$46.9 million. These increases were partially offset by a decrease in overnight borrowings of \$10.7 million. We have experienced a shift in the relative composition of interest-bearing deposits in 2010 compared to 2009 as the proportion of higher-costing time accounts has increased, while the proportion of money market deposit accounts has decreased.

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. In December of 2008, the target interest rate was brought to a historic low with a range of 0% to 0.25% where it remains as of December 31, 2010.

The yield on the loan portfolio, which comprised 83.6% and 89.3% of average earning assets in 2010 and 2009, respectively, increased three basis points in 2010 compared to 2009. This is mainly due to the shift in the mix of loans from construction and commercial loans to higher-yielding commercial real estate loans. Interest foregone on non-accrual loans represented a seven-basis point reduction to the net interest margin in both 2010 and 2009.

The lower yields on investment securities are a result of increased prepayments resulting in accelerated amortization of premiums, and lower yields on recently purchased securities. The yield on private-label CMOs, agency securities and municipal bonds decreased 250 basis points, 118 basis points and ten basis points, respectively, in 2010.

The rate on interest-bearing liabilities decreased fifteen basis points in 2010 compared to 2009, primarily reflecting lower offering rates on money market accounts, as well as the downward re-pricing of time deposits as they mature. In 2010, the rate on other time deposits, CDARS®, and money market accounts decreased thirty-seven basis points, twenty-three basis points, and twenty basis points, respectively. The rate on the subordinated debenture dropped sixty-one basis points due to a decline in the three-month LIBOR rate, to which the debenture rate is indexed.

2009 Compared with 2008:

The tax-equivalent net interest margin decreased to 5.17% in 2009, down twenty-four basis points from 2008. The decrease in the net interest margin was primarily due to the repricing of our loan portfolio in a declining rate environment, and to a lesser extent, interest foregone on non-accrual loans (representing a seven-basis-point impact on the net interest margin in 2009 versus a two-basis-point effect in 2008).

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The net interest rate spread in 2009 is consistent with 2008, reflecting a decrease of seventy-five basis points in the yield on interest-earning assets and a decline of seventy-four basis points in the cost of interest-bearing liabilities.

In 2008, there were seven downward adjustments to the target Federal funds rate totaling 325 basis points, bringing the target interest rate to a historic low with a range of 0% to 0.25%. Market rate changes have a more immediate effect on deposit rates than on loan yields due to our fixed-rate loans (see Table 10 below for our fixed vs. variable loans distribution). In addition, the large majority of our variable loans are tied to the U.S. Treasury Constant Maturity Indices with repricing intervals between one year to five years. The yield on the loan portfolio, which comprised approximately 89% of average earning assets in both 2009 and 2008, decreased eighty-five basis points in 2009 due to the downward repricing of variable-rate loans and new loans originated at lower market rates, as well as maturities and pay downs of higher yielding loans.

The yield on agency securities in 2009 decreased twenty basis points from 2008, mainly reflecting a tighter spread between agency yields and Treasury rates on newly purchased agency securities due to the stabilization of the MBS market in 2009 and increased prepayments of higher-yielding securities which accelerated the amortization of premiums.

Average interest-earning assets increased \$118.4 million, or 13.1%, in 2009 compared to 2008. The increase primarily relates to average loan growth of \$112.1 million and an increase in average investment securities of \$8.6 million, partially offset by a \$2.3 million decline in average Federal funds sold. There was no significant shift in the mix of interest-earning assets in 2009.

The overall cost of liabilities is affected by offered rates and the mix of deposits and other liabilities. The overall rate on interest-bearing liabilities decreased seventy-four basis points in 2009 over 2008. The rate on savings and money market accounts, CDARS®, and time deposits decreased 84 basis points, 80 basis points, and 138 basis points, respectively, in 2009 compared to 2008, reflecting lower offered rates on deposits in response to lower market rates.

The average balance of interest-bearing liabilities increased \$109.2 million, or 17.1%, in 2009 compared to 2008. The increases are pervasive in all categories of interest-bearing liabilities, most notably in CDARS® deposits and purchased funds, which increased \$42.2 million and \$34.4 million respectively in 2009. Late in the first quarter of 2008, we began to offer CDARS®, a network through which the Bank offers FDIC insurance coverage in excess of the current \$250 thousand regulatory maximum by placing deposits in multiple banks participating in the network. CDARS® contributed to an increase in average deposits of \$42.2 million in 2009. We experienced a shift in the relative mix of interest-bearing liabilities in 2009 compared to 2008: the proportion of higher-costing liabilities (mainly CDARS® and purchased funds) has increased from 6.1% of interest-bearing liabilities in 2008 to 15.5% in 2009, while the proportion of money market deposit accounts has decreased from 61.3% in 2008 to 52.5% in 2009.

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Table 3, Analysis of Changes in Net Interest Income, separates the change in net interest income into two components: 1 volume – change caused by increases or decreases in the average asset and liability balances outstanding, and 2 yield/rate – changes in average yields on earning assets and average rates for interest-bearing liabilities.

Table 3 Analysis of Changes in Net Interest Income

(Dollars in thousands)	2010 compared to 2009			2009 compared to 2008		
	Volume	Yield/ Rate ¹	Total	Volume	Yield/ Rate ¹	Total
Assets						
Interest-bearing due from banks	\$ 142	\$-	\$ 142	\$ 1	\$-	\$ 1
Federal funds sold	1	(3)	(2)	(6)	(128)	(134)
Investment securities						
U. S. Government agencies	760	(830)	(70)	(112)	(139)	(251)
Obligations of state and political subdivisions						
Municipal bonds ²	272	(185)	87	65	168	233
Corporate CMO	94	(30)	64	556	15	571
Loans and bankers' acceptances ²	1,174	297	1,471	7,521	(6,925)	596
Total interest-earning assets	2,443	(751)	1,692	8,025	(7,009)	1,016
Liabilities						
Interest-bearing transaction accounts						
Savings accounts	9	(14)	(5)	44	(273)	(229)
Money market accounts	12	(2)	10	12	(218)	(206)
CDARS® time deposits	(6)	(762)	(768)	10	(3,385)	(3,375)
Other time accounts	238	(117)	121	619	(98)	521
Overnight borrowings	320	(366)	(46)	366	(1,291)	(925)
FHLB fixed-rate advances	(31)	3	(28)	(13)	(254)	(267)
Subordinated debenture	28	-	28	917	30	947
Total interest-bearing liabilities	570	(1,289)	(719)	1,955	(5,605)	(3,650)
Tax-equivalent net interest income	\$ 1,873	\$ 538	\$ 2,411	\$ 6,070	\$(1,404)	\$ 4,666

¹ The changes for each category of interest income and expense are divided between the portion of change attributable to the variance in volume and the portion of change attributable to the variance in rate for that category. The unallocated change in rate or volume variance has been allocated between the rate and volume variances on a pro rata basis.

² Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the Federal statutory rate of 35 percent.

The table indicates that in 2010 and 2009, our net interest income was favorably affected by an increase in the volume of interest-earning assets, partially offset by declines in yields. The decline in our asset yields in 2010 reflected the lower returns on investment securities discussed previously, while the decline in 2009 reflected the downward repricing of our variable loans as their indexed rates reset. Further, net interest income in both 2010 and 2009 benefitted from lower rates on deposits, especially money market and time accounts.

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Provision for Loan Losses

Management assesses the adequacy of the allowance for loan losses on a quarterly basis based on several factors including growth of the loan portfolio, analysis of probable losses in the portfolio, recent loss experience and the current economic climate. Actual losses on loans are charged against the allowance, and the allowance is increased through the provision for loan losses charged to expense to bring the allowance to a level, based on Management's best judgment, to absorb probable losses inherent in the existing loan portfolio. For further discussion, see the section captioned "Critical Accounting Policies."

Our provision for loan losses totaled \$5.4 million in 2010 compared to \$5.5 million in 2009, which was relatively unchanged. See the section captioned "Allowance for Loan Losses" below for further analysis of the provision for loan losses.

Non-interest Income

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

Table 4 Significant Components of Non-interest Income

(Dollars in thousands)	Year Ended December 31,			2010 compared to 2009		2009 compared to 2008	
	2010	2009	2008	Amount Increase (Decrease)	Percent Increase (Decrease)	Amount Increase (Decrease)	Percent Increase (Decrease)
Service charges on deposit accounts	\$ 1,797	\$ 1,782	\$ 1,654	\$ 15	0.8 %	\$ 128	7.7 %
Wealth Management and Trust Services	1,521	1,383	1,292	138	10.0	91	7.0
Net gain on redemption of shares in Visa, Inc.	---	---	457	---	---	(457)	NM
Other non-interest income							
Earnings on Bank owned life insurance	690	696	640	(6)	(0.8)	56	8.8
Customer banking fees and other charges	606	466	409	140	30.0	57	13.9
Merchant interchange income	578	474	329	104	21.9	145	44.1
Other income	329	381	575	(52)	(13.6)	(194)	(33.7)
Total other non-interest income	2,203	2,017	1,953	186	9.2	64	3.3
Total non-interest income	\$ 5,521	\$ 5,182	\$ 5,356	\$ 339	6.5 %	\$ (174)	(3.2 %)

NM - Not Meaningful

2010 Compared with 2009:

When comparing 2010 to 2009, service charge income on deposit accounts remained relatively unchanged.

The increase in Wealth Management and Trust Services (“WMTS”) income is due to higher estate settlement and trust-services fees received in 2010, as well as the increase in assets under management. As of December 31, 2010 and 2009, assets under management totaled approximately \$254.0 million and \$252.5 million, respectively.

The increase in customer banking fees, and other charges, is primarily due to higher Visa® debit card fees, attributable to a higher volume of Visa® debit card usage, as well as a Bank-wide Visa® debit card promotion program. As previously discussed in Item 1A Risk Factors, in December 2010, the Federal Reserve proposed a new regulation to restrict interchange fees charged for debit card transactions by card issuers over \$10 billion in asset size. Because of the uncertainty of the final outcome of the proposed rule, and its effect on the market pricing of the interchange fees, we can not quantify the ultimate impact of this proposal on our Visa® debit card fees.

Merchant interchange income increased due to the higher transaction volume from our merchant customers as well as one-time billing adjustments. The decrease in other non-interest income is mainly due to a decrease in miscellaneous income, partially offset by an increase in the dividend received on Federal Home Loan Bank of San Francisco (“FHLB”) stock.

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2009 Compared with 2008:

In 2008, the mandatory redemption of a portion of our shares of Visa, Inc. generated a net gain of \$457 thousand as discussed in Note 2 to Consolidated Financial Statements in Item 8 of this report. Excluding this nonrecurring gain, non-interest income in 2009 increased \$283 thousand, or 5.8%, from 2008.

The increase in service charges on deposit accounts in 2009 was primarily due to the increase in the volume of deposit accounts.

The increase in WMTS income in 2009 primarily reflected a higher level of assets under management.

The increase in bank-owned life insurance (“BOLI”) income in 2009 is attributable to the full-year’s worth of income earned on the \$2.2 million of policies purchased in August 2008. The increase in customer banking fees in 2009 is primarily due to a \$46k increase in Visa® debit fees attributable to a higher volume of Visa® card applications resulting from a promotion, as well as an increase in remote deposit capture fees. Merchant interchange fee income increased \$145 thousand in 2009 due to lower interchange costs charged by our data processing vendor resulting from the renegotiation of our data processing contract. The decrease in other income in 2009 is primarily due to decreases of \$164 thousand of dividends on FHLB stock and the absence of \$42 thousand in interest we received in the second quarter of 2008 on amended tax returns.

Non-interest Expense

Table 5, Significant Components of Non-interest Expense, summarizes the amounts and changes in dollars and percentages. Our efficiency ratio (the ratio of non-interest expense divided by the sum of non-interest income and net interest income) totaled 55.20%, 54.89%, and 53.39% in 2010, 2009 and 2008, respectively.

Table 5 Significant Components of Non-interest Expense

(Dollars in thousands)	Year Ended			2010 compared to 2009		2009 compared to 2008	
	2010	December 31, 2009	2008	Amount Increase (Decrease)	Percent Increase (Decrease)	Amount Increase (Decrease)	Percent Increase (Decrease)
Salaries and related benefits	\$ 18,240	\$ 17,001	\$ 16,097	\$ 1,239	7.3 %	\$ 904	5.6 %
Occupancy and equipment	3,576	3,516	3,202	60	1.7	314	9.8
Depreciation and amortization	1,344	1,370	1,340	(26)	(1.9)	30	2.2
FDIC Insurance	1,506	1,800	507	(294)	(16.3)	1,293	255.0
Data processing costs	1,916	1,650	1,825	266	16.1	(175)	(9.6)
Professional services	1,917	1,727	1,600	190	11.0	127	7.9
Other non-interest expense							
Advertising	459	528	439	(69)	(13.1)	89	20.3
Director expense	475	420	444	55	13.1	(24)	(5.4)
Other expense	3,924	3,684	3,223	240	6.5	461	14.3
Total other non-interest expense	4,858	4,632	4,106	226	4.9	526	12.8

Total non-interest expense	\$ 33,357	\$ 31,696	\$ 28,677	\$ 1,661	5.2	%	\$ 3,019	10.5	%
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2010 Compared with 2009:

The increase in salaries and benefits over the same period last year is primarily due to higher personnel-related costs associated with branch expansion, as well as annual merit increases. The number of average FTE totaled 201 and 195 in 2010 and 2009, respectively. In addition, a rise in employee benefit rates contributed to the increase.

The increases in occupancy and equipment expense are mainly due to an increase in rent for our Greenbrae branch in its first full-year of service in 2010, and also the new Santa Rosa loan production office, partially offset by cost savings from the relocation of our Corte Madera branch.

The decrease in 2010 FDIC insurance is due to the absence of a special assessment totaling \$496 thousand in the second quarter of 2009, partially offset by a higher FDIC assessment rate and higher deposits. Further, we elected to participate in the FDIC Transaction Account Guarantee Program, which provided unlimited insurance coverage on non-interest-bearing transaction accounts defined by the FDIC, on which we paid a 10 basis point surcharge per \$100 covered balances in excess of \$250 thousand through 2009. The 10 basis point surcharge on non-interest-bearing transaction accounts over \$250 thousand increased to 15 basis points from January to December 2010, at which time the program expired.

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As discussed in section the captioned “FDIC Insurance Assessments” in Item 1 Business above, on February 7, 2010, the FDIC adopted a new FDIC insurance assessment base effective in the second quarter of 2011, which is expected to lower our FDIC insurance cost by approximately one-third annually.

The increase in data processing expense is due to process re-engineering costs, an annual contractual rate increase, as well as the outsourcing of certain trust operations.

The increase in professional service expenses in 2010 when compared to 2009 is mainly due to higher costs associated with strategic expansion initiatives and investment advisory fees.

Advertising expenses decreased, primarily due to a decrease in the usage of traditional print advertising channels as part of the marketing program.

Director fees increased due to the director compensation rate increase, partially offset by fewer directors.

The increase in other non-interest expense from a year ago was primarily due to a higher provision for losses on off-balance sheet commitments due to a higher commitment amount, operational losses, printing and stationery costs, charitable contributions and staff relation costs.

2009 Compared with 2008:

The increase in salaries and benefits in 2009 from the prior year primarily reflected annual merit increases, higher personnel costs associated with branch expansion, higher incentive compensation, as well as higher employee insurance. Average FTE totaled 195 and 190 during 2009 and 2008, respectively.

The increase in occupancy and equipment expenses in 2009 from 2008 was primarily related to higher premises rent associated with the new Greenbrae branch opened in September 2009 and increases for renewed leases, as well as a full year of rent for the Mill Valley branch opened in June 2008.

Depreciation and amortization increased slightly in 2009 and reflected amortization of the recently capitalized leasehold improvements of the Greenbrae and Mill Valley branches, partially offset by the effect of certain assets that became fully-depreciated in 2009.

The increase in FDIC insurance in 2009 was due to a higher FDIC assessment rate (which more than doubled from 2008), and higher deposits. Effective April 1, 2009, the FDIC adopted a final rule revising its risk-based insurance assessment system and effectively increasing the overall assessment rate. The revised initial base assessment rates for Risk Category 1 institutions ranged from twelve to sixteen basis points, on an annualized basis. The FDIC also imposed a special deposit insurance assessment of five basis points on all insured institutions’ total assets minus Tier 1 capital at June 30, 2009 in order to replenish the Deposit Insurance Fund. As a result, we recognized \$496 thousand from this special assessment in 2009.

Data processing costs decreased in 2009 over 2008 as we benefitted from the renegotiation of our contract with our data processing vendor.

The increase in professional services in 2009 over 2008 was primarily due to an increase in legal expenses relating to the repurchase of preferred shares as well as legal expenses relating to delinquent loans. These increases were partially offset by decreases in other professional fees associated with the discontinuation of a consulting agreement that began in July of 2006 and ended in June of 2008.

The increase in advertising expenses from 2008 is primarily due to fees associated with a new public relations firm. The decrease in director expense in 2009 is primarily due to the departure of two directors who retired in May 2009.

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The increase in other expense in 2009 over 2008 reflected operational losses in the second quarter of 2009 as well as the absence of a \$242 thousand litigation liability cost reversed in 2008. In 2007, other expense included a pre-tax non-recurring charge of \$242 thousand recorded in the fourth quarter for the potential obligation to Visa U.S.A. in connection with certain litigation indemnifications provided to Visa U.S.A. by Visa member banks. Such amount was reversed in 2008 against other expense upon Visa Inc.'s Initial Public Offering in 2008 as discussed in Note 13 to Consolidated Financial Statements.

Provision for Income Taxes

We reported a provision for income taxes of \$8.2 million, \$7.8 million, and \$7.9 million for the years ended December 31, 2010, 2009, and 2008 respectively. The effective tax rates were 37.6%, 37.9%, and 39.3% for those same periods. These 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 qualified municipal securities, BOLI and certain tax-exempt loans). Therefore, there are normal fluctuations in the effective rate from period to period based on the relationship of net permanent differences to income before tax. We have not been subject to an alternative minimum tax ("AMT") during these periods.

Bancorp and the Bank have entered into a tax allocation agreement which provides that income taxes shall be allocated between the parties on a separate entity basis. The intent of this agreement is that each member of the consolidated group will incur no greater tax liability than it would have incurred on a stand-alone basis.

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FINANCIAL CONDITION

Short-term Investment

At December 31, 2010 and 2009, we had \$19.5 million and \$15 million held in money market accounts with our correspondent banks, respectively, which earned interest at rates between 0.35% to 0.55% during 2010 and at a rate of 0.60% during 2009.

Investment Securities

We maintain an investment securities portfolio to provide liquidity and to generate earnings on funds that have not been loaned to customers. Management determines the maturities and the types of securities to be purchased based on the liquidity level and the desire to attain a reasonable investment yield balanced with risk exposure. Table 6 shows the makeup of the securities portfolio by expected maturity at December 31, 2010 and 2009. Expected maturities differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. Equity securities with a zero cost basis and a fair value of \$608 thousand are excluded from the following table because they do not have a stated maturity.

Table 6 Investment Securities

Type and Maturity Grouping	December 31, 2010				December 31, 2009				
	Principal Amount	Amortized Cost ¹	Fair Value	Weighted Average Yield ²	Principal Amount	Amortized Cost ¹	Fair Value	Weighted Average Yield ²	
(Dollars in thousands)									
Held to maturity									
State and municipal									
Due within 1 year	\$ 1,624	\$ 1,478	\$ 1,500	5.81	\$ 665	\$ 671	\$ 682	4.76	%
Due after 1 but within 5 years	5,471	5,304	5,440	4.41	3,770	3,863	4,017	5.41	
Due after 5 but within 10 years	20,905	20,589	20,784	5.11	11,840	12,403	12,831	5.72	
Due after 10 years	7,561	7,546	7,366	6.01	13,335	13,459	13,256	5.78	
Total held to maturity	35,561	34,917	35,090	5.23	29,610	30,396	30,786	5.69	
Available for sale									
U. S. government agencies									
Due within 1 year	5,946	5,839	5,873	5.16	3,264	3,270	3,289	4.62	
Due after 1 but within 5 years	72,509	71,899	73,700	3.56	36,986	37,339	38,672	4.99	
Due after 5 but within 10 years	15,518	15,483	15,685	4.10	29,563	30,674	30,373	3.84	
Due after 10 years	---	---	---	---	10,525	10,650	10,888	5.06	
Total	93,973	93,221	95,258	3.75	80,338	81,933	83,222	4.56	
Corporate CMOs									
Due within 1 year	---	---	---	---	2,088	2,103	2,075	3.91	
	15,869	15,849	15,870	4.27	4,637	4,646	4,628	4.89	

Due after 1 but within 5 years									
Due after 5 but within 10 years	---	---	---	---	8,068	8,070	7,893	4.62	
Total	15,869	15,849	15,870	4.27	14,793	14,819	14,596	4.60	
Total available for sale	109,842	109,070	111,128	3.83	95,131	96,752	97,818	4.57	
Total	\$ 145,403	\$ 143,987	\$ 146,218	4.17	% \$ 124,741	\$ 127,148	\$ 128,604	4.83	%

1 Book value reflects cost, adjusted for accumulated amortization and accretion.

2 Yields on tax-exempt securities are presented on a tax-equivalent basis and weighted average calculation is based on amortized cost of securities.

The carrying amount of our investment securities portfolio, consisting primarily of obligations of U.S. government agencies, state and municipal securities and corporate collateralized mortgage obligations (“CMOs”), increased \$18.4 million or 14.4% at December 31, 2010 due to our excess liquidity from deposit inflows that has not been deployed to lending, and the recognition of a zero-cost basis equity security at its fair value of \$608 thousand. U.S. government agency securities, which make up 65.0% and 64.9% of the portfolio at December 31, 2010 and 2009 respectively, increased \$12.0 million in 2010. State and municipal securities, which represented 23.8% and 23.7% of the portfolio at December 31, 2010 and 2009 respectively, increased \$4.5 million. See discussion in section captioned “Securities May Lose Value due to Credit Quality of the Issuers” in Item 1A Risk Factors above. Corporate collateralized mortgage obligation securities increased \$1.3 million in 2010. The weighted average maturity of the portfolio at December 31, 2010 was approximately four years.

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As a member bank of Visa U.S.A., we hold 16,939 shares of Visa Inc. Class B common stock at a zero cost basis. These shares are restricted from resale until their conversion into Class A (voting) shares on the later of March 25, 2011 or the termination of Visa Inc.'s covered litigation escrow account upon the final resolution of the Visa Inc. covered litigation. The stock was classified as available-for-sale securities and reported at fair value, with the unrealized gain, net of tax, recognized in other comprehensive income. The fair value of the Class B common stock we own was \$608 thousand as of December 31, 2010 based on the Class A as-converted rate of 0.5102.

Mortgage-backed securities in the portfolio at December 31, 2010 totaled \$111.1 million, which consisted of \$16.4 million pass-through securities issued by FNMA and FHLMC, \$78.8 million other mortgage backed securities issued or guaranteed by FNMA, FHLMC, or Government National Mortgage Association ("GNMA"), and \$15.9 million of corporate CMOs. We generally invest in mortgage-backed securities with borrowers having strong credit scores and/or collateral compositions reflecting low loan-to-value ratios. Any investment securities in our portfolio that may be backed by sub-prime or Alt-A mortgages relate primarily to certain GNMA agency securities, which are guaranteed by the US government, or a portion of our corporate CMOs, which account for approximately 5% of our total security portfolio. See Note 2 to Consolidated Financial Statements and Item 1A, Risk Factors, for more information on investment securities.

Loans

Table 7 Loans Outstanding by Type at December 31

(Dollars in thousands)	2010	2009	2008	2007	2006
Commercial loans	\$153,836	\$164,643	\$146,483	\$124,336	\$117,391
Real estate					
Commercial owner-occupied	142,590	146,133	140,977	132,614	123,430
Commercial investor	383,553	332,752	326,193	257,127	188,262
Construction	77,619	91,289	121,981	97,153	116,790
Home equity	86,932	83,977	65,076	34,295	30,558
Other residential 1	69,991	69,369	55,600	44,565	28,354
Indirect auto loans	---	---	---	---	84,141
Installment and other consumer loans	26,879	29,585	34,234	34,788	30,852
Total loans	941,400	917,748	890,544	724,878	719,778
Allowance for loan losses	(12,392)	(10,618)	(9,950)	(7,575)	(8,023)
Total net loans	\$929,008	\$907,130	\$880,594	\$717,303	\$711,755

1 Our residential loan portfolio includes no sub-prime loans, nor is it our normal 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 collateral compositions reflecting high loan-to-value ratios. However, substantially all of our residential loans are indexed to Treasury Constant Maturity Rates and have provisions to reset five years after their origination dates.

Commercial loans decreased \$10.8 million in 2010 and increased \$18.2 million in 2009. The decrease in 2010 related to increased pay-downs as borrowers de-leveraged, successful resolution of problem loans and reduced demand by qualified borrowers. The growth in 2009 was the result of our continued emphasis on commercial and industrial lending, specifically asset-based lines of credit.

Commercial real estate loans increased \$47.3 million in 2010 and \$11.7 million in 2009. The increase in 2010 reflects several large new relationships in our newer markets, primarily San Francisco and Santa Rosa. Of the commercial real

estate loans at December 31, 2010, 73% are non-owner occupied and 27% are owner occupied. Our commercial real estate loan portfolio is weighted towards term loans for which the primary source of repayment is cash flow from net operating income of the real estate property. The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2010 and 2009:

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Table 8 Commercial Real Estate Loans Outstanding by Geographic Location

(Dollars in thousands)	December 31, 2010			December 31, 2009		
	Amount	% of Commercial real estate loans		Amount	% of Commercial real estate loans	
Marin	\$235,584	44.8	%	\$224,018	46.8	%
Sonoma	80,563	15.3		66,329	13.8	
San Francisco	78,307	14.9		58,219	12.2	
Alameda	36,083	6.8		30,265	6.3	
Contra Costa	7,855	1.5		7,909	1.6	
Napa	12,117	2.3		12,282	2.6	
Sacramento	11,057	2.1		12,760	2.7	
Other	64,577	12.3		67,103	14.0	
Total	\$526,143	100.0	%	\$478,885	100.0	%

Construction loans decreased \$13.7 million in 2010, primarily due to a slow down in construction activities, as well as a conscious effort to reduce our concentration in construction loans. Construction loans decreased \$30.7 million in 2009 primarily due to the successful completion and sell-through of construction development projects booked in prior years. Table 9 below shows an analysis of construction loans by type and location.

Table 9 Construction Loans Outstanding by Type and Geographic Location

Construction loans by type (Dollars in thousands)	December 31, 2010			December 31, 2009		
	Amount	% of Construction Loans		Amount	% of Construction Loans	
Single family non-owner-occupied	\$12,453	16.0	%	\$14,903	16.3	%
Single family owner-occupied	3,448	4.4		6,404	7.0	
Commercial non-owner-occupied	7,189	9.3		6,444	7.1	
Commerical owner-occupied	3,386	4.4		3,204	3.5	
Land non-owner-occupied	37,660	48.5		43,750	47.9	
Land owner-occupied	2,595	3.4		-	-	
Tenants-in-common and other	10,888	14.0		16,584	18.2	
Total	\$77,619	100.0	%	\$91,289	100.0	%

Construction loans by geographic location (Dollars in thousands)	December 31, 2010			December 31, 2009		
	Amount	% of Construction Loans		Amount	% of Construction Loans	
Marin	\$17,710	22.8	%	\$19,729	21.6	%
Sonoma	7,884	10.1		8,302	9.1	
San Francisco	44,310	57.1		52,641	57.7	
Alameda	1,748	2.3		2,545	2.8	
Contra Costa	265	0.3		320	0.3	
Napa	1,002	1.3		879	1.0	
Riverside	4,652	6.0		4,418	4.8	
Other	48	0.1		2,455	2.7	

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Total	\$77,619	100.0	%	\$91,289	100.0	%
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Home equity lines of credit increased \$3.0 million to \$86.9 million in 2010. Other residential real estate loans increased \$622 thousand in 2010 and \$13.8 million in 2009. The majority of the residential real estate loan growth in 2009 was the result of the conversion from acquisition and development loans in the construction portfolio to loans on tenants-in-common units in San Francisco.

Approximately 86% of our outstanding loans are secured by real estate at both December 31, 2010 and 2009. At December 31, 2010, approximately 16% of our commercial real estate loans and half of our residential real estate loans contain an interest-only feature as part of the loan terms. Approximately 88% of the interest-only commercial real estate loans and 91% of the residential real estate loans are considered to have low credit risk (graded "Pass") and are current with their payments. Also see Item 1A, Risk Factors, regarding our loan concentration risk. As of December 31, 2010, approximately \$41.8 million of our loans have interest reserves, the majority of which are construction loans. When we determine a loan is impaired before the interest reserve has been depleted, the interest funded by the interest reserve is applied against loan principal. As of December 31, 2010, no construction loans having interest reserve balances were determined to be impaired.

Variable rate loans at their established interest rate floors or ceilings are included as fixed rate loans in the following table. Table 10 shows a shift towards fixed rate loans within the portfolio in 2010 when compared to 2009 as variable rate loans continued to re-price down to their floor rates in a low-interest rate environment. The large majority of the variable rate loans are tied to independent indices (such as the Wall Street Journal prime rate or a Treasury Constant Maturity Rate). Substantially all loans with an original term of more than five years have provisions for the fixed rates to reset, or convert to a variable rate, after one, three or five years.

Table 10 Loan Portfolio Maturity Distribution and Interest Rate Sensitivity

(Dollars in thousands)	December 31, 2010				December 31, 2009			
	Fixed Rate	Variable Rate	Total	Percent	Fixed Rate	Variable Rate	Total	Percent
Due within 1 year	\$134,346	\$118,860	\$253,206	26.9 %	\$114,727	\$94,534	\$209,261	22.8 %
Due after 1 but within 5 years	214,467	52,236	266,703	28.3	198,635	76,501	275,136	30.0
Due after 5 years	421,491	---	421,491	44.8	336,616	96,735	433,351	47.2
Total	\$770,304	\$171,096	\$941,400	100.0 %	\$649,978	\$267,770	\$917,748	100.0 %
Percentage	81.83 %	18.17 %	100.00 %		70.82 %	29.18 %	100.00 %	

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Allowance for Loan Losses

Credit risk is inherent in the business of lending. As a result, we maintain an allowance for loan losses to absorb losses inherent in our loan portfolio through a provision for loan losses charged against earnings. All specifically identifiable and quantifiable losses are charged off against the allowance. The balance of our allowance for loan losses is Management's best estimate of the remaining losses inherent in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rates and economic and political environments. Based on the current conditions of the loan portfolio, Management believes that the \$12.4 million allowance for loan losses at December 31, 2010 is adequate to absorb losses inherent in our loan portfolio. No assurance can be given, however, that adverse economic conditions or other circumstances will not result in increased losses in the portfolio.

The Components of the Allowance for Loan Losses

As stated previously in "Critical Accounting Policies," and Note 1 to the Consolidated Financial Statements in this report, the overall allowance consists of a specific allowance for individually identified impaired loans, an allowance factor for categories of credits with similar characteristics and trends, and an allowance for changing environmental factors.

The first component, the specific allowance, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management's ongoing loan grading process, individual loans are identified that have conditions that indicate the borrower may be unable to pay all amounts due under the contractual terms. These loans are evaluated individually for impairment by Management and specific allowances for loan losses are established when the discounted cash flows of future payments or collateral value of collateral-dependent loans are lower than the recorded investment in the loan. Impaired loan balances increased from \$12.2 million at December 31, 2009 to \$14.1 million at December 31, 2010. The specific allowance increased from \$45 thousand at December 31, 2009 to \$1.1 million at December 31, 2010. The increase in the specific allowance primarily related to commercial, mobile home and home equity loans awaiting resolution of pending events before a determination can be made as to whether or not the loan should be charged-off.

The second component, the allowance factor, is an estimate of the probable inherent losses in each loan pool stratified by major categories or loans with similar characteristics in our loan portfolio. This analysis encompasses loan types and economic and business conditions unique to each segment, including the Bank's own loss history. This analysis covers our entire loan portfolio but excludes any loans that were analyzed individually for specific allowances as discussed above. For loans graded "Substandard" and not already evaluated for impairment in the first component analysis above, they are also assigned an allowance factor. Confirmation of the quality of our grading process is obtained by independent reviews conducted by consultants specifically hired for this purpose and by various bank regulatory agencies. There are limitations to any credit risk grading process. The number of loans makes it impractical to review every loan at every reporting date. Therefore, it is possible that in the future some currently performing loans not recently graded will not be as strong as their last grading and an insufficient portion of the allowance will have been allocated to them. Grading and loan review often must be done without knowing whether all relevant facts are at hand. Troubled borrowers may deliberately or inadvertently omit important information from reports or conversations with lending officers regarding their financial condition and the diminished strength of repayment sources.

The total amount allocated for the second component is determined by applying loss estimation factors to outstanding loan types. At December 31, 2010 and 2009, the allowance allocated by categories of credits totaled \$8.3 million and \$7.6 million, respectively. The increase mainly related to an increased allowance factor for non-owner-occupied

commercial real estate loans, as Management recognizes increased inherent risk and concentration in these loans, as well as a factor added for loans graded "Substandard". As disclosed in Note 3 to Consolidated Financial Statements in Item 8 below, loans graded "Substandard" totaled \$53.2 million as of December 31, 2010.

The third component of the allowance for loan losses is an economic component that is not allocated to specific loans or groups of loans, but rather is intended to absorb losses caused by portfolio trends, concentration of credit, growth, and economic trends. The general valuation allowance, including the economic component and unallocated allowance, totaled approximately \$3.0 million at both December 31, 2010 and 2009. Management proactively evaluates economic and other qualitative loss factors used to determine the adequacy of the allowance for loan losses. After assessing the economic outlook, Management did not revise the economic component in 2010 due to limited signs of economic recovery and continued financial stress experienced by borrowers in our markets. The persistently high unemployment rate and restrained spending by consumers and businesses are expected to prevent rapid economic expansion and recovery of housing prices.

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Table 11 shows the allocation of the allowance by loan type as well as the percentage of total loans in each of the same loan types.

Table 11 Allocation of Allowance for Loan Losses

	December 31, 2010		December 31, 2009		December 31, 2008		December 31, 2007		December 31, 2006	
	Loans as percent	Allowance balance of total allocation	Loans as percent	Allowance balance of total allocation	Loans as percent	Allowance balance of total allocation	Loans as percent	Allowance balance of total allocation	Loans as percent	Allowance balance of total allocation
(Dollars in thousands)										
Commercial loans	\$3,114	16.3 %	\$2,544	17.9 %	\$2,306	16.5 %	\$1,811	17.2 %	\$1,710	16.3 %
Real Estate										
Commercial	5,171	55.9	4,006	52.2	3,911	52.5	2,866	53.8	2,262	43.3
Construction	1,694	8.3	1,832	9.9	2,118	13.6	1,659	13.4	1,995	16.2
Home Equity	643	9.2	586	9.2	453	7.3	205	4.7	182	4.3
Other residential	738	7.4	734	7.6	588	6.2	426	6.1	271	3.9
Installment and other consumer	835	2.9	662	3.2	563	3.9	430	4.8	1,389	16.0
Unallocated allowance	197	N/A	254	N/A	11	N/A	178	N/A	214	N/A
Total allowance for loan losses	\$12,392		\$10,618		\$9,950		\$7,575		\$8,023	
Total percent		100.00%		100.00%		100.00%		100.00%		100.00%

The allowance for loan losses as a percentage of loans totaled 1.32% at December 31, 2010, compared to 1.16% at December 31, 2009. The increase in the allowance for loan losses as a percentage of loans reflects a higher level of non-performing loans and the related specific reserves.

Table 12 shows the activity in the allowance for loan losses for each of the years in the five-year period ended December 31, 2010. Net charge-offs totaled \$3.6 million and \$4.8 million in 2010 and 2009, respectively, primarily related to commercial and construction loans secured by real property where the value of collateral has declined, and to a lesser extent, personal loans and home equity loans. Our 2010 and 2009 construction loan losses have stemmed primarily from the land development and single-family residential construction projects in Oregon and Sonoma County, California, where property values have been affected more significantly than in our core market of Marin County. Net charge-offs in 2008 totaling \$2.6 million primarily relate to construction loans secured by real property where the value of collateral declined. The percentage of net charge-offs to average loans decreased from 0.53% in 2009 to 0.38% in 2010, primarily due to a lower level of credit losses in the commercial portfolio.

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Table 12 Allowance for Loan Losses at December 31

(Dollars in thousands)	2010	2009	2008	2007	2006
Beginning balance	\$10,618	\$9,950	\$7,575	\$8,023	\$7,115
Cumulative-effect adjustment of election of fair value accounting on indirect auto portfolios 1	---	---	---	(1,048)	---
Provision for loan losses	5,350	5,510	5,010	685	1,266
Loans charged off					
Commercial	(643)	(1,552)	(1,100)	---	(172)
Real Estate					
Commercial	(47)	(9)	---	---	---
Construction	(2,628)	(3,046)	(1,508)	---	---
Home equity	(150)	(96)	---	---	---
Installment and other consumer	(318)	(659)	(72)	(115)	(424)
Total	(3,786)	(5,362)	(2,680)	(115)	(596)
Loan loss recoveries					
Commercial	95	52	24	---	35
Real Estate					
Construction	95	397	---	---	---
Installment and other consumer	20	71	21	30	203
Total	210	520	45	30	238
Net loans charged off	(3,576)	(4,842)	(2,635)	(85)	(358)
Ending balance	\$12,392	\$10,618	\$9,950	\$7,575	\$8,023
Total loans outstanding at end of year, before deducting allowance for loan losses	\$941,400	\$917,748	\$890,544	\$724,878	\$719,778
Average total loans outstanding during year	\$929,755	\$910,456	\$798,369	\$703,087	\$701,732
Ratio of allowance for loan losses to total loans at end of year	1.32 %	1.16 %	1.12 %	1.05 %	1.11 %
Net charge-offs to average loans	0.38 %	0.53 %	0.33 %	0.01 %	0.05 %
Ratio of allowance for loan losses to net charge-offs	346.5 %	219.3 %	377.6 %	8,911.8 %	2,241.1 %

1 In conjunction with the election of accounting for the indirect auto loan portfolio at fair value in 2007, an unrealized loss of \$3.5 million was recorded as a reduction of loans, and the allowance for loan losses was reduced by \$1.0 million.

Non-performing assets for each of the past five years are presented below. The ratio of allowance for loan losses to non-accrual loans increased from 91.8% at December 31, 2009 to 95.9% at December 31, 2010. There were no accruing loans past due 90 days or more, nor other real estate owned at the end of the years presented.

Table 13

Non-performing Assets at December 31

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(Dollars in thousands)	2010		2009		2008		2007		2006	
Non-performing loans:										
Construction	\$9,297		\$6,520		\$5,804		\$---		\$---	
Commercial real estate	632		3,722		---		---		---	
Commercial	2,486		910		145		---		49	
Installment and other consumer	362		313		455		---		---	
Home equity line of credit	-		100		288		144		---	
Other residential	148		---		---		---		---	
Total non-accrual loans	12,925		11,565		6,692		144		49	
Repossessed personal properties	135		96		---		---		---	
Total non-performing assets	13,060		11,661		6,692		144		49	
Accruing restructured loans:										
Installment and other consumer	925		566		119		---		---	
Home Equity	259		---		---		---		---	
Commercial	-		49		---		---		---	
Total accruing restructured loans	1,184		615		119		---		---	
Total impaired loans	14,109		12,180		6,811		\$144		\$49	
Allowance for loan losses to non-accrual loans at period end										
	95.9	%	91.8	%	148.7	%	5,260.4	%		NM
Non-performing loans to total loans										
	1.37	%	1.26	%	0.75	%	0.02	%	0.01	%

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Troubled debt restructured loans, whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties, totaled \$1.2 million and \$780 thousand as of December 31, 2010 and 2009, respectively.

Other Assets

As financial institutions continue to fail, the FDIC Deposit Insurance Fund is depleting rapidly. Therefore, in December 2009, the FDIC required banks to prepay their regular insurance premiums for 2010 through 2012. Other assets included \$3.0 million and \$4.4 million of prepaid FDIC assessments at December 31, 2010 and 2009, respectively. Each quarter for the next two years, the prepaid insurance asset balance will be reduced by the FDIC insurance expense that is applicable to that quarter.

BOLI totaled \$18.3 million at December 31, 2010, compared to \$17.6 million at December 30, 2009, and is recorded in other assets. Other assets also include net deferred tax assets of \$6.6 million and \$6.5 million at December 31, 2010 and 2009, respectively. These deferred tax assets consist primarily of tax benefits expected to be realized in future periods related to temporary differences of allowance for loan losses, depreciation, state tax, stock-based compensation and deferred compensation. Management believes these assets to be realizable due to our consistent record of earnings and the expectation that earnings will continue at a level adequate to realize such benefits.

In addition, we held \$5.0 million and \$4.7 million of FHLB stock recorded at cost in other assets at December 31, 2010 and 2009, respectively. The FHLB paid \$16 thousand and \$9 thousand in cash dividends in 2010 and 2009, respectively. On February 22, 2011, FHLB declared a cash dividend for the fourth quarter of 2010 at an annualized dividend rate of 0.29%. Management does not believe that FHLB stock is other-than-temporarily-impaired as we expect to be able to redeem the stock at cost.

Deposits

Deposits, which are used to fund our interest earning assets, increased \$71.7 million, or 7.6%, in 2010. Failures in a large number of banks have led to increased customer concern over deposit safety. We believe that we have successfully attracted new deposits due to our financial soundness, our personalized customer service, and our focus on relationship-building and cross-selling. The economic downturn also appears to have impacted the general public's investment behavior, as evidenced by a national trend of increasing household savings and movement away from higher-risk equity investments.

We have experienced a slight shift in the mix of interest-bearing deposits in 2010 compared to 2009. The proportion of money market deposit accounts has decreased while the proportion of time deposits and non-interest bearing deposits have increased slightly. We believe the shift in relative proportions is due to the low interest rate environment as time deposit accounts generally offer higher interest rates and due to customers seeking safety as CDARS® deposits are fully insured by the FDIC. No individual customer accounted for more than 5% of deposits.

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Table 14 shows the relative composition of our average deposits for the years 2010, 2009 and 2008.

Table 14 Distribution of Average Deposits

(Dollars in thousands)	Year ended December 31,						
	2010		2009		2008		
	Amount	Percent	Amount	Percent	Amount	Percent	
Non-interest bearing	\$263,742	26.4	% \$232,502	25.6	% \$208,320	25.7	%
Interest bearing	98,168	9.8	90,159	9.9	78,671	9.7	
Savings	51,738	5.2	45,944	5.0	40,239	5.0	
Money market	390,575	39.0	391,571	43.1	390,383	48.2	
CDARS®	71,432	7.1	51,248	5.6	9,039	1.1	
Other Time deposits							
Less than \$100,000	43,069	4.3	36,350	4.0	39,496	4.9	
\$100,000 or more	81,562	8.2	61,574	6.8	44,239	5.4	
Total other time deposits	124,631	12.5	97,924	10.8	83,735	10.3	
Total Average Deposits	\$1,000,286	100.00	% \$909,348	100.00	% \$810,387	100.0	%

Table 15 below shows the maturity groupings for time deposits of \$100,000 or more, including CDARS® deposits at December 31, 2010, 2009 and 2008.

Table 15 Maturities of Time Deposits of \$100,000 or more at December 31

(Dollars in thousands)	December 31,		
	2010	2009	2008
Three months or less	\$77,173	\$56,456	\$27,985
Over three months through six months	24,135	19,446	7,462
Over six months through twelve months	35,713	30,458	15,907
Over twelve months	18,699	5,830	4,105
Total	\$155,720	\$112,190	\$55,459

Borrowings

We currently have \$219.2 million in secured lines of credit with FHLB, \$40.2 million with Federal Reserve Bank of San Francisco (“FRB”) and \$77.0 million in unsecured lines with correspondent banks to cover any short or long-term borrowing needs. As of December 31, 2010, we had three FHLB fixed-rate advances outstanding totaling \$55 million, leaving \$164.2 million available borrowing capacity with FHLB. The FRB and correspondent bank lines were unutilized at December 31, 2010. For additional information, see Note 8 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Deferred Compensation Obligations

We maintain a nonqualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments upon retirement, death, or disability. The plan provides for payments for up to fifteen years commencing upon retirement and reduced benefits upon early retirement, disability, or termination of employment. The participating employee may elect to receive payments over periods not to exceed fifteen years. At December 31, 2010 and 2009, our aggregate payment obligations under this plan totaled \$2.8 million and \$2.7 million, respectively. For additional information, see

Note 11 to the Consolidated Financial Statements in Item 8 below.

Off Balance Sheet Arrangements

We make commitments to extend credit in the normal course of business to meet the financing needs of our customers. For additional information, see Note 17 to the Consolidated Financial Statements in Item 8 below.

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Commitments

The following is a summary of our contractual commitments as of December 31, 2010.

Table 16 Contractual Commitments at December 31, 2010

(Dollars in thousands)	Payments due by period				Total
	<1 year	1-3 years	4-5 years	>5 years	
Operating leases	\$2,440	\$4,873	\$4,704	\$15,492	\$27,509
Federal Home Loan Bank Borrowings	15,000	40,000	---	---	55,000
Subordinated debenture	---	---	---	5,000	5,000
Total	\$17,440	\$44,873	\$4,704	\$20,492	\$87,509

The contractual amount of loan commitments not reflected on the Consolidated Statement of Condition was \$252.7 million and \$231.9 million at December 31, 2010 and 2009, respectively.

As permitted or required under California law and to the maximum extent allowable under that law, we have certain obligations to indemnify our current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in, or not opposed to, our best interests, and with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments we could be required to make under these indemnification obligations is unlimited; however, we have a director and officer insurance policy that mitigates our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification obligations, net of expected insurance recoveries, is minimal.

Capital Adequacy

As discussed in Note 16 to the Consolidated Financial Statements, the Bank's capital ratios are above regulatory guidelines to be considered "well capitalized" and Bancorp's ratios exceed the required minimum ratios for capital adequacy purposes. The Bank's total risk-based capital ratio increased from 11.60% at December 31, 2009, to 12.70% at December 31, 2010, and Bancorp's total risk-based capital ratio increased from 12.33% at December 31, 2009, to 13.34% at December 31, 2010. The increases in the risk-based capital ratio are primarily due to the accumulation of net income in 2010 of \$13.6 million.

We expect to maintain strong capital levels. Our potential sources of capital include future earnings and shares issued upon the exercise of stock options. In addition, the warrant issued under the TCPP to purchase 154,521 shares of our common stock remains outstanding. The warrant, if exercised, would provide us with \$4.2 million additional Tier 1 capital. We are also positioned to access capital markets, if necessary, for up to \$75 million through a shelf registration filed on Form S-3 in the fourth quarter of 2009.

Liquidity

The goal of liquidity management is to provide adequate funds to meet both loan demand and unexpected deposit withdrawals. We accomplish this goal by maintaining an appropriate level of liquid assets, and formal lines of credit with the FHLB, FRB and correspondent banks that enable us to borrow funds as needed. Our Asset/Liability Management Committee ("ALCO"), which is comprised of certain directors of the Bank, is responsible for establishing and monitoring our liquidity targets and strategies.

Management regularly adjusts our investments in liquid assets based upon our assessment of expected loan demand, expected deposit flows, yields available on interest-earning securities and the objectives of our asset/liability management program. ALCO has also developed a contingency plan should liquidity drop unexpectedly below internal requirements.

We obtain funds from the repayment and maturity of loans as well as deposit inflows, investment security maturities and paydowns, Federal funds purchased FHLB advances, and other borrowings. Our primary uses of funds are the origination of loans, the purchase of investment securities, withdrawals of deposits, maturity of certificate of deposits, repayment of borrowings and dividends to stockholders.

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We must retain and attract 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. Any long-term decline in retail deposit funding would adversely impact our liquidity. Management does not anticipate significant reliance on Federal funds purchased and FHLB advances in the near future, as our core deposit inflow has provided adequate liquidity to fund our operations. If we were to rely on Federal Funds purchased or FHLB advances in the future, we expect to have the ability to post adequate collateral for such funding requirements.

As presented in the accompanying consolidated statements of cash flows, the sources of liquidity vary between periods. Consolidated cash and cash equivalents at December 31, 2010 totaled \$85.2 million, an increase of \$46.6 million over December 31, 2009. The primary sources of funds during 2010 included a \$71.7 million net increase in deposits, \$37.9 million in pay-downs and maturities of investment securities, and \$23.5 million net cash provided by operating activities. The primary uses of funds were \$56.0 million for investment securities purchases, and \$26.9 million in loan originations (net of principal collections). The excess liquidity from deposit inflows has not been deployed. The banking industry, as a whole, is experiencing diminished loan demand from qualified borrowers.

At December 31, 2010, our cash and cash equivalents and unpledged available-for-sale securities maturing within one year totaled \$91.1 million. The remainder of the unpledged available-for-sale securities portfolio of \$91.4 million provides additional liquidity. These liquid assets equaled 15.1% of our assets at December 31, 2010, compared to 11.9% at December 31, 2009, well in excess of our internal liquidity policy. The increased liquidity at December 31, 2010 was primarily due to deposit growth exceeding loan growth.

We anticipate that cash and cash equivalents on hand and other sources of funds will provide adequate liquidity for our operating, investing and financing needs and our regulatory liquidity requirements for the foreseeable future. Management monitors our liquidity position daily, balancing loan funding/payments with changes in deposit activity and overnight investments. Our emphasis on local deposits combined with our 10.1% equity to assets ratio, provides a very stable funding base. In addition to cash and cash equivalents, we have substantial additional borrowing capacity including unsecured lines of credit totaling \$77.0 million with correspondent banks. Further, on March 30, 2009, we pledged a certain residential loan portfolio that increased our borrowing capacity with the FRB, which totaled \$40.2 million at December 31, 2010. As of December 31, 2010, there is no debt outstanding to correspondent banks or the FRB. We are also a member of the FHLB and have a line of credit (secured under terms of a blanket collateral agreement by a pledge of essentially all of our financial assets) in the amount of \$219.2 million, of which \$164.2 million was available at December 31, 2010. Borrowings under the line are limited to eligible collateral. The interest rates on overnight borrowings with both correspondent banks and the FHLB are determined daily and generally approximate the Federal Funds target rate.

Undisbursed loan commitments, which are not reflected on the consolidated statement of condition, totaled \$252.7 million at December 31, 2010 at rates ranging from 1.91% to 8.25%. This amount included \$143.8 million under commercial lines of credit (these commitments are contingent upon customers maintaining specific credit standards), \$73.5 million under revolving home equity lines, \$22.7 million under undisbursed construction loans, \$8.9 million under personal and other lines of credit, and a remaining \$3.8 million under standby letters of credit. These commitments, to the extent used, are expected to be funded primarily through the repayment of existing loans, deposit growth and existing balance sheet liquidity. Over the next twelve months \$173.8 million of time deposits will mature. We expect these funds to be replaced with new time or savings accounts.

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 is restricted to the lesser of the Bank's retained earnings or the amount of the Bank's undistributed net profits from the previous three fiscal years. As the Bank made a \$28 million distribution to Bancorp in March 2009 in connection with

Bancorp's repurchase of preferred stock, distributions from the Bank to Bancorp will be subject to advance regulatory approval for three years beginning in 2010. The primary uses of funds for Bancorp are stockholder dividends and ordinary operating expenses. In 2010, after approval by the DFI, the Bank paid a \$3 million dividend to Bancorp, which held \$6.7 million of cash at December 31, 2010 to cover Bancorp's operational needs and cash dividends to shareholders for the near future. Management anticipates that there will be sufficient earnings at the Bank level to provide dividends to Bancorp to meet its funding requirements for the foreseeable future.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our most significant form of market risk is interest rate risk. The risk is inherent in our deposit and lending activities. Management, together with ALCO, has sought to manage rate sensitivity and maturities of assets and liabilities to minimize the exposure of our earnings and capital to changes in interest rates. Additionally, interest rate risk exposure is managed with the goal of minimizing the impact of interest rate volatility on our net interest margin. 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. Interest rate risk exposure is managed with the goal of minimizing the impact of interest rate volatility on the net interest margin.

Activities in asset and liability management include, but are not limited to, lending, borrowing, accepting deposits and investing in securities. Interest rate risk is the primary market risk associated with asset and liability management. Sensitivity of net interest income (“NII”) to interest rate changes results from differences in the maturity or repricing, of asset and liability portfolios. To mitigate interest rate risk, the structure of our assets and liabilities is managed with the objective of correlating the movements of interest rates on loans and investments with those of deposits and borrowings. The asset and liability policy sets limits on the acceptable amount of change to NII in changing interest rate environments. We use simulation models to forecast NII.

Exposure to interest rate risk is reviewed at least quarterly by the ALCO and the Board of Directors. They utilize interest rate sensitivity simulation models as a tool for achieving these objectives and for developing ways in which to improve profitability. A simplified statement of condition is prepared on a quarterly basis as a starting point, using as inputs, actual loans, investments, borrowings and deposits. If potential changes to net equity value and net interest income resulting from hypothetical interest changes are not within the limits established by the Board of Directors, Management may adjust the asset and liability mix to bring interest rate risk within approved limits.

In the following simulation of NII under various interest rate scenarios, the simplified statement of condition is processed against four interest rate change scenarios, in 100 basis point increments. As the Federal funds target rate at December 31, 2010 was already at its historic low of 0-0.25%, it is unlikely that there will be further reductions in the target rate. Therefore, a reduction-in-rate scenario is not considered in the following table at December 31, 2010. Each of these scenarios assumes that the change in interest rates is immediate and interest rates remain at the new levels.

Table 17 summarizes the effect on NII due to changing interest rates as measured against the flat rate scenario.

Table 17 Effect of Interest Rate Change on Net Interest Income at December 31, 2010

Changes in Interest Rates (in basis points)	Estimated change in NII (as percent of NII)
up 400	4.5%
up 300	2.4%
up 200	0.6%
up 100	(0.2)%

The above table estimates the impact of interest rate changes. The estimated changes are within our policy guidelines established by ALCO. The table indicates that at December 31, 2010, we were asset sensitive in a rising interest rate environment. The results shown reflect a lag in the upward re-pricing of loans due to loans on floors. We have mitigated earnings sensitivity somewhat through the procurement of fixed-rate borrowings.

As stated previously in the section captioned "Supervision and Regulation" included in Item 1 Business of this report, the Dodd-Frank Act repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the ultimate impact of this legislation on us has not yet been determined, we do not expect to incur significant interest expense on business transaction accounts immediately when the legislation takes effect in July 2011. If we were to pay interest on certain deposits that are currently non-interest bearing, causing these deposits to become rate sensitive, we would become less asset sensitive than the model currently indicates.

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From time to time, we enter into certain interest rate swap contracts designated as fair value hedges 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 15 to the consolidated financial statements in this Form 10-K.

As with any simulation model or other method of measuring interest rate risk, certain limitations are inherent in the process. For example, although certain of our assets and liabilities may have similar maturities or repricing time frames, they may react differently to changes in market interest rates. In addition, the changes in interest rates on certain categories of either our assets or liabilities may precede or lag changes in market interest rates.

Also, the actual rates and timing of prepayments on loans and investment securities could vary significantly from the assumptions used in the various scenarios. Further, changes in U.S. Treasury rates accompanied by a change in the shape of the yield curve could produce different results from those presented in the table. Accordingly, the results presented should not be relied upon as indicative of actual results in the event of changing market interest rates.

Interest rate sensitivity is a function of the repricing characteristics of our assets and liabilities. One aspect is the time frame within which the interest earning assets and interest bearing liabilities are subject to change in interest rates at repricing or maturity. An analysis of the repricing time frames is called a "gap" analysis because it shows the gap between the amounts of assets and liabilities repricing in each of several periods of time. Another aspect is the relative magnitude of the repricing for each category of interest earning asset and interest bearing liability given various changes in market rates. Gap analysis gives no indication of the relative magnitude of repricing. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of change in market rates. Interest rate sensitivity gaps are calculated as the difference between the amounts of assets and liabilities that are subject to repricing during various time periods.

Table 18 shows our repricing gaps as of December 31, 2010. Due to the limitations of gap analysis, as described above, we do not generally use it in managing interest rate risk. Instead we rely on the more sophisticated simulation model described above as the primary tool in measuring and managing interest rate risk. Our equity securities (Visa Stock) with a fair value of \$608 thousand are excluded from the investment securities in the following table.

Table 18

Interest Rate Sensitivity

(Dollars in thousands) At December 31, 2010	1-30 Days	31-90 Days	91-180 Days	181-365 Days	Over one year	Total
Interest Earning Assets						
Investment securities 1	\$---	\$---	\$---	\$7,351	\$138,694	\$146,045
Loans	142,340	20,942	49,614	43,762	684,742	941,400
Total	142,340	20,942	49,614	51,113	823,436	1,087,445
Interest Bearing Liabilities						
Transaction, savings and money market deposits	533,289	---	---	---	---	533,289
CDARS® time deposits	15,989	35,902	5,103	10,017	250	67,261
Other time deposits less than \$100,000	4,937	7,560	9,200	12,129	7,966	41,792
Other time deposits \$100,000 or more	9,920	17,540	19,351	24,738	19,653	91,202
Federal Home Loan Bank borrowings	---	---	---	---	55,000	55,000
Subordinated debenture						