

BANCORP RHODE ISLAND INC

Form 10-Q

August 04, 2010

**Table of Contents**

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

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

**For the quarterly period ended June 30, 2010  
or**

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

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

**Commission File No. 001-16101**

**BANCORP RHODE ISLAND, INC.**

(Exact name of Registrant as specified in its charter)

Rhode Island

05-0509802

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

ONE TURKS HEAD PLACE, PROVIDENCE, RI 02903

(Address of principal executive offices)

(401) 456-5000

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock, as of August 2, 2010:

Common Stock Par Value \$0.01

4,674,091 shares

(class)

(outstanding)



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

<b>Description</b>	<b>Page Number</b>
Cover Page	1
<u>Table of Contents</u>	2
 <b><u>Part I Financial Information</u></b>	
 <u>Item 1. Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Operations</u>	4
<u>Consolidated Statements of Changes in Shareholders' Equity</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Condensed Notes to Consolidated Financial Statements</u>	7-20
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21-42
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	43
<u>Item 4. Controls and Procedures</u>	44
 <b><u>Part II Other Information</u></b>	
<u>Item 1. Legal Proceedings</u>	45
<u>Item 1A. Risk Factors</u>	45
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
<u>Item 3. Defaults Upon Senior Securities</u>	45
<u>Item 5. Other Information</u>	45
<u>Item 6. Exhibits</u>	46
<u>Signature Page</u>	47
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	

Exhibit 32.1

Exhibit 32.2

**Special Note Regarding Forward Looking Statements**

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

**Table of Contents**

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

	<i>June 30, 2010</i>	<i>December 31, 2009</i>
	<i>(In thousands)</i>	
<b>ASSETS:</b>		
Cash and due from banks	\$ 23,857	\$ 18,866
Overnight investments	30,224	1,964
<b>Total cash and cash equivalents</b>	<b>54,081</b>	<b>20,830</b>
Available for sale securities (amortized cost of \$336,707 and \$380,108, respectively)	345,566	381,839
Stock in Federal Home Loan Bank of Boston	16,274	16,274
Loans and leases receivable:		
Commercial loans and leases	764,374	732,397
Residential mortgage loans	164,750	173,294
Consumer and other loans	207,400	206,156
<b>Total loans and leases receivable</b>	<b>1,136,524</b>	<b>1,111,847</b>
Allowance for loan and lease losses	(17,396)	(16,536)
<b>Net loans and leases receivable</b>	<b>1,119,128</b>	<b>1,095,311</b>
Premises and equipment, net	12,127	12,378
Goodwill, net	12,262	12,239
Accrued interest receivable	4,704	4,964
Investment in bank-owned life insurance	30,644	30,010
Prepaid expenses and other assets	18,734	16,101
<b>Total assets</b>	<b>\$ 1,613,520</b>	<b>\$ 1,589,946</b>
<b>LIABILITIES:</b>		
Deposits:		
Demand deposit accounts	\$ 290,794	\$ 204,281
NOW accounts	73,501	74,558
Money market accounts	83,315	65,076
Savings accounts	366,087	367,225
Certificate of deposit accounts	360,323	387,144
<b>Total deposits</b>	<b>1,174,020</b>	<b>1,098,284</b>
Overnight and short-term borrowings	37,338	40,171
Wholesale repurchase agreements	20,000	20,000
Federal Home Loan Bank of Boston borrowings	223,396	277,183
Subordinated deferrable interest debentures	13,403	13,403
Other liabilities	16,236	20,244
<b>Total liabilities</b>	<b>1,484,393</b>	<b>1,469,285</b>

**SHAREHOLDERS EQUITY:**

Common stock, par value \$0.01 per share, authorized 11,000,000 shares: Issued: 5,047,941 and 4,969,444 shares, respectively	50	50
Additional paid-in capital	73,514	72,783
Treasury stock, at cost: 373,850 and 364,750 shares, respectively	(12,527)	(12,309)
Retained earnings	62,332	59,012
Accumulated other comprehensive income, net	5,758	1,125
<b>Total shareholders equity</b>	<b>129,127</b>	<b>120,661</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 1,613,520</b>	<b>\$ 1,589,946</b>

*See accompanying notes to unaudited consolidated financial statements*

Table of Contents

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

	<i>Three Months Ended</i>		<i>Six Months Ended</i>	
	<i>June 30,</i>		<i>June 30,</i>	
	<i>2010</i>	<i>2009</i>	<i>2010</i>	<i>2009</i>
	<i>(In thousands, except per share data)</i>			
Interest and dividend income:				
Overnight investments	\$	\$	\$ 5	\$ 9
Mortgage-backed securities	3,041	3,360	6,270	6,763
Investment securities	490	536	1,040	987
Loans and leases	15,105	14,896	29,673	29,593
<b>Total interest and dividend income</b>	<b>18,636</b>	<b>18,792</b>	<b>36,988</b>	<b>37,352</b>
Interest expense:				
Deposits	2,164	4,224	4,442	8,718
Overnight and short-term borrowings	19	21	37	48
Wholesale repurchase agreements	143	134	282	267
Federal Home Loan Bank of Boston borrowings	2,518	2,650	5,183	5,275
Subordinated deferrable interest debentures	166	190	330	389
<b>Total interest expense</b>	<b>5,010</b>	<b>7,219</b>	<b>10,274</b>	<b>14,697</b>
<b>Net interest income</b>	<b>13,626</b>	<b>11,573</b>	<b>26,714</b>	<b>22,655</b>
Provision for loan and lease losses	1,550	2,600	3,150	4,210
<b>Net interest income after provision for loan and lease losses</b>	<b>12,076</b>	<b>8,973</b>	<b>23,564</b>	<b>18,445</b>
Noninterest income:				
Total other-than-temporary impairment losses on available for sale securities	(49)		49	
Non-credit component of other-than-temporary losses recognized in other comprehensive income	5		(664)	
Credit component of other-than-temporary impairment losses on available for sale securities	(44)		(615)	
Service charges on deposit accounts	1,348	1,367	2,612	2,577
Income from bank-owned life insurance	318	304	633	593
Commissions on nondeposit investment products	148	111	385	267
Loan related fees	133	229	322	628
Gain on sale of available for sale securities	103		578	61
Net gains on lease sales and commissions on loans originated for others	6	19	42	48
Other income	273	184	643	397
<b>Total noninterest income</b>	<b>2,285</b>	<b>2,214</b>	<b>4,600</b>	<b>4,571</b>



Noninterest expense:				
Salaries and employee benefits	5,746	4,926	11,589	10,079
Occupancy	829	832	1,690	1,788
Data processing	654	670	1,308	1,290
Professional services	537	646	1,169	1,344
FDIC insurance	475	1,176	950	1,563
Marketing	383	332	641	647
Loan workout and other real estate owned	337	149	673	277
Equipment	255	242	510	483
Loan servicing	171	189	347	348
Other expenses	1,043	983	2,041	1,949
<b>Total noninterest expense</b>	<b>10,430</b>	<b>10,145</b>	<b>20,918</b>	<b>19,768</b>
<b>Income before income taxes</b>	<b>3,931</b>	<b>1,042</b>	<b>7,246</b>	<b>3,248</b>
Income tax expense	1,250	302	2,346	1,045
<b>Net income</b>	<b>2,681</b>	<b>740</b>	<b>4,900</b>	<b>2,203</b>
Preferred stock dividends		(375)		(750)
Prepayment charges and accretion of preferred stock discount		(62)		(123)
<b>Net income applicable to common shares</b>	<b>\$ 2,681</b>	<b>\$ 303</b>	<b>\$ 4,900</b>	<b>\$ 1,330</b>
<b>Per share data:</b>				
Basic earnings per common share	\$ 0.57	\$ 0.07	\$ 1.05	\$ 0.29
Diluted earnings per common share	\$ 0.57	\$ 0.07	\$ 1.05	\$ 0.29
Cash dividends declared per common share	\$ 0.17	\$ 0.17	\$ 0.34	\$ 0.34
Weighted average common shares outstanding basic	4,664	4,602	4,643	4,596
Weighted average common shares outstanding diluted	4,690	4,620	4,670	4,615

*See accompanying notes to unaudited consolidated financial statements*

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

Six months ended June 30,	Preferred Stock	Common Stock	Additional Paid-in Capital <i>(In thousands, except per share data)</i>	Treasury Stock	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Total
<b>2009</b>							
Balance at December 31, 2008	\$ 28,595	\$ 49	\$ 73,323	\$ (12,055)	\$ 58,763	\$ 415	\$ 149,090
Cumulative effect of a change in accounting principle, net of taxes of (\$77)					137	(137)	
Net income					2,203		2,203
Other comprehensive income:							
Unrealized holding losses on securities available for sale, net of taxes of \$303						(564)	(564)
Reclassification adjustment for net gains included in net income, net of taxes of \$21						(40)	(40)
Total comprehensive income							1,599
Exercise of stock options		1	413				414
Macrolease acquisition			78				78
Share repurchases				(254)			(254)
Share-based compensation			(19)				(19)
Tax benefit from exercise of stock options			78				78
Preferred stock discount accretion	123				(123)		
Dividends on preferred stock (\$25.00 per preferred share)					(750)		(750)
Dividends on common stock (\$0.34 per common share)					(1,562)		(1,562)
Balance at June 30, 2009	\$ 28,718	\$ 50	\$ 73,873	\$ (12,309)	\$ 58,668	\$ (326)	\$ 148,674
<b>2010</b>							
Balance at December 31, 2009	\$	\$ 50	\$ 72,783	\$ (12,309)	\$ 59,012	\$ 1,125	\$ 120,661
Net income					4,900		4,900
Other comprehensive income:							
						4,578	4,578

Unrealized holding gains on securities available for sale, net of taxes of (\$2,465)							
Reclassification adjustment for net gains included in net income, net of taxes of \$202						(376)	(376)
Non-credit portion OTTI, net of taxes of (\$233)						431	431
Total comprehensive income							9,533
Exercise of stock options		297					297
Macrolease acquisition		211					211
Share repurchases			(218)				(218)
Share-based compensation		228					228
Tax benefit from exercise of stock options		(5)					(5)
Dividends on common stock (\$0.34 per common share)					(1,580)		(1,580)
Balance at June 30, 2010	\$	\$ 50	\$ 73,514	\$ (12,527)	\$ 62,332	\$ 5,758	\$ 129,127

*See accompanying notes to unaudited consolidated financial statements*

**Table of Contents**

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

	<i>Six Months Ended</i>	
	<i>June 30,</i>	
	<i>2010</i>	<i>2009</i>
	<i>(In thousands)</i>	
Cash flows from operating activities:		
Net income	\$ 4,900	\$ 2,203
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion, net	(2,778)	(2,878)
Provision for loan and lease losses	3,150	4,210
Income from bank-owned life insurance	(633)	(593)
Share-based compensation expense	228	(19)
Net gains on lease sales	(19)	(24)
Gain on sale of available for sale securities	(578)	(61)
Credit component of other-than-temporary impairment losses on available for sale securities	615	
Gain on sale of other real estate owned	(34)	(32)
Proceeds from sales of leases	909	759
Leases originated for sale	(890)	(579)
Decrease in accrued interest receivable	260	169
Increase in prepaid expenses and other assets	(326)	(328)
Decrease in other liabilities	(3,820)	(2,882)
Net cash provided by (used in) operating activities	984	(55)
Cash flows from investing activities:		
Available for sale securities:		
Purchases	(71,495)	(138,662)
Maturities and principal repayments	101,702	86,252
Proceeds from sales	8,628	1,880
Net increase in loans and leases	(24,469)	(39,249)
Capital expenditures for premises and equipment	(464)	(615)
Proceeds from sale of other real estate owned	755	729
Net cash provided by (used in) investing activities	14,657	(89,665)
Cash flows from financing activities:		
Net increase in deposits	75,736	42,481
Net decrease in overnight and short-term borrowings	(2,833)	(16,875)
Proceeds from long-term borrowings	33,700	49,805
Repayment of long-term borrowings	(87,487)	(16,701)
Exercise of stock options	79	160
Tax benefit from exercise of stock options	(5)	78
Dividends on preferred stock		(608)

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

Dividends on common stock	(1,580)	(1,562)
Net cash provided by financing activities	17,610	56,778
Net increase (decrease) in cash and cash equivalents	33,251	(32,942)
Cash and cash equivalents at beginning of period	20,830	55,457
Cash and cash equivalents at end of period	\$ 54,081	\$ 22,515
Supplementary Disclosures:		
Cash paid for interest	\$ 10,845	\$ 15,180
Cash paid for income taxes	1,955	2,159
Non-cash investing and financing transactions:		
Change in accumulated other comprehensive income, net of taxes	4,202	(604)
Cumulative effect of a change in accounting principle, net of taxes		137
Accrual of cumulative preferred dividends payable		142
Macrolease acquisition	23	78
Transfer of loans to other real estate owned	1,109	756
Transfer of loans to other assets (non-real estate foreclosed assets)		122
Treasury stock acquisitions from shares tendered in stock option exercises	218	254
Non-credit component of other-than-temporary impairment, net of taxes	431	
Sale of available for sale securities not yet settled	4,414	

*See accompanying notes to unaudited consolidated financial statements*

**Table of Contents**

**BANCORP RHODE ISLAND, INC.**

**Notes to Consolidated Financial Statements (unaudited)**

**(1) Basis of Presentation**

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

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

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

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

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

The unaudited interim results of consolidated operations are not necessarily indicative of the results for any future interim period or for the entire year. These interim consolidated financial statements do not include all disclosures associated with annual financial statements and, accordingly, should be read in conjunction with the annual consolidated financial statements and accompanying notes included in the Company's 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC).

**(2) Earnings Per Share**

Basic earnings per share (EPS) exclude dilution and are computed by dividing net income available to common shareholders by the weighted average number of common shares and participating securities outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of additional common stock that then share in the earnings of the Company.

**Table of Contents**

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<i>(In thousands, except per share data)</i>	
Basic EPS Computation:		
Numerator:		
Net income	\$ 2,681	\$ 740
Preferred stock dividend		(375)
Preferred stock accretion		(62)
Net income applicable to common shares	\$ 2,681	\$ 303
Denominator:		
Weighted average shares outstanding	4,664	4,602
Basic EPS	\$ 0.57	\$ 0.07
Diluted EPS Computation:		
Numerator:		
Net income applicable to common shares	\$ 2,681	\$ 303
Denominator:		
Common shares outstanding	4,664	4,602
Stock options	25	18
Contingent shares	1	
Total shares	4,690	4,620
Diluted EPS	\$ 0.57	\$ 0.07

For the three months ended June 30, 2010 and 2009, average options to purchase 224,900 and 328,793 shares of common stock, respectively, were outstanding but excluded from the computation of diluted EPS because they were anti-dilutive. For the three months ended June 30, 2009, average common stock warrants of 33,243 were outstanding but excluded from the computation of diluted EPS because they were anti-dilutive. There were no stock warrants outstanding at June 30, 2010.

**(3) Recently Adopted Accounting Pronouncements**

The Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 860, *Transfers and Servicing*, incorporates former Statements of Financial Accounting Standards ( SFAS ) No. 166, *Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140*, which was issued in June 2009. These provisions of ASC 860 eliminate the concept of a qualifying special-purpose entity ( QSPE ), create more stringent conditions for reporting a transfer of a portion of financial assets as a sale, clarify other sale-accounting criteria and change the initial measurement of a transferor's interest in transferred financial assets. These provisions of ASC 860 also require enhanced interim and year-end disclosures about a transferor's continuing involvement with transfers of financial assets accounted for as sales, the risks inherent in the transferred financial assets that have been retained and the nature and financial effect of restrictions on the transferor's assets that continue to be reported in the balance sheet. The adoption of these provisions of ASC 860 on January 1, 2010 did not have a material impact on the Company's consolidated financial statements.

ASC 810, *Consolidations*, incorporates former SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which was issued in June 2009. These provisions of ASC 810 address the effects of eliminating the QSPE concept, changes the approach to determining the primary beneficiary of a variable interest entity ( VIE ) and requires companies to assess more frequently whether a VIE must be consolidated. These provisions also require enhanced

interim and year-end disclosures about the significant judgments and assumptions considered in determining whether a VIE must be consolidated, the nature of restrictions on a consolidated VIE's assets, the risks associated with a company's involvement with a VIE and how that involvement affects the company's financial position, financial performance and cash flows. The adoption of these provisions of ASC 810 on January 1, 2010 did not have a material impact on the Company's consolidated financial statements.



**Table of Contents**

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

**(4) Recently Issued Accounting Pronouncements**

In July 2010, the FASB issued ASU No. 2010-20, *Receivables (Topic 320): Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. ASU No. 2010-20 amends ASC 310, *Receivables*, by requiring more robust and disaggregated disclosures about the credit quality of an entity's financing receivables and its allowance for credit losses. An entity will be required to disclose the nature of credit risk associated with its financing receivables and the assessment of that risk in estimating its allowance for credit losses, as well as changes in the allowance and the reason for those changes. The new and amended disclosures required under ASC 2010-20 that relate to information as of the end of a reporting period are effective for public entities with fiscal years and interim reporting periods ending on or after December 15, 2010. The disclosures that include information for activity that occurs during a reporting period are effective for public companies with the fiscal years or the first interim period beginning after December 15, 2010. The Company expects the adoption of ASU No. 2010-20 will require significant expansion to the Company's disclosures surrounding loans and leases receivable and the allowance for loan and lease losses.

**(5) Available for Sale Securities**

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

**Table of Contents**

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

	<b>Amortized Cost <sup>(1)</sup></b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>
	<i>( In thousands )</i>			
At June 30, 2010:				
GSE obligations	\$ 65,981	\$ 755	\$ (12)	\$ 66,724
Trust preferred CDOs	1,935		(1,460)	475
Collateralized mortgage obligations	37,303	742	(1,620)	36,425
GSE mortgage-backed securities	231,488	10,454		241,942
<b>Total</b>	<b>\$ 336,707</b>	<b>\$ 11,951</b>	<b>\$ (3,092)</b>	<b>\$ 345,566</b>
At December 31, 2009:				
GSE obligations	\$ 80,866	\$ 347	\$ (287)	\$ 80,926
Trust preferred CDOs	2,550		(2,085)	465
Collateralized mortgage obligations	45,641	697	(2,311)	44,027
GSE mortgage-backed securities	251,051	6,353	(983)	256,421
<b>Total</b>	<b>\$ 380,108</b>	<b>\$ 7,397</b>	<b>\$ (5,666)</b>	<b>\$ 381,839</b>

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

The Company sells available for sale securities to capitalize on fluctuations in the market. During the quarter ended June 30, 2010, \$4.2 million of available for sale securities were sold, generating \$103,000 of gains. There were no sales of available for sale securities during the same quarter of 2009. The cost of securities used in calculating gains on the sale of available for sale securities is determined using the specific identification method.

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

	<b>Number of Holdings</b>	<b>Less than One Year</b>		<b>One Year or Longer</b>		<b>Total</b>	
		<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>	<b>Fair Value</b>	<b>Unrealized Losses</b>
<i>(Dollars in thousands)</i>							
At June 30, 2010:							
GSE obligations	1	\$ 4,988	\$ (12)	\$	\$	\$ 4,988	\$ (12)
Trust preferred CDOs	2			475	(1,460)	475	(1,460)
Collateralized mortgage obligations	2			8,817	(1,620)	8,817	(1,620)
GSE mortgage-backed securities							
<b>Total</b>	<b>5</b>	<b>\$ 4,988</b>	<b>\$ (12)</b>	<b>\$ 9,292</b>	<b>\$ (3,080)</b>	<b>\$ 14,280</b>	<b>\$ (3,092)</b>

At December 31, 2009:

GSE obligations	8	\$ 37,081	\$ (287)	\$	\$	\$ 37,081	\$ (287)
Trust preferred CDOs	2			465	(2,085)	465	(2,085)
Collateralized mortgage obligations	5	5,520	(182)	12,088	(2,129)	17,608	(2,311)
GSE mortgage-backed securities	18	69,310	(982)	140	(1)	69,450	(983)
Total	33	\$ 111,911	\$ (1,451)	\$ 12,693	\$ (4,215)	\$ 124,604	\$ (5,666)

**Table of Contents**

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

	After One, But Within Five Years		After Five, But Within Ten Years		After Ten Years	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
At June 30, 2010:						
GSE obligations	\$ 36,017	\$ 36,397	\$ 29,964	\$ 30,327	\$	\$
Trust preferred CDOs					1,935	475
Collateralized mortgage obligations			19,180	19,705	18,123	16,720
GSE mortgage-backed securities	5,226	5,539	16,236	17,388	210,026	219,015
<b>Total</b>	<b>\$ 41,243</b>	<b>\$ 41,936</b>	<b>\$ 65,380</b>	<b>\$ 67,420</b>	<b>\$ 230,084</b>	<b>\$ 236,210</b>
At December 31, 2009:						
GSE obligations	\$ 75,866	\$ 76,013	\$ 5,000	\$ 4,913	\$	\$
Trust preferred CDOs					2,550	465
Collateralized mortgage obligations			23,156	22,957	22,485	21,070
GSE mortgage-backed securities	1,548	1,604	23,589	24,624	225,914	230,193
<b>Total</b>	<b>\$ 77,414</b>	<b>\$ 77,617</b>	<b>\$ 51,745</b>	<b>\$ 52,494</b>	<b>\$ 250,949</b>	<b>\$ 251,728</b>

At June 30, 2010 and December 31, 2009, respectively, \$226.5 million and \$271.5 million of available for sale securities were pledged as collateral for repurchase agreements, municipal deposits, treasury, tax and loan deposits, swap agreements, current and future Federal Home Loan Bank of Boston ( FHLB ) borrowings and future Federal Reserve discount window borrowings.

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

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

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

To date, CDO A has experienced \$69.0 million, or 24.9%, in deferrals/defaults of its underlying collateral. During the second quarter of 2010, CDO A did not experience additional deferred/defaulted collateral. Additionally, the Company continues to receive interest payments due. Projected credit loss severity assumptions were increased in estimated future cash flow scenarios and it was determined that management expects to recover the security's amortized cost. The Company has previously recorded credit related other-than-temporary impairment losses totaling \$271,000.

**Table of Contents**

CDO B has experienced \$159.0 million, or 27.4%, in deferrals/defaults of the securities underlying collateral to date, although no deferrals/defaults occurred during the second quarter of 2010. The Company has not received its scheduled quarterly interest payments since June 30, 2009 because the security is adding interest to the principal rather than paying out. Projected credit loss severity assumptions were increased in estimated future cash flow scenarios and it was determined that management does not expect to recover an additional \$44,000 of the security's amortized cost. For the quarter ended June 30, 2010, the Company recorded other-than-temporary impairment charges totaling \$49,000, representing the difference between the security's fair value and book value less any previously recognized non-credit other-than-temporary impairment. The portion deemed to be credit related of \$44,000 has been recorded as a reduction to noninterest income, while the non-credit portion of \$5,000 has been recorded as a reduction of other comprehensive income. Through June 30, 2010, credit related other-than-temporary impairment losses on this security total \$728,000.

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

<i>(In thousands)</i>	<b>Credit Component of Other-Than-Temporary Impairment Losses For Which a Portion Was Recognized in Other Comprehensive Income</b>	
	<b>2010</b>	<b>2009</b>
Balance, January 1	\$ (384)	\$
Credit losses for which an other-than-temporary impairment was previously recognized	(615)	
Balance, June 30	\$ (999)	\$

The decline in fair value of the remaining available for sale securities in an unrealized loss position is due to general market concerns of the liquidity and creditworthiness of the issuers of the securities. Management believes that it will recover the amortized cost basis of the securities and that it is more likely than not that it will not sell the securities before recovery. As such, management has determined that the securities are not other-than-temporarily impaired as of June 30, 2010. If market conditions for securities worsen or the creditworthiness of the underlying issuers deteriorates, it is possible that the Company may recognize additional other-than-temporary impairments in future periods.

**(6) Derivatives**

All derivatives are recognized as either assets or liabilities on the balance sheet and are measured at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative and resulting designation. Derivatives used to hedge the exposure to changes in fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Derivatives used to hedge the exposure to variability in expected cash flows or other types of forecasted transactions are considered cash flow hedges. For derivatives designated as fair value hedges, changes in the fair value of the derivative are recognized in earnings together with the changes in the fair value of the related hedged item. The net amount, if any, representing hedge ineffectiveness, is reflected in earnings. For derivatives designated as cash flow hedges, the effective portion of changes in the fair value of the derivative is recorded in other comprehensive income and recognized in earnings when the hedged transaction affects earnings. The ineffective portion of changes in the fair value of cash flow hedges is recognized directly in earnings. For derivatives not designated as hedges, changes in fair value are recognized in earnings, in noninterest income. The Company may use interest rate contracts (swaps, caps and floors) as part of interest rate risk management strategy. Interest rate swap, cap and floor agreements are entered into as hedges against future interest rate fluctuations on specifically identified assets or liabilities. The Company did not have derivative fair value or derivative cash flow hedges at June 30, 2010 or December 31, 2009.



**Table of Contents**

The table below presents the fair value of the Company's derivative financial instruments as well as their classification on the consolidated balance sheets as of June 30, 2010 and December 31, 2009:

<i>(In thousands)</i>	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	As of	As of	Balance Sheet Location	As of	As of
		June 30, 2010	December 31, 2009		June 30, 2010	December 31, 2009
		Fair Value	Fair Value		Fair Value	Fair Value
Derivatives <b>not</b> designated as hedging instruments						
Interest rate products	Other assets	\$ 929	\$ 391	Other liabilities	\$ 988	\$ 426
Total derivatives <b>not</b> designated as hedging instruments		\$ 929	\$ 391		\$ 988	\$ 426

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

As the interest rate swaps associated with this program do not meet hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. As of June 30, 2010, the Company had ten interest rate swaps with an aggregate notional amount of \$35.2 million related to this program. During the three months ended June 30, 2010 and 2009, the Company recognized net losses of \$55,000 and net gains of \$69,000 respectively, related to changes in the fair value of these swaps.

The table below presents the effect of the Company's derivative financial instruments on the consolidated income statements for the three months ended June 30, 2010 and 2009:

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in	
		Income on Derivative <sup>(1)</sup>	
		Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
<i>(In thousands)</i>			
Interest Rate Products	Loan related fees	\$ (55)	\$ 69
Total		\$ (55)	\$ 69

(1) The amount of gain or (loss) recognized



in income  
represents net fee  
income and  
changes related  
to the fair value  
of the interest  
rate products.

**Table of Contents**

The table below presents the effect of the Company's derivative financial instruments on the consolidated income statements for the six months ended June 30, 2010 and 2009:

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative <sup>(1)</sup>	
		Six Months Ended June 30,	
		2010	2009
		<i>(In thousands)</i>	
Interest Rate Products	Loan related fees	\$ (23)	\$ 322
Total		\$ (23)	\$ 322

(1) The amount of gain or (loss) recognized in income represents net fee income and changes related to the fair value of the interest rate products.

By using derivative financial instruments, the Company exposes itself to credit risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk for the Company. When the fair value of a derivative is negative, the Company owes the counterparty and, therefore, it does not possess credit risk. The credit risk in derivative instruments is mitigated by entering into transactions with highly-rated counterparties that management believes to be creditworthy and by limiting the amount of exposure to each counterparty.

Certain of the derivative agreements contain provisions that require the Company to post collateral if the derivative exposure exceeds a threshold amount. As of June 30, 2010, the Company has posted collateral of \$890,000 in the normal course of business.

The Company has agreements with certain of its derivative counterparties that contain credit-risk-related contingent provisions. These provisions provide the counterparty with the right to terminate its derivative positions and require the Company to settle its obligations under the agreements if the Company defaults on certain of its indebtedness or if the Company fails to maintain its status as a well-capitalized institution. As of June 30, 2010, the Company had no derivative agreements in a net liability position, excluding fair value adjustments for credit risk.

**(7) Fair Value of Financial Instruments**

ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the

measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities. Market participants are buyers and sellers in the principal market that are independent, knowledgeable, able to transact and willing to transact.

**Table of Contents**

ASC 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about what assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. A fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs is included in ASC 820. The fair value hierarchy is as follows:

Level 1: Inputs are unadjusted quoted prices in active markets for assets or liabilities identical to those reported at fair value.

Level 2: Inputs other than quoted prices included within Level 1, Level 2 inputs are observable either directly or indirectly. These inputs include quoted prices in active or not active markets or inputs derived from or corroborated by observable market data.

Level 3: Inputs are unobservable inputs for an asset or liability. These inputs are used to determine fair value only when observable inputs are not available.

The following tables summarize the financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, segregated by the level of valuation inputs within the fair value hierarchy utilized to measure fair value:

		Fair Value Measurements at June 30, 2010		
		Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
<i>(In thousands)</i>	<b>Total</b>			
GSE obligations	\$ 66,724	\$	\$ 66,724	\$
Trust preferred CDOs	475		475	
Collateralized mortgage obligations	36,425		36,425	
GSE mortgage-backed securities	241,942		241,942	
Total available for sale securities	345,566		345,566	
Interest rate swap assets	929		929	
Interest rate swap liabilities	988		988	

<i>(In thousands)</i>	<b>Total</b>	<b>Fair Value Measurements at December 31, 2009</b>		
		<b>Using</b>	<b>Significant</b>	<b>Significant</b>
		<b>Quoted</b>	<b>Other</b>	<b>Other</b>
		<b>Prices in</b>	<b>Observable</b>	<b>Unobservable</b>
		<b>Active</b>	<b>Inputs</b>	<b>Inputs</b>
		<b>Markets</b>	<b>(Level 2)</b>	<b>(Level 3)</b>
		<b>for</b>		
		<b>Identical</b>		
		<b>Assets</b>		
		<b>(Level 1)</b>		
GSE obligations	\$ 80,926	\$	\$ 80,926	\$
Trust preferred CDOs	465		465	
Collateralized mortgage obligations	44,027		44,027	
GSE mortgage-backed securities	256,421		256,421	
Total available for sale securities	381,839		381,839	
Interest rate swap assets	391		391	
Interest rate swap liabilities	426		426	
	15			

**Table of Contents**

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Financial assets and financial liabilities measured at fair value on a recurring basis include the following:

*Available for sale securities* Available for sale securities are reported at fair value primarily utilizing Level 2 inputs. The Company obtains fair value measurements from independent pricing sources, which base their fair value measurements upon observable inputs such as reported trades of comparable securities, broker quotes, the U.S. Treasury (the Treasury) yield curve, benchmark interest rates, market spread relationships, historic and consensus prepayment rates, credit information and the security's terms and conditions.

The Company used significant unobservable inputs (Level 3) to value two of its available for sale securities at June 30, 2009. Each of these securities is a collateralized debt obligation backed by trust preferred securities. At the time of the valuation, there was limited trading in these and comparable securities due to recent economic conditions and observable pricing was difficult to obtain. At June 30, 2009, the Company obtained valuations from four sources, including broker quotes and cash flow scenario analyses. The fair values obtained were assigned a weighting that was dependent upon the methods used to calculate the prices. Cash flow scenarios (Level 3) were given more weight than broker quotes (Level 2) because the broker quotes were believed to be based on distressed sales, evidenced by the inactive market. The weighting was then used to determine an overall fair value of the securities.

At June 30, 2010, management reviewed the fair values provided by the same pricing sources as used in the previous reporting periods. Based on management's understanding of the methods employed, three of the four sources were excluded from the valuation process. These sources were excluded because either the assumptions used were inappropriate or because of the uncertainty surrounding the methodology in determining the fair values, including a previous source of cash flow scenario analyses that adopted the fair value methodology of a previously excluded source. As a result, broker quotes (Level 2) were used to determine the fair value of these securities. The broker quotes given for the securities were based on executed trades of similar collateral structure and performance. Although limited trades occurred, they were likely orderly transactions when considering the number of potential buyers the transactions were marketed to and the intention by the sellers to maximize their proceeds. Management believes that the broker quotes are the best representation of the price that would be obtained for these particular securities in an orderly transaction under current market conditions.

*Interest rate swaps* The fair values for the interest rate swap assets and liabilities represent a Level 2 valuation and are based on settlement values adjusted for credit risks associated with the counterparties and the Company. Credit risk adjustments consider factors such as the likelihood of default by the Company and its counterparties, its net exposures and remaining contractual life. To date, the Company has not realized any losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of interest rate swap assets and liabilities attributable to credit risk was not significant during the reported periods. See also *Note 5 Derivatives*.

**Table of Contents**

The following tables show a reconciliation of the beginning and ending balances for fair value measurements using significant unobservable inputs:

<i>(In thousands)</i>	<b>Fair Value Measurements Using Significant Unobservable Inputs</b>	
	<b>2010</b>	<b>2009</b>
	<i>Trust preferred collateralized debt obligations</i>	
Balance, January 1	\$	\$ 1,480
Increase in unrealized holding losses		(814)
Other-than-temporary impairment		
Transfers to Level 2		
Transfers to Level 3		
Balance, June 30	\$	\$ 666

Transfers between Level 1, Level 2 and Level 3 of the fair value hierarchy are recognized based on the valuation method used at the end of each reporting period. There were no transfers of financial assets or liabilities between Level 1, Level 2 or Level 3 during the three months ended June 30, 2010 or 2009.

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis, but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following tables summarize the financial assets and financial liabilities measured at fair value on a nonrecurring basis as of and for the three months ended June 30, 2010 and June 30, 2009, segregated by the level of valuation inputs within the fair value hierarchy utilized to measure fair value:

<i>(In thousands)</i>	<b>Fair Value Measurements at June 30, 2010 Using Quoted Prices</b>			
	<b>Total</b>	<b>in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Other Unobservable Inputs (Level 3)</b>
Collateral-dependent loans and leases	\$ 1,823	\$	\$ 1,823	\$
Other real estate owned	1,109		1,109	

<b>Fair Value Measurements at June 30, 2009 Using</b>		
<b>Quoted Prices in Active Markets for Identical</b>	<b>Significant Other Observable</b>	<b>Significant Other Unobservable</b>

<i>(In thousands)</i>	<b>Total</b>	<b>Assets (Level 1)</b>	<b>Inputs (Level 2)</b>	<b>Inputs (Level 3)</b>
Collateral-dependent loans and leases	\$ 5,946	\$	\$ 5,946	\$
Other real estate owned	756		756	
Non-real estate foreclosed assets	122		122	

*Impaired loans* Impaired loans and leases were \$7.9 million on June 30, 2010. Impaired loans and leases that are deemed collateral dependent are valued based upon the fair value of the underlying collateral. The inputs used in the appraisal of the collateral are observable and, therefore, categorized as Level 2. The valuation allowance for collateral-dependent loans and leases was \$1.3 million and \$1.9 million at June 30, 2010 and December 31, 2009, respectively.



**Table of Contents**

*OREO and Non-real estate foreclosed assets* Fair value estimates of OREO and non-real estate foreclosed assets are based on independent appraisals or brokers' opinions of the value of the property or similar properties less estimated costs to sell at the date the loan is charged-off and the property is transferred into OREO and/or non-real estate foreclosed assets. A valuation allowance is maintained for declines in fair value and estimated selling costs. The inputs used to estimate the fair values are observable, and therefore, categorized as Level 2.

The aggregate fair value of financial assets and financial liabilities presented does not represent the underlying value of the Company taken as a whole. The fair value estimates provided are made at a specific point in time, based on relevant market information and the characteristics of the financial instrument. The estimates do not provide for any premiums or discounts that could result from concentrations of ownership of a financial instrument. Because no active market exists for some of the Company's financial instruments, certain fair value estimates are based on subjective judgments regarding current economic conditions, risk characteristics of the financial instruments, future expected loss experience, prepayment assumptions and other factors. The resulting estimates involve uncertainties and therefore cannot be determined with precision. Changes made to any of the underlying assumptions could significantly affect the estimates. The estimated fair value approximates the carrying value for cash and cash equivalents, overnight investments and accrued interest receivable and payable. The methodologies for other financial assets and financial liabilities are discussed below:

*Loans and leases receivable* Fair value estimates are based on loans and leases with similar financial characteristics. Loans and leases have been segregated by homogenous groups into residential mortgage, commercial, and consumer and other loans. Fair values are estimated by discounting contractual cash flows, adjusted for prepayment estimates, using discount rates approximately equal to current market rates on loans with similar characteristics and maturities. The incremental credit risk for nonperforming loans has been considered in the determination of the fair value of loans.

*Stock in the Federal Home Loan Bank of Boston* The fair value of stock in the FHLB equals the carrying value reported in the balance sheet. This stock is redeemable at full par value only by the FHLB. The nation's Federal Home Loan Bank System (the FHLB System) is under stress due to deterioration in the financial markets, particularly in relation to valuation of mortgage securities. Several Federal Home Loan Banks have announced impairment charges of these and other assets and as such their capital positions have deteriorated to the point that several have suspended or reduced their dividends, or eliminated the ability of members to redeem capital stock. These institutions obtain their funding primarily through issuance of consolidated obligations of the FHLB System. The U.S. Government does not guarantee these obligations and each of the 12 Federal Home Loan Banks is generally jointly and severally liable for repayment of each other's debt. We are a member of the FHLB-Boston which in February 2009 announced that, while it meets all of its regulatory capital requirements, it has suspended its quarterly dividend and will continue its moratorium on excess stock repurchase. The FHLB - Boston is currently operating with retained earnings below its targeted level. Should financial conditions continue to weaken, the FHLB System (including FHLB-Boston) in the future may have to curtail advances to member institutions like us. Should the FHLB System deteriorate to the point of not being able to fund future advances to banks, including the Bank, this would place increased pressure on other wholesale funding sources. Furthermore, we are required to invest in FHLB stock in order to borrow from the FHLB System and our investment in the FHLB - Boston could be adversely impacted if the financial health of the FHLB System worsens.

*Deposits* The fair values reported for demand deposit, NOW, money market, and savings accounts are equal to their respective book values reported on the balance sheet. The fair values disclosed are, by definition, equal to the amount payable on demand at the reporting date. The fair values reported for certificate of deposit accounts are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on certificate of deposit accounts with similar remaining maturities. The estimated fair value of deposits does not take into account the value of the Company's long-term relationships with depositors. Nonetheless, the Company would likely realize a core deposit premium if its deposit portfolio was sold in the principal market for such deposits.



**Table of Contents**

*Wholesale repurchase agreements* The fair values reported for wholesale repurchase agreements are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on borrowings with similar characteristics and maturities.

*Federal Home Loan Bank of Boston borrowings* The fair values reported for FHLB borrowings are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on borrowings with similar characteristics and maturities.

*Subordinated deferrable interest debentures* The fair values reported for subordinated deferrable interest debentures are based on the discounted value of contractual cash flows. The discount rates used are representative of approximate rates currently offered on instruments with similar terms and maturities.

*Financial instruments with off-balance sheet risk* Since the Bank's commitments to originate or purchase loans, and for unused lines and outstanding letters of credit, are primarily at market interest rates, there is no significant fair value adjustment.

The book values and estimated fair values for the Company's financial instruments are as follows:

	<b>June 30, 2010</b>		<b>December 31, 2009</b>	
	<b>Book Value</b>	<b>Estimated Fair Value</b>	<b>Book Value</b>	<b>Estimated Fair Value</b>
	(In thousands)			
<b>Assets:</b>				
Cash and due from banks	\$ 23,857	\$ 23,857	\$ 18,866	\$ 18,866
Overnight investments	30,224	30,224	1,964	1,964
Available for sale securities	345,566	345,566	381,839	381,839
Stock in the FHLB	16,274	16,274	16,274	16,274
Loans and leases receivable, net of allowance for loan and lease losses:				
Commercial loans and leases	750,462	768,589	718,943	725,967
Residential mortgage loans	163,073	166,345	171,842	175,816
Consumer and other loans	205,593	198,522	204,526	197,137
Interest rate swaps	929	929	391	391
Accrued interest receivable	4,704	4,704	4,964	4,964
<b>Liabilities:</b>				
<b>Deposits:</b>				
Demand deposit accounts	\$ 290,794	\$ 290,794	\$ 204,281	\$ 204,281
NOW accounts	73,501	73,501	74,558	74,558
Money market accounts	83,315	83,315	65,076	65,076
Savings accounts	366,087	366,087	367,225	367,225
Certificate of deposit accounts	360,323	363,021	387,144	390,210
Overnight and short-term borrowings	37,338	37,338	40,171	40,171
Wholesale repurchase agreements	20,000	20,295	20,000	20,432
FHLB borrowings	223,396	246,895	277,183	301,210
Subordinated deferrable interest debentures	13,403	15,302	13,403	15,440
Interest rate swaps	988	988	426	426
Accrued interest payable	1,551	1,551	2,122	2,122

**Table of Contents**

**(8) Contingent Liabilities**

In June 2009, the Bank received a Notice of Assessment from the Massachusetts Department of Revenue ( DOR ) challenging the 2002 to 2006 state income tax due from BRI Investment Corp., a Rhode Island passive investment company. The DOR seeks to collapse the income from BRI Investment Corp. into the Bank s income and assess state corporate excise tax on the resulting apportioned income. The passive investment company is not subject to corporate income tax in the State of Rhode Island. The Bank filed an Application for Abatement in September 2009 contesting the assessment and asserting its position. The Bank was notified in March 2010 that the application was denied and subsequently filed a petition with the Massachusetts Appellate Tax Board pursuing its position.

In June 2010, the DOR performed an audit of tax years 2007 and 2008, challenging the Bank s position of the tax treatment of BRI Investment Corp. under the same assertion. The Bank has not yet received a Notice of Intent to Assess from the DOR, but was provided with an estimate of the tax assessment and penalties for 2007 and 2008. The total estimated tax assessment, accrued interest and penalties for all years is \$650,000. Management believes it more likely than not that the Bank will prevail in its tax position, and therefore has not recorded a contingent liability for this matter.

**(9) Transfers and Servicing**

The Bank routinely enters into loan and lease participations with third parties. In accordance with U.S. GAAP, these participations are accounted for as sales and, therefore, are not included in the Company s consolidated financial statements. In some cases, the Bank has continuing involvement with the loan and lease participations in the form of servicing. Servicing of the loan and lease participations typically involves collecting principal and interest payments and monitoring delinquencies on behalf of the assigned party of the participation. The Bank typically receives just adequate compensation for its servicing responsibilities. As such, there are no servicing assets or liabilities recorded in the Company s consolidated financial statements at June 30, 2010 or December 31, 2009.

Through its Macrolease platform, the Bank has a recourse obligation under a lease participation agreement for up to 8.0% of the original sold balance of approximately \$9.8 million. Historically, delinquency rates for the lease portfolio have been significantly lower. At June 30, 2010 and December 31, 2009, a liability for the recourse obligation of \$98,000 was included in the Company s consolidated financial statements.

**Table of Contents*****ITEM 2. Management's Discussion and Analysis*****General**

The Company's principal subsidiary, Bank Rhode Island, is a commercial bank chartered as a financial institution in the State of Rhode Island. The Bank pursues a community banking mission and is principally engaged in providing banking products and services to businesses and individuals in Rhode Island and nearby areas of Massachusetts. The Bank offers its customers a wide range of business, commercial real estate, consumer and residential loans and leases, deposit products, nondeposit investment products, cash management, private banking and other banking products and services designed to meet the financial needs of individuals and small- to mid-sized businesses. The Bank also offers both commercial and consumer online banking products and maintains a web site at <http://www.bankri.com>. The Bank competes with a variety of traditional and nontraditional financial service providers both within and outside of Rhode Island. The Company and Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by certain of those regulatory authorities. The Bank's deposits are insured by the FDIC, subject to regulatory limits. The Bank is also a member of the Federal Home Loan Bank of Boston (FHLB). The Company's common stock is traded on the Nasdaq Global Select Market<sup>SM</sup> under the symbol BARI. The Company's financial reports can be accessed through its website within 24 hours of filing with the SEC.

**Critical Accounting Policies**

Accounting policies involving significant judgments and assumptions by management, which have, or could have, a material impact on the carrying value of certain assets or net income, are considered critical accounting policies. The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. As discussed in the Company's 2009 Annual Report on Form 10-K, management has identified the accounting for the allowance for loan and lease losses, review of goodwill for impairment, valuation of available for sale securities and income taxes as the Company's most critical accounting policies.

**Overview**

The primary drivers of the Company's operating income are net interest income, which is strongly affected by the net yield on interest-earning assets and liabilities (net interest margin), and the quality of the Company's assets.

The Company's net interest income represents the difference between interest income and its cost of funds. Interest income depends on the amount of interest-earning assets outstanding during the year and the interest rates earned thereon. Cost of funds is a function of the average amount of deposits and borrowed money outstanding during the year and the interest rates paid thereon. The net interest margin is calculated by dividing net interest income by average interest-earning assets. Net interest spread is the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. Net interest margin generally exceeds the net interest spread as a portion of interest-earning assets is funded by various noninterest-bearing sources (primarily noninterest-bearing deposits and shareholders' equity). The increases (decreases) in the components of interest income and interest expense, expressed in terms of fluctuation in average volume and rate, are summarized under *Rate/Volume Analysis* on page 34. Information as to the components of interest income and interest expense and average rates is provided under *Average Balances, Yields and Costs* on page 33.

Because the Company's assets are not identical in duration and in repricing dates to its liabilities, the spread between the two is vulnerable to changes in market interest rates as well as the overall shape of the yield curve. These vulnerabilities are inherent to the business of banking and are commonly referred to as interest rate risk. How to measure interest rate risk and, once measured, how much risk to take are based on numerous assumptions and other subjective judgments. See also discussion under *Interest Rate Risk* on page 38.

**Table of Contents**

The quality of the Company's assets also influences its earnings. Loans and leases that are not paid on a timely basis and exhibit other weaknesses can result in the loss of principal and/or interest income. Additionally, the Company must make timely provisions to the allowance for loan and lease losses based on estimates of probable losses inherent in the loan and lease portfolio; these additions, which are charged against earnings, are necessarily greater when greater probable losses are expected. Further, the Company incurs expenses as a result of resolving troubled assets. All of these reflect the credit risk that the Company takes on in the ordinary course of business and are further discussed under *Financial Condition Asset Quality* on pages 27 to 28.

The Company's business strategy has been to concentrate its asset generation efforts on commercial and consumer loans and its deposit generation efforts on checking and savings accounts. These deposit accounts are commonly referred to as core deposits. This strategy is based on the Company's belief that it can distinguish itself from its larger competitors, and indeed attract customers from them, through a higher level of service and through its ability to set policies and procedures, as well as make decisions, locally. The loan and deposit products referenced also tend to be geared more toward customers who are relationship oriented than those who are seeking stand-alone or single transaction products. The Company believes that its service-oriented approach enables it to compete successfully for relationship-oriented customers. Additionally, the Company is predominantly an urban franchise with a high concentration of businesses, which makes deployment of funds in the commercial lending area practicable. Commercial loans are attractive to the Company, among other reasons, because of their higher yields. Similarly, core deposits are attractive to the Company because of their generally lower interest cost and potential for fee income.

The deposit market in Rhode Island is highly concentrated. The State's three largest banks have an aggregate market share of approximately 84% (based upon June 2009 FDIC statistics, excluding one bank that draws its deposits primarily from the internet) in Providence and Kent Counties, the Bank's primary marketplace. Competition for loans and deposits remains intense. This competition has resulted in considerable advertising and promotional product offerings by competitors, including print, radio and television media, as well as, web-based advertising and promotions.

The Company also seeks to leverage business opportunities presented by its customer base, franchise footprint and resources. In 2005, the Bank completed the acquisition of an equipment leasing company located in Long Island, New York ( Macrolease ) and formed a private banking division. Historically, the Bank has used the Macrolease platform to generate additional income by originating equipment loans and leases for third parties and to grow the loan and lease portfolio. Due to the lack of purchasers in the market during 2008 and 2009, the amount of Macrolease-generated loans and leases held by the Bank has grown substantially. Currently, the Bank seeks to maintain the level of Macrolease-generated loans and leases at no more than \$100.0 million. Additionally, the Bank continues to seek generation of additional income by originating equipment loans and leases for third parties as opportunities arise.

For the three months ended June 30, 2010, approximately 86% of the Company's revenues (defined as net interest income plus noninterest income) were derived from its net interest income. In a continuing effort to diversify its sources of revenue, the Company has sought to expand its sources of noninterest income (primarily fees and charges for products and services the Bank offers). Service charges on deposit accounts remain the largest component of noninterest income. The future operating results of the Company will depend upon on the ability to maintain its net interest margin, while minimizing its exposure to credit risk, along with increasing sources of noninterest income, while controlling the growth of noninterest or operating expenses.

**Table of Contents****Financial Condition Executive Summary**

Selected balance sheet data is presented in the table below as of the dates indicated:

	<b>June 30, 2010</b>	<b>March 31, 2010</b>	<b>December 31, 2009</b>	<b>September 30, 2009</b>	<b>June 30, 2009</b>
	<i>(Dollars in thousands, except per share data)</i>				
Total assets	\$ 1,613,520	\$ 1,586,778	\$ 1,589,946	\$ 1,569,084	\$ 1,583,686
Loans and leases receivable	1,136,524	1,123,838	1,111,847	1,116,627	1,117,655
Available for sale securities	345,566	365,110	381,839	365,706	376,026
Goodwill, net	12,262	12,262	12,239	12,051	12,051
Core deposits <sup>(1)</sup>	813,697	728,969	711,140	685,104	681,834
Certificates of deposit	360,323	378,102	387,144	406,827	402,839
Borrowings	294,137	341,344	350,757	340,081	336,244
Common shareholders equity	129,127	123,679	120,661	121,961	119,956
Book value per common share	27.63	26.69	26.16	26.46	26.07
Tangible book value per common share	25.00	24.05	23.50	23.85	23.45
Tangible common equity ratio <sup>(2) (3)</sup>	7.30%	7.08%	6.87%	7.06%	6.86%
Core deposits to total deposits <sup>(1) (3)</sup>	69.3%	65.8%	64.8%	62.7%	62.9%

(1) Core deposits consist of demand deposit, NOW, money market and savings accounts.

(2) Calculated by dividing common shareholders equity less goodwill by total assets less goodwill.

(3) Non-GAAP performance measure.

Total assets increased by \$23.6 million since December 31, 2009. Total loans and leases increased by \$24.7 million during the first six months of 2010, with increases in commercial loans and leases of \$32.0 million, or 4.4%, and consumer and other loans of \$1.2 million, or 0.6%, respectively. These increases were offset by a decrease in the

residential mortgage loan portfolio of \$8.5 million, or 4.9%. Available for sale securities decreased \$36.3 million, or 9.5%, since year-end. The Bank's core deposits increased by \$102.6 million, or 14.4%, since year-end. Within this increase, demand deposit accounts increased by \$86.5 million, or 42.3%, and money market accounts increased by \$18.2 million, or 28.0%. The increase in demand deposit accounts reflects a temporary inflow in late June 2010 of approximately \$53.0 million attributable to the settlement of personal litigation to which the Bank was not a party. Excluding the temporary inflow, the Bank's core deposits increased by \$49.6 million, or 7.0%, and demand deposit accounts increased by \$33.5 million, or 16.4%. Certificate of deposit accounts decreased by \$26.8 million, or 6.9%, savings accounts decreased by \$1.1 million, or 0.3%, and NOW accounts decreased by \$1.1 million, or 1.4%, since year-end. Borrowings decreased by \$56.6 million, or 16.1%, since December 31, 2009. Shareholders' equity as a percentage of total assets was 8.0% and 7.6% at June 30, 2010 and December 31, 2009, respectively.

The Company's financial position at June 30, 2010 as compared to June 30, 2009 reflects net growth of \$18.9 million in total loans and leases. This increase reflects the continuing conversion of the balance sheet to a more commercial profile with increases in commercial loans and leases of \$52.7 million, or 7.4%. Consumer loans decreased \$7.3 million, or 3.4%, from the prior year quarter-end. The residential mortgage portfolio declined \$26.5 million, or 13.9%, from June 30, 2009. Available for sale securities at June 30, 2010 decreased by \$30.5 million, or 8.1%, from the same period in 2009. Core deposits have increased \$131.9 million, or 19.3%, since the prior year quarter-end, with growth centered in demand deposit accounts of \$85.7 million, money market accounts of \$54.1 million and NOW accounts of \$7.7 million. Excluding the temporary inflow previously referenced, core deposits have increased \$78.9 million, or 11.6%, and demand deposit accounts have increased \$32.7 million, or 15.9%, since the prior year quarter-end. These increases were offset by decreases in certificate of deposit accounts (CDs) of \$42.5 million and savings accounts of \$15.6 million since June 30, 2009. Borrowings have decreased by \$42.1 million from the same period in 2009.



**Table of Contents****Financial Condition Detailed Analysis****Investments**

Total investments consist of available for sale securities, stock in the FHLB and overnight investments. Total investments comprised \$392.1 million, or 24.3% of total assets at June 30, 2010, compared to \$400.1 million, or 25.2% of total assets at December 31, 2009, representing a decrease of \$8.0 million, or 2.0%. Available for sale securities are recorded at fair value. At June 30, 2010, the fair value of available for sale securities was \$345.6 million and carried a total of \$8.9 million of net unrealized gains at the end of the quarter, compared to \$1.7 million at December 31, 2009.

The investment portfolio provides the Company a source of short-term liquidity and acts as a counterbalance to loan and deposit flows. During the first six months of 2010, the Company purchased \$71.5 million of available for sale securities compared to \$138.7 million during the same period in 2009. Maturities, calls and principal repayments totaled \$101.7 million for the six months ended June 30, 2010 compared to \$86.3 million for the same period in 2009. Additionally, in the first six months of 2010, the Company sold \$12.8 million of available for sale securities generating gains of \$578,000 compared to sales of \$1.9 million and gains of \$61,000 for the same period in 2009.

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

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

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

To date, CDO A has experienced \$69.0 million, or 24.9%, in deferrals/defaults of its underlying collateral. During the second quarter of 2010, CDO A did not experience additional deferred/defaulted collateral. Additionally, the Company continues to receive interest payments due. Projected credit loss severity assumptions were increased in estimated future cash flow scenarios and it was determined that management expects to recover the security's amortized cost. The Company has previously recorded credit related other-than-temporary impairment losses totaling \$271,000.

**Table of Contents**

CDO B has experienced \$159.0 million, or 27.4%, in deferrals/defaults of the securities underlying collateral to date, although no deferrals/defaults occurred during the second quarter of 2010. The Company has not received its scheduled quarterly interest payments since June 30, 2009 because the security is adding interest to the principal rather than paying out. Projected credit loss severity assumptions were increased in estimated future cash flow scenarios and it was determined that management does not expect to recover an additional \$44,000 of the security's amortized cost. For the quarter ended June 30, 2010, the Company recorded other-than-temporary impairment charges totaling \$49,000, representing the difference between the security's fair value and book value less any previously recognized non-credit other-than-temporary impairment. The portion deemed to be credit related of \$44,000 has been recorded as a reduction to noninterest income, while the non-credit portion of \$5,000 has been recorded as a reduction of other comprehensive income. Through June 30, 2010, credit related other-than-temporary impairment losses on this security total \$728,000.

The decline in fair value of the remaining available for sale securities in an unrealized loss position is due to general market concerns of the liquidity and creditworthiness of the issuers of the securities. Management believes that it will recover the amortized cost basis of the securities and that it is more likely than not that it will not sell the securities before recovery. As such, management has determined that the securities are not other-than-temporarily impaired as of June 30, 2010. If market conditions for securities worsen or the creditworthiness of the underlying issuers deteriorates, it is possible that the Company may recognize additional other-than-temporary impairments in future periods.

**Loans and Leases**

Total loans and leases increased by \$24.7 million since December 31, 2009 and stood at \$1.14 billion at June 30, 2010. As a percentage of total assets, loans and leases increased to 70.4% at June 30, 2010, compared to 69.9% at December 31, 2009. This increase was centered in commercial loans, where the Company concentrates its origination efforts, and was partially offset by decreases in residential mortgage loans, which the Company has historically purchased. Total loans and leases as of June 30, 2010 are comprised of three broad categories: commercial loans and leases that aggregate \$764.4 million, or 67.3% of the portfolio; residential mortgages that aggregate \$164.8 million, or 14.5% of the portfolio; and consumer and other loans that aggregate \$207.4 million, or 18.2% of the portfolio.

*Commercial loans and leases* The commercial loan and lease portfolio (consisting of commercial real estate, commercial and industrial, equipment leases, multi-family real estate, construction and small business loans) increased \$32.0 million, or 4.4%, during the six months of 2010, with the commercial real estate portfolio driving the growth.

The Bank's business lending group originates business loans, also referred to as commercial and industrial loans. In addition, Macrolease-generated equipment loans are included in the commercial and industrial loan portfolio. Total commercial and industrial loans decreased \$5.2 million, or 3.0%, since year-end.

The Bank's business lending group also originates owner-occupied commercial real estate loans, term loans and revolving lines of credit. Since December 31, 2009, owner-occupied commercial real estate loans increased by \$6.4 million, or 3.8%.

The Bank's commercial real estate ( CRE ) group originates nonowner-occupied commercial real estate, multi-family residential real estate and construction loans. These real estate secured commercial loans are offered as both fixed and adjustable-rate products. Since December 31, 2009, CRE loans have increased \$24.0 million, or 9.3%.

The Bank purchases equipment leases from originators outside of the Bank. The U.S. Government or its agencies are the principal lessees on these purchased leases. These government leases generally have maturities of five years or less and are not dependent on residual collateral values. At June 30, 2010, \$21.6 million of purchased government leases were included in the commercial loan and lease portfolio representing an increase of \$8.7 million, or 67.1%, since year-end.

**Table of Contents**

With the Macrolase platform, the Bank originates and purchases equipment loans and leases for its own portfolio, as well as originates loans and leases for third parties as a source of noninterest income. Macrolase-generated equipment loans of \$38.6 million and \$43.1 million were included in the commercial and industrial portfolio at June 30, 2010 and December 31, 2009, respectively. Since December 31, 2009, total Macrolase-generated equipment loans and leases decreased \$9.9 million, or 10.0%, to \$89.4 million.

At June 30, 2010, small business loans (business lending relationships of approximately \$500,000 or less) were \$59.8 million compared to \$56.1 million at December 31, 2009. At June 30, 2010 and December 31, 2009, small business loans represented 7.8% and 7.7% of the commercial loan and lease portfolio, respectively. These loans reflect those originated by the Bank's business development group, as well as throughout the Bank's branch system. The Bank utilizes credit scoring and streamlined documentation, as well as traditional review standards, in originating these credits.

The Bank is a participant in the U.S. Small Business Administration (SBA) Lender Program in both Rhode Island and Massachusetts. The Bank was named the No. 1 SBA lender in Rhode Island as of the SBA's fiscal year end at September 30, 2009. SBA guaranteed loans exist throughout the portfolios managed by the Bank's various lending groups.

The Company believes it is well positioned for continued commercial growth. The Bank places particular emphasis on the generation of small- to medium-sized commercial relationships (those with \$10.0 million or less in total loan commitments).

*Residential mortgage loans* Since inception, the Bank has concentrated its portfolio lending efforts on commercial and consumer lending opportunities. From time to time, the Bank purchases high credit quality residential mortgage loans from third party originators to utilize available cash flow and originates mortgage loans for its own portfolio on a limited basis. The Bank did not purchase any mortgage loans during the second quarter of 2010 or 2009. At June 30, 2010 residential mortgage loans decreased \$8.5 million, or 4.9%, to \$164.8 million from year-end. During this period, the Bank originated \$1.8 million of mortgages for the portfolio. Comparatively, during the first six months of 2009, the Bank originated \$2.7 million of mortgages for the portfolio.

*Consumer loans* The consumer loan portfolio increased \$1.2 million, or 0.6%, during the first six months of 2010 as advances of \$17.5 million exceeded repayments of \$16.2 million. The Company continues to offer consumer lending as it believes that these amortizing fixed rate products, along with floating rate lines of credit, possess attractive cash flow characteristics.

**Table of Contents**

The following is a summary of loans and leases receivable:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<i>(In thousands)</i>	
<b>Commercial loans and leases:</b>		
Commercial real estate nonowner occupied	\$ 185,437	\$ 170,148
Commercial real estate owner occupied	174,267	167,853
Commercial and industrial	173,588	178,808
Multi-family	67,588	66,350
Small business	59,833	56,148
Construction	30,925	23,405
Leases and other <sup>(a)</sup>	77,688	75,057
Subtotal	769,326	737,769
Unearned lease income	(6,777)	(7,693)
Net deferred loan origination costs	1,825	2,321
Total commercial loans and leases	764,374	732,397
<b>Residential mortgage loans:</b>		
One- to four-family adjustable rate	110,344	115,855
One- to four-family fixed rate	53,730	56,724
Subtotal	164,074	172,579
Premium on loans acquired	689	738
Net deferred loan origination fees	(13)	(23)
Total residential mortgage loans	164,750	173,294
<b>Consumer loans:</b>		
Home equity term loans	119,813	119,909
Home equity lines of credit	85,142	83,771
Unsecured and other	1,431	1,410
Subtotal	206,386	205,090
Net deferred loan origination costs	1,014	1,066
Total consumer loans	207,400	206,156
Total loans and leases receivable	\$ 1,136,524	\$ 1,111,847

(a) There were no leases held for sale at June 30, 2010 or

December 31,  
2009.

Deposits

Total deposits increased by \$75.7 million, or 6.9%, during the first six months of 2010, from \$1.10 billion, or 69.1% of total assets at December 31, 2009 to \$1.17 billion, or 72.8% of total assets at June 30, 2010.

The following table sets forth certain information regarding deposits:

	June 30, 2010			December 31, 2009		
	Amount	Percent Of Total	Weighted Average Rate <i>(In thousands)</i>	Amount	Percent of Total	Weighted Average Rate
NOW accounts	\$ 73,501	6.2%	0.07%	\$ 74,558	6.8%	0.09%
Money market accounts	83,315	7.1%	0.83%	65,076	5.9%	1.10%
Savings accounts	366,087	31.2%	0.52%	367,225	33.4%	0.64%
Certificate of deposit accounts	360,323	30.7%	1.57%	387,144	35.3%	1.80%
Total interest bearing deposits	883,226	75.2%	0.94%	894,003	81.4%	1.13%
Noninterest bearing accounts	290,794	24.8%	0.00%	204,281	18.6%	0.00%
Total deposits	\$ 1,174,020	100.0%	0.70%	\$ 1,098,284	100.0%	0.92%

**Table of Contents**

During the first six months of 2010, competition for deposits remained strong in the Company's market areas. Demand deposit accounts grew \$86.5 million over the past six months. This growth reflects a temporary inflow received in late June 2010 of approximately \$53.0 million attributable to the settlement of personal injury litigation to which the Bank was not a party. Excluding the temporary inflow, demand deposit accounts grew \$33.5 million in the past six months. Money market accounts grew \$18.2 million when compared to year-end. These increases offset the decline in CDs of \$26.8 million, NOW accounts of \$1.1 million and savings accounts of \$1.1 million. At June 30, 2010, brokered CDs were \$27.1 million, or 2.3% of total deposits, compared to \$33.5 million, or 3.0% at year-end. The Bank may continue to utilize brokered CDs if rates are attractive compared to wholesale funding.

**Borrowings**

On a long-term basis, the Company intends to continue concentrating on increasing its core deposits and may utilize FHLB borrowings or repurchase agreements as cash flows dictate, as opportunities present themselves and as part of the Bank's overall strategy to manage interest rate risk. The Bank also may borrow from the Federal Reserve discount window on occasion to support its liquidity.

The Bank routinely enters into repurchase agreements with its larger deposit and commercial customers as part of its cash management services. These repurchase agreements represent an additional source of funds and are typically overnight borrowings. Repurchase agreements with Bank customers totaled \$36.9 million and \$37.0 million at June 30, 2010 and December 31, 2009, respectively. The Bank also borrows funds through the use of wholesale repurchase agreements with correspondent banks. Overnight and short-term borrowings decreased \$2.8 million during the first six months of 2010 from the December 31, 2009 level of \$40.2 million. FHLB borrowings decreased by \$53.8 million from the December 31, 2009 amount of \$277.2 million. Wholesale repurchase agreements remained constant from the December 31, 2009 balance of \$20.0 million.

**Asset Quality**

Nonperforming assets consist of nonperforming loans and other real estate owned (OREO). Nonperforming loans nonaccrual loans, loans past due 90 days or more, but still accruing and impaired loans. Under certain circumstances the Company may restructure the terms of a loan as a concession to a borrower. These restructured loans are generally considered nonperforming loans until a history of collection on the restructured terms of the loan has been established. OREO consists of real estate acquired through foreclosure proceedings and real estate acquired through acceptance of a deed in lieu of foreclosure.

*Nonperforming assets* At June 30, 2010, the Company had nonperforming assets of \$16.8 million, representing 1.04% of total assets compared to nonperforming assets of \$20.0 million, or 1.26% of total assets at December 31, 2009.

**Table of Contents**

The following table sets forth information regarding nonperforming assets and loans and leases 60-89 days past due as of the dates indicated:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<i>(In thousands)</i>	
Loans and leases accounted for on a nonaccrual basis	\$ 12,450	\$ 16,830
Loans and leases past due 90 days or more, but still accruing	941	826
Restructured loans and leases on a nonaccrual basis	1,420	659
<b>Total nonperforming loans and leases</b>	<b>14,811</b>	<b>18,315</b>
Other real estate owned	1,948	1,700
<b>Total nonperforming assets</b>	<b>\$ 16,759</b>	<b>\$ 20,015</b>
Delinquent loans and leases 60-89 days past due	\$ 2,343	\$ 2,028
Restructured loans and leases not included in nonperforming assets	\$ 445	\$ 445
Nonperforming loans and leases as a percent of total loans and leases	1.30%	1.65%
Nonperforming assets as a percent of total assets	1.04%	1.26%
Delinquent loans and leases 60-89 days past due as a percent of total loans and leases	0.21%	0.19%

Included in nonaccrual loans and leases at June 30, 2010 were \$7.9 million of impaired loans and leases with specific impairment reserves against these loans and leases of \$1.3 million. At December 31, 2009, there were \$12.4 million of impaired loans and leases with specific impairment reserves of \$1.9 million.

The following table provides further detailed information regarding the types of nonperforming loans and leases as of the dates indicated:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<i>(Dollars in thousands)</i>	
<b>Nonperforming loans and leases:</b>		
Commercial real estate	\$ 5,131	\$ 6,909
Commercial and industrial	1,155	2,919
Multifamily		205
Small business	986	1,147
Construction	469	469
Leases	2,252	1,878
Residential	3,737	4,124
Consumer	1,081	664
<b>Total nonperforming loans and leases</b>	<b>\$ 14,811</b>	<b>\$ 18,315</b>

The Company evaluates the underlying collateral of each nonperforming loan and lease and continues to pursue the collection of interest and principal. Management believes that the current level of nonperforming assets remains low relative to the size of the Company's loan portfolio and as compared to peer institutions. If current economic conditions continue or worsen, management believes it is likely that the level of nonperforming assets would increase, as would the level of charged-off loans.

*Higher-Risk Loans* Certain types of loans, such as option ARM products, junior lien loans, high loan-to-value ratio loans, interest only loans, subprime loans and loans with initial teaser rates, can have a greater risk of non-collection than other loans. Additional information about higher-risk loans may be useful in understanding the risks associated with the loan portfolio and in evaluating any known trends or uncertainties that could have a material impact on the results of operations. As of June 30, 2010 and December 31, 2009, the Company had \$110.9 million and \$113.6 million, respectively, of junior lien home equity loans and lines of credit. The allowance for loan and lease losses attributable to these loans at June 30, 2010 and December 31, 2009 was \$1.0 million. The Company does not hold other types of higher-risk loans.



**Table of Contents**

*Adversely classified assets* - The Company's management classifies certain assets as substandard, doubtful or loss based on criteria established under banking regulations. An asset is considered substandard if inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the insured institution will sustain some loss if existing deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

At June 30, 2010, the Company had \$20.7 million of assets that were classified as substandard. This compares to \$22.1 million of assets that were classified as substandard at December 31, 2009. The Company had no assets that were classified as loss or doubtful at either date. Performing loans may or may not be adversely classified depending upon management's judgment with respect to each individual loan. At June 30, 2010, included in the assets that were classified as substandard were \$5.9 million of performing loans. This compares to \$3.7 million of adversely classified performing loans as of December 31, 2009. These amounts constitute assets that, in the opinion of management, could potentially migrate to nonperforming or doubtful status. If current weak economic conditions continue or worsen, management believes it is likely that the level of adversely classified assets would increase. This in turn may necessitate further increases to the provision for loan losses in future periods.

**Allowance for Loan and Lease Losses**

During the first six months of 2010, the Company made additions to the allowance for loan and lease losses of \$3.2 million and experienced net charge-offs of \$2.3 million compared to additions to the allowance for loan and lease losses of \$4.2 million and net charge-offs of \$2.0 million for the first six months of 2009. The net charge-offs were primarily within the residential mortgage and commercial loan and lease portfolios. At June 30, 2010, the allowance for loan and lease losses stood at \$17.4 million and represented 117.45% of nonperforming loans and leases and 1.53% of total loans and leases outstanding. This compares to an allowance for loan and lease losses of \$16.5 million, representing 90.29% of nonperforming loans and 1.49% of total loans and leases outstanding at December 31, 2009.

**Table of Contents**

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

	<b>Six Months Ended June 30, 2010</b>	<b>Six Months Ended June 30, 2009</b>
	<i>(In thousands)</i>	
Balance at beginning of period	\$ 16,536	\$ 14,664
Loans and leases charged-off:		
Commercial real estate loans	(627)	(1)
Commercial and industrial loans		(356)
Small business loans	(415)	(694)
Leases	(526)	(4)
Residential mortgage loans	(837)	(930)
Consumer and other loans	(116)	(26)
Total loans charged-off	(2,521)	(2,011)
Recoveries of loans and leases previously charged-off:		
Commercial real estate loans	179	
Commercial and industrial loans	15	9
Small business loans	19	8
Leases	6	4
Residential mortgage loans		2
Consumer and other loans	12	19
Total recoveries of loans previously charged-off	231	42
Net charge-offs	(2,290)	(1,969)
Provision for loan and lease losses charged against income	3,150	4,210
Balance at end of period	\$ 17,396	\$ 16,905

The following table represents the allocation of the allowance for loan and lease losses as of the dates indicated:

<b>June 30, 2010</b>	<b>December 31, 2009</b>
<i>(In thousands)</i>	

**Loan category**

Assessing the appropriateness of the allowance for loan and lease losses involves substantial uncertainties and is based upon management's evaluation of the amounts required to meet estimated charge-offs in the loan and lease portfolio after weighing various factors. Management's methodology to estimate loss exposure includes an analysis of individual loans and leases deemed to be impaired, reserve allocations for various loan types based on payment status or loss experience and an unallocated allowance that is maintained based on management's assessment of many factors including the growth, composition and quality of the loan portfolio, historical loss experiences, general economic conditions and other pertinent factors. These risk factors are reviewed and revised by management where conditions indicate that the estimates initially applied are different from actual results. If credit performance is worse than

anticipated, the Company could incur additional loan and lease losses in future periods. The unallocated allowance for loan and lease losses was \$1.7 million at June 30, 2010 compared to \$1.3 million at December 31, 2009. Management believes that the allowance for loan and lease losses as of June 30, 2010 is appropriate.

**Table of Contents**

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

**Results of Operations Executive Overview**

Selected income statement, per share data and operating ratios are presented in the table below for the three-month periods indicated:

	<b>For the three-month periods ended</b>				
	<b>June 30, 2010</b>	<b>March 31, 2010</b>	<b>December 31, 2009</b>	<b>September 30, 2009</b>	<b>June 30, 2009</b>
	<i>(Dollars in thousands, except per share data)</i>				
Income statement data:					
Net interest income	\$ 13,626	\$ 13,088	\$ 13,001	\$ 12,666	\$ 11,573
Noninterest income	2,285	2,315	2,353	2,241	2,214
Noninterest expense	10,430	10,488	9,949	9,812	10,145
Net income	2,681	2,219	1,133	2,203	740
Net income applicable to common shares	2,681	2,219	1,133	779	303
Per share data:					
Diluted earnings per share	\$ 0.57	\$ 0.48	\$ 0.24	\$ 0.17	\$ 0.07
Dividends per common share	\$ 0.17	\$ 0.17	\$ 0.17	\$ 0.17	\$ 0.17
Operating ratios:					
Net interest margin <sup>(1) (5)</sup>	3.67%	3.52%	3.42%	3.38%	3.10%
Return on assets <sup>(2) (5)</sup>	0.68%	0.57%	0.28%	0.56%	0.19%
Return on equity <sup>(3) (5)</sup>	8.54%	7.32%	3.67%	2.56%	1.00%
Efficiency ratio <sup>(4) (5)</sup>	65.55%	68.09%	64.80%	65.82%	73.58%

(1) Calculated by dividing annualized net interest income by average interest-earning assets.

(2) Calculated by dividing annualized net income by average total assets.

- (3) Calculated by dividing annualized net income applicable to common shares by average common shareholders equity.
- (4) Calculated by dividing noninterest expense by net interest income plus noninterest income.
- (5) Non-GAAP performance measure.

The Company's 2010 second quarter net income of \$2.7 million increased by \$462,000, or 20.8%, from the prior quarter (three months ended March 31, 2010). Net income was up \$1.9 million, or 262.3%, on a comparative quarter basis (as compared to the three months ended June 30, 2009). Diluted earnings per common share (EPS) were up 18.8% on a linked-quarter basis (as compared to the three months ended March 31, 2010) and increased 714.3% as compared to the same quarter a year ago.

The second quarter 2010 net interest income increased by \$538,000, or 4.1%, as compared to the first quarter of 2010. The increase in the net interest margin of 15 basis points (bps), to 3.67%, was due to the lower cost of liabilities of 7 bps and the increase in yield on interest-earning assets of 6 bps. The increases in net interest income and yield on interest-earning assets as compared to the first quarter of 2010 reflect the recognition of approximately \$130,000 in interest income collected on a nonperforming loan.

**Table of Contents**

Compared to the second quarter of 2009, net interest income increased by \$2.1 million. The decrease in cost of funds of 74 bps exceeded the decrease in the yield on interest-earning assets of 3 bps.

The provision for loan and lease losses of \$1.6 million for the three months ended June 30, 2010 decreased by \$50,000 on a linked-quarter basis. In comparison to the second quarter of 2009, the provision for loan and lease losses decreased by \$1.1 million.

Noninterest income for the second quarter of 2010 decreased on a linked-quarter basis by \$30,000. Gains on the sale of available for sale securities decreased by \$372,000, commissions on nondeposit investment products decreased by \$89,000, loan related fees decreased by \$56,000 and other miscellaneous income decreased by \$97,000. These decreases were offset by a decrease in impairment charges on other-than-temporarily impaired available for sale securities of \$527,000 on a linked-quarter basis. Additionally, service charges on deposit accounts increased by \$84,000 during the second quarter of 2010.

In comparison to the 2009 second quarter, noninterest income was up \$71,000. The Company recognized a gain on the sale of available for sale securities of \$103,000 during the second quarter of 2010, while there were no sales during the same period of 2009. Commissions on nondeposit investment products increased \$37,000 and other miscellaneous income increased \$89,000. These increases were offset by decreased loan related fees of \$96,000 and credit losses of other-than-temporarily impaired securities of \$44,000.

Noninterest expenses decreased on a linked-quarter basis by \$58,000, with a decrease in costs of salaries and employee benefits of \$97,000, professional services of \$95,000 and occupancy of \$32,000. Increases in marketing costs of \$125,000 and other expenses of \$45,000 partially offset the decreases.

Second quarter 2010 noninterest expenses increased \$285,000, compared to the second quarter of 2009. Salaries and employee benefits costs increased \$820,000, loan workout and other real estate owned expense increased \$188,000, marketing costs increased \$51,000 and other expenses increased \$60,000, compared to the second quarter a year ago. Within the net increase in noninterest expenses were decreases in costs of FDIC insurance of \$701,000 and professional services of \$109,000.

The Company's key operating ratios are return on assets, return on equity and the efficiency ratio. For the second quarter of 2010, the return on assets, return on equity and efficiency ratio metrics all improved on a linked-quarter basis and compared to the same quarter of the prior year. The Company continues to focus on growing revenue while controlling the increase in expenses as part of its effort to improve earnings and build shareholder value.

**Results of Operations Comparison of the Three Months Ended June 30, 2010 and 2009****General**

Net income for the three months ended June 30, 2010 increased \$1.9 million, or 262.3%, to \$2.7 million, or \$0.57 per diluted common share from \$740,000, or \$0.07 per diluted common share for the same period of 2009.

**Net Interest Income**

Net interest income for the quarter ended June 30, 2010 was up \$2.1 million, or 17.7%, from the \$11.6 million earned in the second quarter of 2009. Net interest margin for the second quarter of 2010 of 3.67% increased 57 bps from the net interest margin for the 2009 period of 3.10%. Average earning assets were down \$2.9 million, or 0.2%, and average interest-bearing liabilities were up \$4.7 million, or 0.4%, from the comparable period a year earlier.

**Table of Contents**

*Average Balances, Yields and Costs* - The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the three month periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances and include nonperforming loans and leases. Available for sale securities are stated at amortized cost.

<i>(In thousands)</i>	<b>For the three months ended June 30,</b>					
	<b>Average Balance</b>	<b>2010 Interest Earned/ Paid</b>	<b>Average Yield</b>	<b>Average Balance</b>	<b>2009 Interest Earned/ Paid</b>	<b>Average Yield</b>
<b>Assets</b>						
Earning assets:						
Overnight investments	\$ 2,009	\$	0.09%	\$ 3,149	\$	0.08%
Available for sale securities	346,907	3,531	4.08%	370,685	3,896	4.22%
Stock in the FHLB	16,274		0.00%	15,671		0.00%
Loans and leases receivable:						
Commercial loans and leases	757,664	10,943	5.79%	694,723	10,041	5.79%
Residential mortgage loans	167,289	1,939	4.64%	198,144	2,460	4.97%
Consumer and other loans	204,235	2,223	4.36%	214,928	2,395	4.47%
Total earning assets	1,494,378	18,636	5.00%	1,497,300	18,792	5.03%
Cash and due from banks	18,798			12,335		
Allowance for loan and lease losses	(17,034)			(15,788)		
Premises and equipment	12,244			12,425		
Goodwill, net	12,262			12,051		
Accrued interest receivable	4,252			4,213		
Bank-owned life insurance	30,435			29,158		
Prepaid expenses and other assets	16,898			9,285		
Total assets	\$ 1,572,233			\$ 1,560,979		
<b>Liabilities and Shareholders</b>						
<b>Equity</b>						
Interest-bearing liabilities:						
Deposits:						
NOW accounts	\$ 69,378	\$ 12	0.07%	\$ 67,072	\$ 14	0.08%
Money market accounts	81,271	165	0.81%	16,228	51	1.26%
Savings accounts	373,225	506	0.54%	385,887	930	0.97%
Certificate of deposit accounts	374,935	1,481	1.58%	424,699	3,229	3.05%
Overnight and short-term						
borrowings	37,011	19	0.20%	45,065	22	0.19%
Wholesale repurchase agreements	20,000	143	2.82%	10,000	134	5.32%
FHLB borrowings	247,720	2,518	4.02%	249,852	2,649	4.20%
Subordinated deferrable interest						
debentures	13,403	166	4.93%	13,403	190	5.67%

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

Total interest-bearing liabilities	1,216,943	5,010	1.65%	1,212,206	7,219	2.39%
Noninterest-bearing deposits	219,136			185,196		
Other liabilities	10,168			13,565		
Total liabilities	1,446,247			1,410,967		
Shareholders' equity:	125,986			150,012		
Total liabilities and shareholders' equity	\$ 1,572,233			\$ 1,560,979		
Net interest income		\$ 13,626			\$ 11,573	
Net interest rate spread			3.35%			2.64%
Net interest rate margin			3.67%			3.10%



**Table of Contents**

*Rate/Volume Analysis* The following table sets forth certain information regarding changes in the Company's interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in rate (changes in rate multiplied by comparative period average balance) and (ii) changes in volume (changes in average balances multiplied by comparative period rate). The net change attributable to the combined impact of rate and volume was allocated proportionally to the individual rate and volume changes.

<i>(In thousands)</i>	<b>Three Months Ended June 30, 2010 vs. 2009</b>		
	<b>Increase/(Decrease) Due to Rate</b>	<b>Volume</b>	<b>Total</b>
Interest income:			
Available for sale securities	\$ (207)	\$ (158)	\$ (365)
Commercial loans and leases	45	857	902
Residential mortgage loans	(163)	(358)	(521)
Consumer and other loans	9	(181)	(172)
<b>Total interest income</b>	<b>(316)</b>	<b>160</b>	<b>(156)</b>
Interest expense:			
NOW accounts	(2)		(2)
Money market accounts	(24)	138	114
Savings accounts	(395)	(29)	(424)
Certificate of deposit accounts	(1,358)	(390)	(1,748)
Overnight and short-term borrowings	1	(4)	(3)
Wholesales repurchase agreements	(82)	91	9
FHLB borrowings	(109)	(22)	(131)
Subordinated deferrable interest debentures	(24)		(24)
<b>Total interest expense</b>	<b>(1,993)</b>	<b>(216)</b>	<b>(2,209)</b>
<b>Net interest income</b>	<b>\$ 1,677</b>	<b>\$ 376</b>	<b>\$ 2,053</b>

*Interest Income - Investments* Total investment income (consisting of interest on overnight investments and available for sale securities) was \$3.5 million for the quarter ended June 30, 2010, compared to \$3.9 million for the 2009 period. The decrease in total investment income was \$365,000, or 9.4%.

With respect to duration and repricing of the Company's available for sale investment portfolio, the majority of the Company's investments are comprised of government-sponsored enterprise ( GSE ) obligations and private-labeled and GSE mortgage-backed securities with repricing periods or expected durations of less than five years.

*Interest Income - Loans and Leases* - Interest from loans and leases was \$15.1 million for the quarter ended June 30, 2010 and represented a yield on total loans and leases of 5.36%. This compares to \$14.9 million of interest and a yield of 5.39% for the second quarter of 2009. Interest income on loans and leases increased \$209,000, or 1.4%, with the decrease in yield on loans and leases of 3 bps offset by the increase in the average balance of loans and leases of \$21.4 million, or 1.9%.

The average balance of the various components of the loan and lease portfolio changed from the second quarter of 2009 as follows: commercial loans and leases increased \$62.9 million, or 9.1%; consumer and other loans decreased \$10.7 million, or 5.0%; and residential mortgage loans decreased \$30.9 million, or 15.6%. Changes in the average yields from the second quarter of 2009 were as follows: commercial loans and leases remained constant at 5.79%;

consumer and other loans decreased 11 bps to 4.36%; and residential mortgage loans decreased 33 bps to 4.64%.

*Interest Expense Deposits and Borrowings* Interest paid on deposits and borrowings decreased \$2.2 million, or 30.6%, to \$5.0 million for the three months ended June 30, 2010, down from \$7.2 million for the same period during 2009. The overall average cost for interest-bearing liabilities decreased 74 bps to 1.65% for the second quarter of 2010, compared to 2.39% for the second quarter of 2009. The average balance of total interest-bearing liabilities increased \$4.7 million, or 0.4%, to \$1.22 billion for the three months ended June 30, 2010 compared to the same period in 2009.

**Table of Contents**

The growth in deposit average balances was centered primarily in money market accounts up \$65.0 million, or 400.8%, (primarily due to new retail products available and the Bank's strategy to allow short-term CDs with higher costs to decline) and NOW accounts up \$2.3 million, or 3.4%. The increase was offset by a decrease in CDs of \$49.8 million, or 11.7%, and savings accounts of \$12.7 million, or 3.3%.

Average borrowings decreased as compared to the second quarter of 2009, with a decrease in short-term borrowings of \$8.1 million, or 17.9%, and FHLB funding of \$2.1 million, or 0.9%, offset with an increase in wholesale repurchase agreements of \$10.0 million, or 100.0%.

Market competition from bank and non-bank financial institutions continues to be strong in the Company's market area. However, lower Federal Funds rates, reduced FHLB borrowing levels, disciplined deposit pricing and maturation and/or repricing of higher yielding CDs to lower rates have decreased the cost of interest-bearing liabilities in the second quarter of 2010 compared to the same period in 2009.

Overall, the Company's liability costs continue to be dependent upon a number of factors including general economic conditions, national and local interest rates, competition in the local deposit marketplace, interest rate tiers offered and the Company's cash flow needs.

**Provision for Loan and Lease Losses**

The provision for loan and lease losses was \$1.6 million for the quarter ended June 30, 2010, compared to \$2.6 million for the second quarter of 2009. This represents a decrease of \$1.1 million, or 40.4%.

Management evaluates several factors including new loan originations, actual and estimated charge-offs, risk characteristics of the loan and lease portfolio and general economic conditions when determining the provision for loan and lease losses. Growth in the loan and lease portfolio necessitates increases in the provision for loan and lease losses. As the loans and leases mature, or if current weak economic conditions continue or worsen, management believes it likely that the level of nonperforming assets would increase, which may in turn lead to increases to the provision for loan and lease losses. Also see discussion under *Allowance for Loan and Lease Losses*.

**Noninterest Income**

Total noninterest income increased \$71,000, or 3.2%, to \$2.3 million for the second quarter of 2010, from \$2.2 million for the second quarter of 2009. During the quarter, a gain on sale of available for sale securities of \$103,000 was recognized, while there were no sales during the same period of 2009. Commissions on nondeposit investment products increased by \$37,000, or 33.3%, and other miscellaneous income increased by \$89,000, or 48.4%. Loan related fees decreased by \$96,000, or 41.9%, compared to the second quarter of 2009. In addition, the Company recognized a credit loss on an other-than-temporarily impaired available for sale security of \$44,000 for the quarter ended June 30, 2010. There were no credit losses recognized for the same period of 2009.

**Noninterest Expense**

Noninterest expense for the second quarter of 2010 increased \$285,000, or 2.8%, to \$10.4 million from \$10.1 million in 2009.

Salaries and employee benefits increased \$820,000, or 16.6%, compared to the second quarter of 2009. The increase in salaries and employee benefits was due to several factors, including the expansion of the workforce and a reduction in deferred salaries and benefits costs caused by declines in the volume of Macrolease-generated loans and leases. In addition, an adjustment in the forfeiture rate of share-based compensation reduced the expense in the second quarter of 2009, while there was no adjustment in the second quarter of 2010.

**Table of Contents**

Loan workout and other real estate owned expenses increased \$188,000, or 126.2%, marketing costs increased \$51,000, or 15.4%, and other expenses increased \$60,000, or 6.1%. The increases in noninterest expense were partially offset by decreases in FDIC insurance expense of \$701,000, or 59.6%, resulting from a special assessment imposed on financial institutions in the second quarter of 2009, and professional services costs of \$109,000, or 16.9%. Overall, the improvement in the Company's net interest margin exceeded the increases in noninterest expense during the second quarter of 2010, decreasing the efficiency ratio to 65.55% compared to 73.58% for the same period a year ago.

**Income Tax Expense**

Income tax expense of \$1.3 million was recorded for the three months ended June 30, 2010, compared to \$302,000 for the same period during 2009. This represented total effective tax rates of 31.8% and 29.0%, respectively. Tax-favored income from bank-owned life insurance, along with the Company's utilization of a Rhode Island passive investment company, has reduced the effective tax rate from the 40.9% combined statutory federal and state tax rate.

As discussed in *Note 7 Contingent Liabilities* of the Company's consolidated financial statements, the Massachusetts Department of Revenue (DOR) has challenged a tax position of the Bank. While management believes it more likely than not that the Bank will prevail in its tax position, the Company's tax expense would increase if it does not.

**Results of Operations Comparison of the Six Months Ended June 30, 2010 and 2009****General**

Net income for the first six months of 2010 increased \$2.7 million, or 122.4%, to \$4.9 million, or \$1.05 per diluted common share from \$2.2 million, or \$0.29 per diluted common share for the first six months of 2009.

**Net Interest Income**

For the six months ended June 30, 2010, net interest income was \$26.7 million, compared to \$22.7 million for the 2009 period. The net interest margin for the first six months of 2010 was 3.59%, up from the net interest margin for the 2009 period of 3.09%. The increase in net interest income of \$4.1 million, or 17.9%, was attributable to a lower cost of funds on interest-bearing liabilities of 77 bps. Average earning assets were \$24.2 million, or 1.6% higher, and average interest-bearing liabilities were \$24.0 million, or 2.0% higher, than the comparable period a year earlier.

**Table of Contents**

*Average Balances, Yields and Costs* The following table sets forth certain information relating to the Company's average balance sheet and reflects the average yield on assets and average cost of liabilities for the six month periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from daily balances and include nonperforming loans. Available for sale securities are stated at amortized cost.

<i>(In thousands)</i>	<b>Six Months Ended June 30,</b>					
	<b>Average Balance</b>	<b>2010 Interest Earned/ Paid</b>	<b>Average Yield</b>	<b>Average Balance</b>	<b>2009 Interest Earned/ Paid</b>	<b>Average Yield</b>
<b>Assets</b>						
Earning assets:						
Overnight investments	\$ 2,150	\$ 5	0.50%	\$ 1,984	\$ 9	0.96%
Available for sale securities	359,640	7,310	4.10%	356,714	7,750	4.38%
Stock in the FHLB	16,274		0.00%	15,671		0.00%
Loans receivable:						
Commercial loans and leases	744,825	21,254	5.74%	683,843	19,747	5.81%
Residential mortgage loans	169,834	3,968	4.67%	202,949	5,120	5.05%
Consumer and other loans	204,039	4,451	4.40%	211,361	4,726	4.51%
Total earning assets	1,496,762	36,988	4.97%	1,472,522	37,352	5.10%
Cash and due from banks	16,139			20,288		
Allowance for loan and lease losses	(17,129)			(15,224)		
Premises and equipment	12,301			12,490		
Goodwill, net	12,221			12,058		
Accrued interest receivable	4,312			4,251		
Bank-owned life insurance	30,277			29,011		
Prepaid expenses and other assets	16,232			9,109		
Total assets	\$ 1,571,115			\$ 1,544,505		
<b>Liabilities and Shareholders</b>						
<b>Equity</b>						
Interest-bearing liabilities:						
Deposits:						
NOW accounts	\$ 69,025	\$ 27	0.08%	\$ 64,176	\$ 32	0.10%
Money market accounts	76,356	314	0.83%	10,450	52	1.01%
Savings accounts	371,497	1,037	0.56%	386,046	2,013	1.05%
Certificate of deposit accounts	380,237	3,064	1.62%	421,680	6,621	3.17%
Overnight and short-term						
borrowings	38,080	37	0.20%	48,635	48	0.20%
Wholesale repurchase agreements	19,116	282	2.93%	10,000	267	5.39%
FHLB borrowings	259,665	5,183	3.97%	248,769	5,275	4.22%
Subordinated deferrable interest						
debentures	13,403	330	4.95%	13,403	389	5.83%

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

Total interest-bearing liabilities	1,227,379	10,274	1.69%	1,203,159	14,697	2.46%
Noninterest-bearing deposits	209,489			178,360		
Other liabilities	9,652			13,153		
Total liabilities	1,446,520			1,394,672		
Shareholders' Equity:	124,595			149,833		
Total liabilities and shareholders equity	\$ 1,571,115			\$ 1,544,505		
Net interest income		\$ 26,714			\$ 22,655	
Net interest rate spread			3.28%			2.64%
Net interest rate margin			3.59%			3.09%

**Table of Contents**

*Rate/Volume Analysis* The following table sets forth certain information regarding changes in the Company's interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in rate (changes in rate multiplied by comparative period average balance) and (ii) changes in volume (changes in average balances multiplied by comparative period rate). The net change attributable to the combined impact of rate and volume was allocated proportionally to the individual rate and volume changes.

<i>(In thousands)</i>	<b>Six Months Ended June 30, 2010 vs. 2009</b>		
	<b>Increase/(decrease) due to</b>		
	<b>Rate</b>	<b>Volume</b>	<b>Total</b>
<b>Interest income:</b>			
Overnight investments	\$ (5)	\$ 1	\$ (4)
Available for sale securities	(583)	143	(440)
Commercial loans and leases	(192)	1,699	1,507
Residential mortgage loans	(374)	(778)	(1,152)
Consumer and other loans	15	(290)	(275)
<b>Total interest income</b>	<b>(1,139)</b>	<b>775</b>	<b>(364)</b>
<b>Interest expense:</b>			
NOW accounts	(7)	2	(5)
Money market accounts	(11)	273	262
Savings accounts	(903)	(73)	(976)
Certificate of deposit accounts	(2,880)	(677)	(3,557)
Overnight and short-term borrowings	(1)	(10)	(11)
Wholesale repurchase agreements	(154)	169	15
FHLB borrowings	(313)	221	(92)
Subordinated deferrable interest debentures	(59)		(59)
<b>Total interest expense</b>	<b>(4,328)</b>	<b>(95)</b>	<b>(4,423)</b>
<b>Net interest income</b>	<b>\$ 3,189</b>	<b>\$ 870</b>	<b>\$ 4,059</b>

*Interest Income - Investments* Total investment income (consisting of interest on overnight investments and available for sale securities) was \$7.3 million for the six months ended June 30, 2010, compared to \$7.8 million for the 2009 period. The decrease in total investment income was \$444,000, or 5.7%.

*Interest Income - Loans and Leases* - Interest from loans and leases was \$29.7 million for the six months ended June 30, 2010, and represented a yield on total loans and leases of 5.34%. This compares to \$29.6 million of interest, and a yield of 5.42%, for the same period a year ago. Interest income increased \$80,000, or 0.3%, with the decrease in yield on loans and leases of 8 bps partially offset by the increase in the average balance of loans and leases of \$20.5 million, or 1.9%.

The average balance of the components of the loan and lease portfolio for the six months ended June 30, 2010 changed compared to the same period in 2009 as follows: commercial loans and leases increased \$61.0 million, or 8.9%; consumer and other loans decreased \$7.3 million, or 3.5%; and residential mortgage loans decreased \$33.1 million, or 16.3%. Changes in the average yields for the six months ended June 30, 2010 compared to the same period in 2009 were as follows: commercial loans and leases decreased 7 bps to 5.74%; consumer and other loans decreased 11 bps to 4.40%; and residential mortgage loans decreased 38 bps to 4.67%.

*Interest Expense Deposits and Borrowings* Interest paid on deposits and borrowings decreased \$4.4 million, or 30.1%, to \$10.3 million for the six months ended June 30, 2010, down from \$14.7 million for the same period during 2009. The overall average cost for interest-bearing liabilities decreased 77 bps to 1.69% for the first six months of 2010, compared to 2.46% for the first six months of 2009. The average balance of total interest-bearing liabilities increased \$24.2 million, or 2.0%, to \$1.23 billion for the first six months of 2010 compared to the same period in 2009.



**Table of Contents**

The growth in deposit average balances was centered primarily in money market accounts up \$65.9 million, or 630.7%, (primarily due to new retail products available and the Bank's strategy to allow short-term CDs with higher costs to decline) and NOW accounts up \$4.8 million, or 7.6%. The increase was offset by a decrease in CDs of \$41.4 million, or 9.8%, and savings accounts of \$14.5 million, or 3.8%.

Average borrowings increased as compared to the second quarter of 2009, with an increase in FHLB funding of \$10.9 million, or 4.4%, and wholesale repurchase agreements of \$9.1 million, or 91.2%, offset with a decrease in short-term borrowings of \$10.6 million, or 21.7%.

Market competition from bank and non-bank financial institutions continues to be strong in the Company's market area. However, lower Federal Funds rates, reduced FHLB borrowing levels, disciplined deposit pricing and maturation and/or repricing of higher yielding CDs to lower rates have decreased the cost of interest-bearing liabilities for the six months ended June 30, 2010 compared to the same period in 2009.

Overall, the Company's liability costs continue to be dependent upon a number of factors including general economic conditions, national and local interest rates, competition in the local deposit marketplace, interest rate tiers offered and the Company's cash flow needs.

**Provision for Loan and Lease Losses**

For the six months ended June 30, 2010, the provision for loan and lease losses was \$3.2 million, down \$1.1 million, or 25.2%, from the \$4.2 million recorded during the same period in 2009.

Management evaluates several factors including new loan originations, actual and estimated charge-offs, risk characteristics of the loan and lease portfolio and general economic conditions when determining the provision for loan and lease losses. Growth in the loan and lease portfolio necessitates increases in the provision for loan and lease losses. As the loans and leases mature, or if current weak economic conditions continue or worsen, management believes it likely that the level of nonperforming assets would increase, which may in turn lead to increases to the provision for loan and lease losses. Also see discussion under *Allowance for Loan and Lease Losses*.

**Noninterest Income**

Total noninterest income increased \$29,000, or 0.6%, to \$4.6 million for the first six months of 2010 from \$4.6 million for the same period in 2009. Gains on the sale of available for sale securities increased by \$517,000, or 847.5%, commissions on nondeposit investment products increased \$118,000, or 44.2%, and other miscellaneous income increased \$246,000, or 62.0%, during the second quarter of 2010. These increases were offset by credit losses on other-than-temporarily impaired securities of \$615,000 and decreased loan related fees of \$306,000, or 48.7%. The Company did not recognize credit losses on other-than-temporarily impaired securities during the first six months of 2009.

**Noninterest Expense**

Noninterest expense for the six months of 2010 increased \$1.2 million, or 5.8%, to \$20.9 million from \$19.8 million in 2009.

Salaries and employee benefits costs increased \$1.5 million, or 15.0%, compared to the first six months of 2009. The increase in salaries and benefits costs is attributable to several factors, including higher incentive costs driven by improved financial performance, expansion of the workforce and a reduction in deferred salaries and benefits caused by the declines in the volume of Macrolease-generated loans and leases for the first six months of 2010. In addition, as a result of the separation of the Chief Business Officer from the Bank in 2009, adjustments reducing retirement and share-based payment costs were recorded for the first six months of 2009.

Loan workout and other real estate owned expenses increased \$396,000, or 143.0%, and equipment costs, data processing costs and other expenses increased \$137,000, or 3.7%. The increases in noninterest expense were partially offset by decreases in FDIC insurance expense of \$613,000, or 39.2%, resulting from a special assessment imposed on financial institutions in the second quarter of 2009, professional services costs of \$175,000, or 13.0%, and occupancy costs of \$98,000, or 5.5%.

**Table of Contents**

Overall, the increase in noninterest expense for the first six months of 2010 was exceeded by the growth in net interest income, improving the Company's efficiency ratio. The efficiency ratio for the first six months of the year declined from 72.61% in 2009 to 66.80% in 2010.

**Income Tax Expense**

Income tax expense of \$2.3 million was recorded for the six months ended June 30, 2010, compared to \$1.0 million for the same period during 2009. This represented total effective tax rates of 32.4% and 32.2%, respectively. Tax-favored income from bank-owned life insurance, along with the Company's utilization of a Rhode Island passive investment company, has reduced the effective tax rate from the 40.9% combined statutory federal and state tax rates. As discussed in *Note 7 – Contingent Liabilities* of the Company's consolidated financial statements, the Massachusetts Department of Revenue (DOR) has challenged a tax position of the Bank. While management believes it more likely than not that the Bank will prevail in its tax position, the Company's tax expense would increase if it does not.

**Liquidity and Capital Resources****Liquidity**

Liquidity is defined as the ability to meet current and future financial obligations of a short-term nature. The Company further defines liquidity as the ability to respond to the needs of depositors and borrowers, as well as to earnings enhancement opportunities, in a changing marketplace.

The primary source of funds for the payment of dividends and expenses by the Company is dividends paid to it by the Bank. Bank regulatory authorities generally restrict the amounts available for payment of dividends if the effect thereof would cause the capital of the Bank to be reduced below applicable capital requirements. These restrictions indirectly affect the Company's ability to pay dividends. The primary sources of liquidity for the Bank consist of deposit inflows, loan repayments, borrowed funds and maturing investment securities and sales of securities from the available for sale portfolio. While management believes that these sources are sufficient to fund the Bank's lending and investment activities, the availability of these funding sources are subject to broad economic conditions and could be restricted in the future. Such restrictions would impact the Company's immediate liquidity and/or additional liquidity. Management is responsible for establishing and monitoring liquidity targets as well as strategies and tactics to meet these targets. In general, the Company seeks to maintain a high degree of flexibility with a liquidity target of 10% to 30% of total assets. At June 30, 2010, overnight investments and available for sale securities amounted to \$375.8 million, or 23.3% of total assets. This compares to \$383.8 million, or 24.1% of total assets at December 31, 2009. The Bank is a member of the FHLB and, as such, has access to both short- and long-term borrowings. The Bank also has access to funding through wholesale repurchase agreements and brokered deposits, and may utilize additional sources of funding in the future, including borrowings at the Federal Reserve discount window, to supplement its liquidity. Management believes that the Company has adequate liquidity to meet its commitments.

**Capital Resources**

Total shareholders' equity of the Company was \$129.1 million at June 30, 2010 compared to \$120.7 million at December 31, 2009. Net income of \$4.9 million, increased net unrealized holding gains on available for sale securities of \$4.2 million, declines in the non-credit component of other-than-temporary impairment of \$431,000, net stock option activity (stock option exercises, share repurchases and share-based compensation) of \$302,000 and Macrolease contingent share payments of \$211,000 were offset by common stock dividends of \$1.6 million.

**Table of Contents**

In connection with the Macrolease acquisition, the Company has issued 33,268 shares of common stock based upon Macrolease achieving certain performance targets. These shares were issued based on a performance period from the date of acquisition on April 29, 2005 through December 31, 2009. As of April 30, 2010, the performance period through which contingent shares were available has ended. No further shares of common stock were earned in 2010 and, therefore, no further shares will be issued.

All FDIC-insured institutions must meet specified minimal capital requirements. These regulations require banks to maintain a minimum leverage capital ratio. In addition, the FDIC has adopted capital guidelines based upon ratios of a bank's capital to total assets adjusted for risk. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. These regulations require banks to maintain minimum capital levels for capital adequacy purposes and higher capital levels to be considered well-capitalized.

The Federal Reserve Board (FRB) has also issued capital guidelines for bank holding companies. These guidelines require the Company to maintain minimum capital levels for capital adequacy purposes. In general, the FRB has adopted substantially identical capital adequacy guidelines as the FDIC. Such standards are applicable to bank holding companies and their bank subsidiaries on a consolidated basis.

As of June 30, 2010, the Company and the Bank met all applicable minimum capital requirements and were considered well-capitalized by both the FRB and the FDIC.

The Company's and the Bank's actual and required capital amounts and ratios are as follows:

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Considered Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	<i>(Dollars in thousands)</i>					
<b>At June 30, 2010:</b>						
Bancorp Rhode Island, Inc.						
Tier I capital (to average assets)	\$ 124,106	7.91%	\$ 62,780	4.00%	\$ 78,475	5.00%
Tier I capital (to risk weighted assets)	124,106	10.95%	45,334	4.00%	68,002	6.00%
Total capital (to risk weighted assets)	138,309	12.20%	90,669	8.00%	113,336	10.00%
Bank Rhode Island						
Tier I capital (to average assets)	\$ 122,324	7.80%	\$ 62,758	4.00%	\$ 78,448	5.00%
Tier I capital (to risk weighted assets)	122,324	10.80%	45,307	4.00%	67,960	6.00%
Total capital (to risk weighted assets)	136,527	12.05%	90,614	8.00%	113,267	10.00%
<b>At December 31, 2009:</b>						
Bancorp Rhode Island, Inc.						
Tier I capital (to average assets)	\$ 120,297	7.65%	\$ 62,941	4.00%	\$ 78,676	5.00%
Tier I capital (to risk weighted assets)	120,297	10.71%	44,913	4.00%	67,369	6.00%
Total capital (to risk weighted assets)	134,364	11.97%	89,825	8.00%	112,281	10.00%

Bank Rhode Island

Tier I capital (to average assets)	\$ 118,412	7.54%	\$ 62,855	4.00%	\$ 78,569	5.00%
Tier I capital (to risk weighted assets)	118,412	10.55%	44,882	4.00%	67,323	6.00%
Total capital (to risk weighted assets)	132,479	11.81%	89,764	8.00%	112,205	10.00%

**Recent Accounting Pronouncements**

See *Note 4 Recent Accounting Pronouncements* of the consolidated financial statements for details of recently issued accounting pronouncements and their expected impact on the Company's consolidated financial statements.

**Table of Contents*****ITEM 3. Quantitative and Qualitative Disclosures About Market Risk******Interest Rate Risk***

The principal market risk facing the Company is interest rate risk. The Company's objective regarding interest rate risk is to manage its assets and funding sources to produce results which are consistent with its liquidity, capital adequacy, growth and profitability goals, while maintaining interest rate risk exposure within established parameters over a range of possible interest rate scenarios.

Interest rate risk management is governed by the Bank's Asset/Liability Committee (ALCO). The ALCO establishes exposure limits that define the Company's tolerance for interest rate risk. The ALCO monitors current exposures versus limits and reports results to the Board of Directors. The policy limits and guidelines serve as benchmarks for measuring interest rate risk and for providing a framework for evaluation and interest rate risk management decision making. The primary tools for managing interest rate risk currently are the securities portfolio, purchased mortgages, wholesale repurchase agreements and borrowings from the FHLB.

The Company's interest rate risk position is measured using both income simulation and interest rate sensitivity gap analysis. Income simulation is the primary tool for measuring the interest rate risk inherent in the Company's balance sheet at a given point in time by showing the effect on net interest income, over a 12-month period, of interest rate shocks of 300 bps. These simulations take into account repricing, maturity and prepayment characteristics of individual products. The ALCO reviews simulation results to determine whether the exposure resulting from changes in market interest rates remains within established tolerance levels over a 12-month horizon, and develops appropriate strategies to manage this exposure. The Company's guidelines for interest rate risk specify that if interest rates were to shift immediately up or down 300 bps over a 12-month time period, estimated net interest income should decline by no more than 15.0%. Due to the low interest rate environment at June 30, 2010, interest rate shocks down were not performed. As of June 30, 2010, net interest income simulation indicated that the Company's exposure to changing interest rates was within this tolerance. The ALCO reviews the methodology utilized for calculating interest rate risk exposure and may periodically adopt modifications to this methodology.

The following table presents the estimated impact of interest rate shocks on the Company's estimated net interest income over a 12-month period beginning July 1, 2010:

<b>Estimated Exposure to Net Interest Income</b>	
<b>Dollar Change</b>	<b>Percent Change</b>
<i>(Dollars in thousands)</i>	

**Initial Twelve Month Period:**

Up 300 bps	\$ 399	0.75%
------------	--------	-------

The Company also uses interest rate sensitivity gap analysis to provide a more general overview of its interest rate risk profile. The interest rate sensitivity gap is defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. At June 30, 2010, the Company's one year cumulative gap was a positive \$128.6 million, or 8.0% of total assets.

For additional discussion on interest rate risk see the section titled *Asset and Liability Management* on pages 52 through 53 of the Company's 2009 Annual Report on Form 10-K.

**Table of Contents**

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

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

There was no significant change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to affect, the Company's internal control over financial reporting. The Company continues to enhance its internal controls over financial reporting, primarily by evaluating and enhancing process and control documentation. Management discusses with and discloses these matters to the Audit Committee of the Board of Directors and the Company's auditors.

**Table of Contents**

**PART II. Other Information**

**Item 1. Legal Proceedings**

There are no material pending legal proceedings to which the Company or its subsidiaries are a party, or to which any of their property is subject, other than ordinary routine litigation incidental to the business of banking.

**Item 1A. Risk Factors**

There have been no material changes from the risk factors as previously disclosed in the Company's 2009 Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

No information to report.

**Item 3. Defaults Upon Senior Securities**

No defaults upon senior securities have taken place.

**Item 5. Other Information**

No information to report.

**Table of Contents**

**Item 6. Exhibits**

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002



**Table of Contents**

**BANCORP RHODE ISLAND, INC.**  
**SIGNATURES**

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

**Bancorp Rhode Island, Inc.**

August 4, 2010  
(Date)

/s/ Merrill W. Sherman  
Merrill W. Sherman  
President and Chief Executive Officer

August 4, 2010  
(Date)

/s/ Linda H. Simmons  
Linda H. Simmons  
Chief Financial Officer and Treasurer