UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2019

OR

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

For the transition period from __________________ to __________________

Commission File Number 001-33572

Bank of Marin Bancorp

(Exact name of Registrant as specified in its charter)

California	20-8859754
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
504 Redwood Blvd. Suite 100 Novato CA	94947
(Address of principal executive office)	(Zip Code)

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

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

None

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

Title of each class	Trading symbol	Name of each exchange on which registered
Common Stock, No Par Value, and attached Share Purchase Rights	**BMRC**	**The Nasdaq Stock Market**

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ☐ No ☒

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

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

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

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

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

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

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

As of June 29, 2019, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting common equity held by non-affiliates, based upon the closing price per share of the registrant's common stock as reported by the Nasdaq, was approximately $525 million. For the purpose of this response, directors and certain officers of the Registrant are considered affiliates at that date.

As of February 28, 2020, there were 13,596,535 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held on May 12, 2020 are incorporated by reference into Part III.

TABLE OF CONTENTS

PART I

Forward-Looking Statements

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

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

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

Important factors that could cause results or performance to materially differ from those expressed in our prior forward-looking statements are detailed in ITEM 1A. Risk Factors of this report. Forward-looking statements speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events.

ITEM 1 BUSINESS

Bank of Marin (the “Bank”) was incorporated in August 1989, received its charter from the California Superintendent of Banks (now the California Department of Business Oversight or "DBO") and commenced operations in January 1990. The Bank is an insured bank by the Federal Deposit Insurance Corporation (“FDIC”). Bank of Marin Bancorp (“Bancorp”) was formed in 2007 and the Bank became its sole subsidiary when each share of Bank common stock was exchanged for one share of Bancorp common stock. Bancorp is listed on the Nasdaq Stock Market under the symbol BMRC. Upon formation of the holding company, Bancorp became subject to regulation under the Bank Holding Company Act of 1956, as amended, and reporting and examination requirements by the Board of Governors of the Federal Reserve System ("Federal Reserve"). Bancorp files periodic reports and proxy statements with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, as amended.

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

Virtually all of our business is conducted through Bancorp's subsidiary, Bank of Marin, which is headquartered in Novato, California. In addition to our headquarters, we operate twenty-three offices in Alameda, Contra Costa, Marin, Napa, San Francisco, and Sonoma counties, with a strong emphasis on supporting the local communities. Our customer base is made up of business and personal banking relationships from the communities near our office locations. Our business banking focus is on small to medium-sized businesses, professionals and not-for-profit organizations.

We offer a broad range of commercial and retail deposit and lending programs designed to meet the needs of our target markets. Our lending categories include commercial real estate loans, commercial and industrial loans (including small business loans), construction financing, consumer loans, and home equity lines of credit. Merchant card services are available for our business customers. Through third-party vendors, we offer Visa® credit card programs for consumers and businesses, an American Express® credit card program, a leasing program for commercial equipment financing, prepaid business cards for handling expense reimbursements and a full suite of cash management services.

We offer a variety of personal and business checking and savings accounts, and a number of time deposit alternatives, including time certificates of deposit, Individual Retirement Accounts (“IRAs”), Health Savings Accounts ("HSA"), Certificate of Deposit Account Registry Service® ("CDARS"), Insured Cash Sweep® ("ICS"), and Demand Deposit Marketplace℠ ("DDM Sweep") accounts. CDARS, ICS and DDM Sweep accounts are networks through which we offer full FDIC insurance coverage in excess of the regulatory maximum by placing deposits in multiple banks participating in the networks. We also offer deposit options including mobile deposit, remote deposit capture, Automated Clearing House (“ACH”) services, wire transfers, and image lockbox services. A valet pick-up service is available for non-cash deposits to our professional and business clients.

Other products and services include Apple Pay®, Samsung Pay®, Google Pay®, SurePayroll®, Positive Pay (fraud detection tool), and solutions for clients with cash management needs such as Cash Vault and SafePoint®.

Automated teller machines (“ATM's”) are available at most retail branch locations. Our ATM network is linked to the PLUS, CIRRUS and NYCE networks, as well as to a network of nation-wide surcharge-free ATM's called MoneyPass. We also offer our depositors 24-hour access to their accounts by telephone and through digital banking services available to personal and business account holders.

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

We make international banking services available to our customers indirectly through other financial institutions with whom we have correspondent banking relationships.

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

Market Area

Our primary market area consists of Marin, San Francisco, Napa, Alameda, Sonoma, and Contra Costa counties. Our customer base is primarily made up of business, not-for-profit and personal banking relationships within these market areas.

We attract deposit relationships from small to medium-sized businesses, not-for-profit organizations and professionals, merchants and individuals who live and/or work in the communities comprising our market areas. As of December 31, 2019, the majority of our deposits were in Marin County and southern Sonoma County, and approximately 61% of our deposits were from businesses and 39% from individuals.

Competition

The banking business in California generally, and in our market area specifically, is highly competitive with respect to attracting both loan and deposit relationships. The increasingly competitive environment is affected by changes in regulation, interest rates, technology and product delivery systems, and consolidation among financial service providers. The banking industry is seeing strong competition for quality loans, with larger banks expanding their activities to attract businesses that are traditionally community bank customers. In all of our six counties, we have significant competition from nationwide banks with much larger branch networks and greater financial resources, as well as credit unions and other local and regional banks. Nationwide banks have the competitive advantages of national advertising campaigns. Large commercial banks also have substantially greater lending limits and the ability to offer certain services, which are not offered directly by us. Other competitors for depositors' funds are money market mutual funds and non-bank financial institutions such as brokerage firms and insurance companies.

We differentiate ourselves from the numerous, and often larger, financial institutions in our primary market area, with a business model built on relationship banking, disciplined fundamentals and commitment to the communities we serve. The Bank's experienced professionals deliver innovative and custom financing, with a deep local market knowledge and a personal understanding of each customer's unique needs.

In Marin County, we have the fourth largest market share of total deposits at 10.8%, based upon FDIC deposit market share data as of June 30, 2019[1]. A significant driver of our franchise value is the growth and stability of our deposits, a low-cost funding source for our loan portfolio.

Employees

At December 31, 2019, we employed 290 full-time equivalent ("FTE") staff. The actual number of employees, including part-time employees, at year-end 2019 included seven executive officers, 127 other corporate officers and 172 staff. None of our employees are presently represented by a union or covered by a collective bargaining agreement. We believe that our employee relations are good. We have consistently been recognized as one of the "Best Places to Work" by the *North Bay Business Journal.*

SUPERVISION AND REGULATION

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

Bank Holding Company Regulation

Upon formation of the bank holding company on July 1, 2007, we became subject to regulation under the Bank Holding Company Act of 1956, as amended ("BHCA") which subjects Bancorp to Federal Reserve reporting and examination requirements. Under the Federal Reserve law and regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks. Under this requirement, Bancorp is expected to commit resources to support the Bank, including at times when Bancorp may not be in a financial position to provide such resources, and it may not be in Bancorp's, or Bancorp's shareholders' or creditors', best interests to do so. In addition, any capital loans Bancorp makes to the Bank are subordinate in right of payment to depositors and to certain other indebtedness of the Bank. The BHCA regulates the activities of holding companies including acquisitions, mergers and consolidations and, together with the Gramm-Leach Bliley Act of 1999, the scope of allowable banking activities. Bancorp is also a bank holding company within the meaning of the California Financial Code. As such, Bancorp and its subsidiaries are subject to examination by, and may be required to file reports with, the DBO.

Bank Regulation

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

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

The Bank addresses the many state and federal regulations it is subject to through a comprehensive compliance program.

---

[1] Source: S&P Global Market Intelligence of New York, New York

Safety and Soundness Standards (Risk Management)

The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the financial institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational. In particular, recent regulatory pronouncements have focused on operational risk, which arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud, or unforeseen catastrophes will result in unexpected losses. New products and services, third-party risk management and cybersecurity are critical sources of operational risk that financial institutions are expected to address in the current environment. The Board of Directors and various sub-committees oversee Bancorp's consolidated enterprise risk management program that ensures the adequacy of policies, procedures, tolerance levels, risk measurement systems, monitoring processes, management information systems and internal controls.

Dividends and Stock Repurchases

Bancorp's ability to pay dividends to its shareholders may be affected by both general corporate law considerations and the policies of the Federal Reserve applicable to bank holding companies. As a California corporation, Bancorp is subject to the limitations of California law, which allows a corporation to distribute cash or property to shareholders, including a dividend or repurchase or redemption of shares, if the corporation meets certain tests based its performance and financial condition. Bancorp's primary source of cash is dividends received from the Bank. Prior to any distribution from the Bank to Bancorp, we ensure that the dividend computations comply with the provisions of the California Financial Code and regulations set forth by the DBO and the FDIC. See Note 8 to the Consolidated Financial Statements, under the heading “Dividends” in ITEM 8 of this report for more information.

FDIC Insurance Assessments

The FDIC insures our customers' deposits to the maximum amount permitted by law, which is currently $250,000 per depositor, based on the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

FDIC insurance coverage is funded by the FDIC's assessment on insured depository institutions like us and FDIC's annual base assessment rates are currently between 1.5 and 40 basis points on the depository institution's quarterly average consolidated total assets minus average tangible equity. Base assessment rates for banks vary depending on whether a depository institution is small or large and highly complex per FDIC's definition. In deriving the base assessment rate, the FDIC applies financial ratios, scorecards, and other financial measures to determine a bank's ability to withstand financial stress.

Community Reinvestment Act

Congress enacted the Community Reinvestment Act (“CRA”) in 1977 to encourage financial institutions to meet the credit needs of the communities in which they are located. All banks and thrifts have a continuing and affirmative obligation, consistent with safe and sound operations, to help meet the credit needs of their entire communities, including low and moderate income neighborhoods. Regulatory agencies rate each bank's performance in assessing and meeting these credit needs. The Bank is committed to serving the credit needs of the communities in which we do business, and it is our policy to respond to all creditworthy segments of our market. As part of its CRA commitment, the Bank maintains strong philanthropic ties to the community. We invest in affordable housing projects that help economically disadvantaged individuals and residents of low- and moderate-income census tracts, in each case consistent with our long-established prudent underwriting practices. We also donate to, invest in and volunteer with organizations that serve the communities in which we do business, especially low- and moderate-income individuals. These organizations offer educational and health programs to economically disadvantaged students and families, community development services and affordable housing programs. We offer CRA reportable small business, small farm and community development loans within our assessment areas. The CRA requires a depository institution's primary federal regulator, in connection with its examination of the institution, to assess the institution's record in meeting CRA requirements. The regulatory agency's assessment of the institution's record is made available to the public. This record is taken into consideration when the institution establishes a new branch that accepts deposits, relocates an office, applies to merge or consolidate, or expands into other activities. The FDIC assigned a “Satisfactory” rating to its CRA performance examination completed in January 2018, which was performed under the large bank requirements.

In December 2019, the FDIC and the OCC announced a proposal to modernize the agencies’ regulations under the CRA that have not been substantively updated for nearly 25 years. In order to increase transparency for CRA exams, the proposal clarifies what qualifies for credit under the CRA, enabling banks and their partners to better implement lending and deposit activities that can benefit communities. The proposal also updates the definition of a small business loan and creates an additional definition of “assessment area” tied to where deposits are located, in part to address changes that have occurred due to the rise in digital banking, ensuring that banks continue to provide loans and other services to low- and moderate-income individuals and businesses in their communities.

Anti-Money-Laundering Regulations

A series of banking laws and regulations beginning with the Bank Secrecy Act in 1970 requires banks to prevent, detect, and report illicit or illegal financial activities to the federal government to prevent money laundering, international drug trafficking, and terrorism. Under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, financial institutions are subject to prohibitions against specified financial transactions and account relationships, requirements regarding the Customer Identification Program, as well as enhanced due diligence and “know your customer” standards in their dealings with high risk customers, foreign financial institutions, and foreign individuals and entities. In 2016, Customer Due Diligence Rules under the Bank Secrecy Act clarified and strengthened customer due diligence requirements. These rules contained explicit customer due diligence requirements which included a new requirement to identify and verify the identity of beneficial owners of legal entity customers.

Privacy and Data Security

The Gramm-Leach Bliley Act (“GLBA”) of 1999 imposes requirements on financial institutions with respect to consumer privacy and the disclosure of non-public personal information about individuals who apply for or obtain a financial product to be used for personal, family or household purposes. The GLBA generally prohibits disclosure of consumer information to most nonaffiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers and the conditions under which an institution may disclose non-public information about a consumer to a nonaffiliated third-party. The GLBA also directs federal regulators, including the FDIC, to prescribe standards for the security of consumer information. We are subject to such standards, as well as standards for notifying consumers in the event of a security breach. We must disclose our privacy policy to consumers and permit consumers to "opt out" of having non-public customer information disclosed to third parties. We are required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal of information that is no longer needed. We notify our customers when unauthorized disclosure involves sensitive customer information that may be misused. Effective January 2020, the California Consumer Privacy Act (“CCPA”) added required notice about personal information we collect, use, share, and disclose for business purposes. The CCPA provides California residents rights regarding their personal information specifically related to exercising access, data portability and deletion rights. There are also California breach notification and disclosure requirements.

Consumer Protection Regulations

Our lending activities are subject to a variety of statutes and regulations designed to protect consumers, including the CRA, Home Mortgage Disclosure Act, Fair Credit Reporting Act, Fair Lending, Fair Debt Collection Practices Act, Flood Disaster Protection Act, Equal Credit Opportunity Act, the Fair Housing Act, Truth-in-Lending Act ("TILA"), the Real Estate Settlement Procedures Act ("RESPA"), Protecting Tenants at Foreclosure, and the Secure and Fair Enforcement for Mortgage Licensing Act ("SAFE"). Our deposit operations are also subject to laws and regulations that protect consumer rights including Expedited Funds Availability, Truth in Savings Act ("TISA"), and Electronic Funds Transfers.

Other regulatory requirements include: the Unfair, Deceptive or Abusive Acts and Practices ("UDAAP"), Dodd-Frank Act, Right to Financial Privacy, Telephone Consumer Protection Act and Privacy of Consumer Financial Information. Additional rules govern check writing ability on certain interest earning accounts and prescribe procedures for complying with administrative subpoenas of financial records.

Restriction on Transactions between Bank's Affiliates

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

Capital Requirements

The Federal Deposit Insurance Act, as amended (“FDIA”), requires federal banking agencies to take prompt corrective action (“PCA”) with respect to depository institutions that do not meet minimum capital requirements. The FDIA includes the following five capital tiers: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.” A depository institution’s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. Bancorp's ratios exceed the required minimum ratios for capital adequacy purposes and the Bank meets the definition for "well capitalized." Undercapitalized depository institutions may be subject to significant restrictions. Banks that are categorized as "critically undercapitalized" are subject to dividend restrictions.

In July 2013, the federal banking regulators approved a final rule to implement the revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, which became effective January 1, 2015 (subject to a phase-in period). The final rule strengthened the definition of regulatory capital, increased risk-based capital requirements, made selected changes to the calculation of risk-weighted assets, and adjusted the prompt corrective action thresholds. We have implemented the fully phased-in capital rules as of January 1, 2019 and have been in compliance throughout the implementation period of Basel III. For additional information on our risk-based capital positions, refer to the Capital Adequacy section within ITEM 7 to Management's Discussion and Analysis and Note 15 of the Consolidated Financial Statements within ITEM 8 of this report.

Effective January 1, 2020, the federal banking agencies' jointly-issued final rule on the community bank leverage ratio ("CBLR") provides for an optional, simplified measure of capital adequacy for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "Economic Growth Act"). Qualifying community banking organizations are defined as having less than $10 billion in total consolidated assets that meet risk-based qualifying criteria, a CBLR of greater than 9 percent, off-balance sheet exposure of 25 percent or less of total consolidated assets, trading assets and liabilities of 5 percent or less of total consolidated assets, and cannot be an advanced approaches institution. Such a community banking organization would not be subject to other risk-based and leverage capital requirements (including the Basel III and Basel IV requirements) and would be considered to have met the "well capitalized" ratio requirements. The CBLR is determined by dividing a financial institution’s tangible equity capital by its average total consolidated assets. The rule further describes what is included in tangible equity capital and average total consolidated assets. Qualifying banks may opt in and out of the CBLR framework at any time. While we are a qualifying community banking organization, we will assess the implications of opting into this rule in the future. See below, for further discussion of the Economic Growth Act.

The Dodd-Frank Wall Street Reform and Consumer Protection Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act

The Dodd-Frank Act, a landmark financial reform bill comprised of voluminous new rules and restrictions on bank operations, included provisions aimed at preventing a repeat of the 2008 financial crisis and a new process for winding down failing, systemically important institutions in a manner as close to a controlled bankruptcy as possible. Among other things, the Dodd-Frank Act established new government oversight responsibilities, enhanced capital adequacy requirements for certain institutions, established consumer protection laws and regulations, and placed limitations on certain banking activities.

In an attempt to reduce the regulatory burden on U.S. companies, including financial institutions, in May 2018, the current Presidential Administration signed the Economic Growth Act, which repeals or modifies certain provisions of the Dodd-Frank Act and eases regulations on all but the largest banks. The Economic Growth Act’s highlights include improving consumer access to mortgage credit, adding certain protections for consumers, including veterans and active duty military personnel, expanding credit freezes and creating an identity theft protection database. While the Economic Growth Act modifies several provisions in the Dodd-Frank Act, the modifications are subject to implementing regulations and is expected to continue to impact smaller institutions like us over time. In many respects, the regulations of the Dodd-Frank Act have been put in place. We will continue to evaluate the effect of the Dodd-Frank Act and the Economic Growth Act as well as any other new legislative changes for impact on our results of operations and financial condition.

Notice and Approval Requirements Related to Control

Banking laws impose notice, approval and ongoing regulatory requirements on any shareholder or other party that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution. These laws include the BHCA and the Change in Bank Control Act. Among other things, these laws require regulatory filings by a shareholder or other party that seeks to acquire direct or indirect "control" of an FDIC-insured depository institution or bank holding company. The determination whether an investor "controls" a depository institution is based on all of the facts and circumstances surrounding the investment. As a general matter, a party is deemed to control a depository institution or other company if the party owns or controls 25% or more of any class of voting stock. Subject to rebuttal, a party may be presumed to control a depository institution or other company if the investor owns or controls 10% or more of any class of voting stock. Ownership by family members, affiliated parties, or parties acting in concert, is typically aggregated for these purposes. If a party's ownership of the Company were to exceed certain thresholds, the investor could be deemed to "control" the Company for regulatory purposes. This could subject the investor to regulatory filings or other regulatory consequences.

In addition, except under limited circumstances, bank holding companies are prohibited from acquiring, without prior approval: 1) control of any other bank or bank holding company or all or substantially all the assets thereof; or 2) more than 5% of the voting shares of a bank or bank holding company that is not already a subsidiary.

Incentive Compensation

The Dodd-Frank Act required federal bank regulators and the Securities and Exchange Commission ("SEC") to establish joint regulations or guidelines prohibiting incentive-based payment arrangements that encourage inappropriate risks by providing an executive officer, employee, director or principal stockholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. These regulations apply to institutions having at least $1 billion in total assets. In addition, regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies have not finalized regulations proposed in April 2016. If adopted, the proposed regulations could place limits on the manner in which we structure our executive compensation.

The Federal Reserve reviews, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations. The Federal Reserve tailors its reviews for each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives are included in reports of examination. Deficiencies, if any, are incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Available Information

On our Internet web site, www.bankofmarin.com, we post the following filings as soon as reasonably practical after they are filed with or furnished to the Securities and Exchange Commission: Annual Report to Shareholders, Form

10-K, Proxy Statement for the Annual Meeting of Shareholders, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934. All such materials on our website are available free of charge. This website address is for information only and is not intended to be an active link, or to incorporate any website information into this document. In addition, copies of our filings are available by requesting them in writing or by phone from:

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

These materials are also available at the SEC's internet website (https://www.sec.gov).

ITEM 1A RISK FACTORS

We assume and manage a certain degree of risk in order to conduct our business. The material risks and uncertainties that Management believes may affect our business are listed below and in ITEM 7A, *Quantitative and Qualitative Disclosure about Market Risk.* The list is not exhaustive; additional risks and uncertainties that Management is not aware of, or focused on, or currently deems immaterial may also impair business operations. If any of the following risks, or risks that have not been identified, actually occur, our financial condition, results of operations, and stock trading price could be materially and adversely affected. We manage these risks by promoting sound corporate governance practices, which include but are not limited to, establishing policies and internal controls, and implementing internal review processes. Before making an investment decision, investors should carefully consider the risks, together with all of the other information included or incorporated by reference in this Annual Report on Form 10-K and our other filings with the SEC. This report is qualified in its entirety by these risk factors.

Earnings are Significantly Influenced by General Business and Economic Conditions

Our success depends, to a certain extent, on local, national and global economic and political conditions. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers primarily in the State of California with particular focus on the local markets in the San Francisco Bay Area. The local economic conditions in this area have a significant impact on the demand for our products and services as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposits as our primary funding source. Economic pressure on consumers and uncertainty regarding the sustainability of economic improvements may result in changes in consumer and business spending, borrowing and saving habits, which may affect the demand for loans and other products and services we offer. Further, loan defaults that adversely affect our earnings correlate highly with deteriorating economic conditions (such as the unemployment rate), which impact our borrowers' creditworthiness. In addition, health epidemics or pandemics (or expectations about them) such as the novel coronavirus (aka "COVID-19"), international trade disputes, inflation risks, oil price volatility, the level of U.S. debt and global economic conditions could destabilize financial markets in which we operate. Lastly, actions of the Federal Open Market Committee ("FOMC") of the Federal Reserve could cause financial market volatility, which will affect the pricing of our loan and deposit products.

Interest Rate Risk is Inherent in Our Business

Our earnings are largely dependent upon our net interest income, which is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. The banking industry is facing headwinds of interest margin compression coming into 2020 due to a flatter yield curve compared to previous years. Interest rates are sensitive to many factors outside of our control, including general economic conditions and the policies of various governmental and regulatory agencies and, in particular, the FOMC, which regulates the supply of money and credit in the United States. Changes in monetary policy, including changes in interest rates, can influence not only the interest we receive on loans and securities and interest we pay on deposits and borrowings, but can also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the duration of our securities and loan portfolios. Our portfolio of loans and securities will generally decline in value if market interest rates increase, and increase in value if market interest rates decline. In addition, our loans and callable mortgage-backed securities are also subject to prepayment risk when interest rates fall, and the borrowers' credit risk may increase in rising rate environments. Factors such as inflation, productivity, oil prices, unemployment rates, and global demand play a role in the FOMC's consideration of future rate adjustments. On March 3, 2020, in light of the challenges brought by coronavirus and its potential to disrupt the U.S. and worldwide economies, the FOMC reduced the federal funds target rate by 50 basis points to a range of 1.0% to 1.25%. In a press conference on March 3, 2020, Chairman Powell stated that the FOMC "took this action to help the U.S. economy keep strong in the face of new risks to the economic outlook."

Our net interest income is vulnerable to a falling or flat rate environment and will benefit if the prevailing market interest rates increase in the long-term. See the sections captioned “Net Interest Income” in Management's Discussion and Analysis of Financial Condition and Results of Operations in ITEM 7 and *Quantitative and Qualitative Disclosures about Market Risk* in ITEM 7A of this report for further discussion related to management of interest rate risk.

Banks and Bank Holding Companies are Subject to Extensive Government Regulation and Supervision

Bancorp and the Bank are subject to extensive federal and state governmental supervision, regulation and control. Holding company regulations affect the range of activities in which Bancorp is engaged. Banking regulations affect the Bank's lending practices, capital structure, investment practices, dividend policy, and compliance costs among other things. Compliance risk is the current and prospective risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, internal policies and procedures, or ethical standards set forth by regulators. Compliance risk also arises in situations where the laws or rules governing certain bank products or activities of our clients may be ambiguous or untested. This risk exposes Bancorp and the Bank to potential fines, civil money penalties, payment of damages and the voiding of contracts. Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential and an inability to enforce contracts. The Bank manages these risks through its extensive compliance plan, policies and procedures. For further information on supervision and regulation, see the section captioned "SUPERVISION AND REGULATION" in ITEM 1 of this report.

Competition with Other Financial Institutions to Attract and Retain Banking Customers

We are facing significant competition for customers from other banks and financial institutions located in the markets that we serve. We compete with commercial banks, savings institutions, credit unions, non-bank financial services companies, including financial technology firms, and other financial institutions operating within or near our service areas. Some of our non-bank competitors and peer-to-peer lenders may not be subject to the same extensive regulations as we are, giving them greater flexibility in competing for business. We anticipate intense competition will continue for the coming year due to the consolidation of many financial institutions and more changes in legislation, regulation and technology. National and regional banks much larger than our size have entered our market through acquisitions and they may be able to benefit from economies of scale through their wider branch networks, more prominent national advertising campaigns, lower cost of borrowing, capital market access and sophisticated technology infrastructures. Further, intense competition for creditworthy borrowers could lead to pressure for loan rate concessions and affect our ability to generate profitable loans.

Going forward, we may see continued competition in the industry as competitors seek to expand market share in our core markets. Further, our customers may withdraw deposits to pursue alternative investment opportunities in the recent bullish equity market. Technology and other changes have made it more convenient for bank customers to transfer funds into alternative investments or other deposit accounts such as online virtual banks and non-bank service providers. Efforts and initiatives we may undertake to retain and increase deposits, including deposit pricing, can increase our costs. Based on our current strong liquidity position, our adjustment to deposit pricing has lagged the market in a rising interest rate environment. If our customers move money into higher yielding deposits or alternative investments, we may lose a relatively inexpensive source of funds, thus increasing our funding costs through more expensive wholesale borrowings.

Activities of Our Large Borrowers and Depositors May Cause Unexpected Volatilities in Our Loan and Deposit Balances, as well as Net Interest Margin

Rising real estate values in the Bay Area market have motivated some of our borrowers to sell real estate that collateralized our loans, contributing to loan payoff activity. Payoffs of loans originated during a higher interest rate environment may be replaced by new loans with lower interest rates, causing downward pressure on our net interest margin. In addition, our top ten depositor relationships accounted for approximately 16% and 11% of our total deposit balances at December 31, 2019 and 2018, respectively. The increase in 2019 primarily relates to funds deposited by a large existing deposit customer whose deposit volatility increases leading to and during an election year. In addition, the business models and cash cycles of some of our large commercial depositors may also cause short-term volatility in their deposit balances held with us. As our customers' businesses grow, the dollar value of their daily activities may also grow leading to larger fluctuations in daily balances. Any long-term decline in deposit funding would adversely affect our liquidity. For additional information on our management of deposit volatility, refer to the Liquidity section of ITEM 7, Management's Discussion and Analysis, of this report.

Negative Conditions Affecting Real Estate May Harm Our Business and Our Commercial Real Estate ("CRE") Concentration May Heighten Such Risk

Concentration of our lending activities in the California real estate sector could negatively affect our results of operations if adverse changes in our lending area occur. Although we do not offer traditional first mortgages, nor have sub-prime or Alt-A residential loans or significant amounts of securities backed by such loans in the portfolio, we are not immune to volatility in those markets. As of December 31, 2019, approximately 88% of our loans were secured by real estate, of which 68% were secured by CRE and the remaining 22% by residential real estate. Real estate valuations are influenced by demand, and demand is driven by economic factors such as employment rates and interest rates.

Loans secured by CRE include those secured by office buildings, owner-user office/warehouses, mixed-use residential/commercial properties and retail properties. There can be no assurance that the companies or properties securing our loans will generate sufficient cash flows to allow borrowers to make full and timely loan payments to us. In the event of default, the collateral value may not cover the outstanding amount due to us, especially during real estate market downturns.

Rising CRE lending concentrations may expose institutions to unanticipated earnings and capital volatility in the event of adverse changes in the CRE market. Concentration risk exists when financial institutions deploy too many assets to any one industry or segment. Concentration stemming from commercial real estate is one area of regulatory concern. The CRE Concentration Guidance provides supervisory criteria, including the following numerical indicators, to assist bank examiners in identifying banks with potentially significant commercial real estate loan concentrations that may warrant greater supervisory scrutiny: (i) commercial real estate loans exceeding 300% of capital and increasing 50% or more in the preceding three years; or (ii) construction and land development loans exceeding 100% of capital. The CRE Concentration Guidance does not limit banks' levels of commercial real estate lending activities, but rather guides institutions in developing risk management practices and levels of capital that are commensurate with the level and nature of their commercial real estate concentrations. As of December 31, 2019 and 2018, using regulatory definitions in the CRE Concentration Guidance, our CRE loans represented 330% and 340%, respectively, of our total risk-based capital. We are actively working to manage our CRE concentration and we have discussed the CRE Concentration Guidance with the regulatory agencies and believe that our underwriting policies, management information systems, independent credit administration process, and monitoring of real estate loan concentrations are currently sufficient to address the CRE Concentration Guidance.

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

Our primary market is located in both earthquake and wildfire-prone zones in Northern California, which is also subject to other weather or disasters, such as severe rainstorms, drought or flood. These events have interrupted our business operations unexpectedly (e.g., October 2019 PG&E power shutoff's in the North Bay). Climate-related physical changes and hazards could also pose credit risks for us. For example, our borrowers may have collateral properties or operations located in areas at risk of wildfires, or coastal areas at risk to rising sea levels and erosion, or subject to the risk of drought in California. The properties pledged as collateral on our loan portfolio could also be damaged by tsunamis, landslides, floods, earthquakes or wildfires and thereby the recoverability of loans could be impaired. A number of factors can affect credit losses, including the extent of damage to the collateral, the extent of damage not covered by insurance, the extent to which unemployment and other economic conditions caused by the natural disaster adversely affect the ability of borrowers to repay their loans, and the cost of collection and foreclosure to us. Lastly, there could be increased insurance premiums and deductibles, or a decrease in the availability of coverage, due to severe weather-related losses. The ultimate outcome on our business of a natural disaster, whether or not caused by climate change, is difficult to predict.

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

The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, the inability of our employees to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers and the quality of our loan portfolio, may result in loan defaults, foreclosures and additional charge-offs and may necessitate that we significantly increase our allowance for loan losses, each of which could adversely affect our net income. As a result, any inability to successfully manage credit risk could have a material adverse effect on our business, financial condition or results of operations.

We maintain an allowance for loan losses that represents Management's best estimate of probable losses that may be incurred within the existing portfolio of loans (under the "incurred loss model"). The level of the allowance reflects Management's continuing evaluation of specific credit risks, loan loss experience, current loan portfolio quality and present economic, political and regulatory conditions. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and trends, all of which may undergo material changes. Inaccurate assumptions in appraisals or an inappropriate choice of the valuation techniques may lead to an inadequate level of specific reserve or charge-offs. If charge-offs in future periods exceed the allowance for loan losses or cash flows from acquired loans do not perform as expected, we may need to increase our allowance for loan losses.

The adoption of ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* as of January 1, 2020 will impact how we measure the allowance for credit losses as the methodology is based on a current expected credit loss ("CECL") model, rather than incurred losses, and requires the recognition of credit loss expense in the consolidated statements of income and a related allowance for credit losses at the time of origination or purchase of a loan receivable or held-to-maturity debt security. In addition, the CECL model requires the use of not only relevant historical experience and current conditions, but reasonable and supportable forecasts of future events and circumstances (e.g., economic forecasts) incorporating a broad range of information in developing credit loss estimates, which could result in significant changes to both the timing and amount of credit loss expense and allowance. Refer to Note 1 to the Consolidated Financial Statements in ITEM 8 for further information.

Securities May Lose Value due to Credit Quality of the Issuers

We invest in significant portions of investment securities issued by government-sponsored enterprises ("GSE"), such as Federal Home Loan Bank ("FHLB"), Federal National Mortgage Association (“FNMA”), Federal Home Loan Mortgage Corporation ("FHLMC"), and Federal Farm Credit Banks Funding Corporation. We also hold mortgage-backed securities (“MBS”) issued by FNMA and FHLMC, both of which have been under U.S. Government conservatorship since 2008. While we consider FNMA and FHLMC securities to have low credit risk as they carry the explicit backing of the U.S. Government due to the conservatorship, they are not direct obligations of the U.S. Government and the fair value of our securities issued or guaranteed by these two GSE entities may be negatively impacted if the U.S. government ceases to provide them credit support. GSE debt is sponsored but not guaranteed by the federal government and carries implicit backing, whereas government agencies such as Government National Mortgage Association ("GNMA") are divisions of the government whose securities are backed by the full faith and credit of the U.S. Government.

Although Congress has taken steps to improve regulation and consumer protection related to the housing finance system (e.g., Dodd-Frank Act), FNMA and FHLMC have entered their twelfth year of U.S. Government conservatorship via the Federal Housing Finance Agency (the "FHFA"). In September 2019, the U.S. Department of the Treasury issued a Housing Finance Reform Plan that, among other things, directed the Secretary of the Treasury to develop a Roadmap to begin the process of responsibly ending the GSEs' conservatorships. In February 2020, the FHFA hired a financial advisor to assist with the development and implementation of the Roadmap, which will include business and capital structures, as well as market impacts, and timing and available capital raising alternatives. While proposals to end the conservatorship may include an initial public offering, at the date of this report, its future and ultimate impact on the financial markets and our investments in GSEs are uncertain.

While we generally seek to minimize our exposure by diversifying the geographic location of our portfolio, investing in investment grade securities and actively monitoring the credit worthiness of the issuers and/or credit guarantee providers, there is no guarantee that the issuers will remain financially sound or continue their payments on these debentures.

Unexpected Early Termination of Interest Rate Swap Agreements May Affect Earnings

We have entered into interest-rate swap agreements, primarily as an asset/liability risk management tool, in order to mitigate the changes in the fair value of specified long-term fixed-rate loans and firm commitments to enter into long-term fixed-rate loans caused by changes in interest rates. These hedges allow us to offer long-term, fixed-rate loans to customers without assuming the interest rate risk of a long-term asset by swapping our fixed-rate interest stream for a floating-rate interest stream. In the event of default by the borrowers on our hedged loans, we may have to terminate these designated interest-rate swap agreements early, resulting in prepayment penalties charged by our counterparties and negatively affect our earnings.

Growth Strategy or Potential Future Acquisitions May Produce Unfavorable Outcomes

We seek to expand our franchise safely and consistently. A successful growth strategy requires us to manage multiple aspects of the business simultaneously, such as following adequate loan underwriting standards, balancing loan and deposit growth without increasing interest rate risk or compressing our net interest margin, maintaining sufficient capital, and recruiting, training and retaining qualified professionals.

Our strategic plan also includes merger and acquisition possibilities that either enhance our market presence or have potential for improved profitability through financial management, economies of scale or expanded services, such as the Bank of Napa acquisition in 2017. We may incur significant acquisition related expenses either during the due diligence phase of acquisition targets or during integration of the acquirees. These expenses have and may continue to negatively impact our earnings prior to realizing the benefits of acquisitions. We may also be exposed to difficulties in combining the operations of acquired institutions into our own operations, which may prevent us from achieving the expected benefits from our acquisition activities. Our earnings, financial condition and prospects after the merger may affect our stock price and will depend in part on our ability to integrate the operations and management of the acquired institution while continuing to implement other aspects of our business plan. Inherent uncertainties exist in integrating the operations of an acquired institution and there is no assurance that we will be able to do so successfully. Among the issues that we could face are:

- unexpected problems with operations, personnel, technology or credit;
- loss of customers and employees of the acquiree;
- difficulty in working with the acquiree's employees and customers;
- the assimilation of the acquiree's operations, culture and personnel;
- instituting and maintaining uniform standards, controls, procedures and policies; and
- litigation risk not discovered during the due diligence period.

Undiscovered factors as a result of an acquisition could bring liabilities against us, our management and the management of the institutions we acquire. These factors could contribute to our not achieving the expected benefits from our acquisitions within desired time frames, if at all. Further, although we generally anticipate cost savings from acquisitions, we may not be able to fully realize those savings. Any cost savings may be offset by losses in revenues or other charges to earnings.

We May Not Be Able to Attract and Retain Key Employees

Our success depends in large part on our ability to attract qualified personnel and to retain key people, as well as the prompt replacement of retiring executives. Competition for the best people in most activities engaged by us has been intense, especially in light of the recent improvement in the job market, and we may not be able to hire skilled people or retain them. The loss of key personnel could have an unfavorable effect on our business because of the need for prompt replacement of skills and knowledge of our market and years of industry experience.

Accounting Estimates and Risk Management Processes Rely on Analytical and Forecasting Models

The processes we use to estimate probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

The Value of Goodwill and Other Intangible Assets May Decline in the Future

As of December 31, 2019, we had goodwill totaling $30.1 million and a core deposit intangible asset totaling $4.7 million from business acquisitions. A significant decline in expected future cash flows, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock could necessitate taking charges in the future related to the impairment of goodwill or other intangible assets. If we were to conclude that a future write-down of goodwill or other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, financial condition and results of operations.

We May Take Filing Positions or Follow Tax Strategies That May Be Subject to Challenge

We provide for current and deferred tax provision in our consolidated financial statements based on our results of operations, business activities and business combinations, legal structure and federal and state legislation and regulations. We may take filing positions or follow tax strategies that are subject to interpretation of tax statutes. Our net income may be reduced if a federal, state or local authority were to assess charges for taxes that have not been provided for in our consolidated financial statements. Taxing authorities could change applicable tax laws and interpretations, challenge filing positions or assess new taxes and interest charges. If taxing authorities take any of these actions, our business, results of operations or financial condition could be significantly affected.

The Financial Services Industry is Undergoing Rapid Technological Changes and, As a Result, We Have a Continuing Need to Stay Current with Those Changes to Compete Effectively and Increase Our Efficiencies. We May Not Have the Resources to Implement New Technology to Stay Current with These Changes

The financial services industry is undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to providing better client service, the effective use of technology increases efficiency and reduces operational costs. Our future success will depend in part upon our ability to use technology to provide products and services that will satisfy client demands securely and cost-effectively. In connection with implementing new technology enhancements and/or products, we may experience operational challenges (e.g. human error, system error, incompatibility) which could result in us not fully realizing the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner.

Risks Associated with Cybersecurity Could Negatively Affect Our Earnings and Reputation

Our business requires the secure management of sensitive client and bank information. We work diligently to implement security measures that intend to make our communications and information systems safe to conduct business. Cyber threats such as social engineering, ransomware, and phishing emails are more prevalent now than ever before. These incidents include intentional and unintentional events that may present threats designed to disrupt operations, corrupt data, release sensitive information or cause denial-of-service attacks. A cybersecurity breach of systems operated by the Bank, merchants, vendors, customers, or externally publicized breaches of other financial institutions may significantly harm our reputation, result in a loss of customer business, subject us to regulatory scrutiny, or expose us to civil litigation and financial liability. While we have systems and procedures designed to prevent security breaches, we cannot be certain that advances in criminal capabilities, physical system or network break-ins or inappropriate access will not compromise or breach the technology protecting our networks or proprietary client information. If a material security breach were to occur, the Bank has policies and procedures in place to ensure timely disclosure.

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

We depend on the accuracy and completeness of information and systems provided by certain key vendors, including but not limited to data processing, payroll processing, technology support, investment safekeeping and accounting.

For example, we outsource core processing to Fidelity Information Services ("FIS") and wire processing to Finastra, which are leading financial services solution providers that allow us access to competitive technology offerings without having to invest in their development. Our ability to operate, as well as our financial condition and results of operations, could be negatively affected in the event of an interruption of an information system, an undetected error, a cyber-breach, or in the event of a natural disaster whereby certain vendors are unable to maintain business continuity.

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

Bancorp is a separate legal entity from its subsidiary, the Bank. Bancorp receives substantially all of its cash stream from the Bank in the form of dividends, which is Bancorp's principal source of funds to pay cash dividends to Bancorp's common shareholders, service subordinated debt, and cover operational expenses of the holding company. Various federal and state laws and regulations limit the amount of dividends that the Bank may pay to Bancorp. In the event that the Bank is unable to pay dividends to Bancorp, Bancorp may not be able to pay dividends to its shareholders or pay interest on the subordinated debentures. As a result, it could have an adverse effect on Bancorp's stock price and investment value.

Federal law would prohibit capital distributions from the Bank, with limited exceptions, if the Bank were categorized as "undercapitalized" under applicable Federal Reserve or FDIC regulations. In addition, as a California bank, Bank of Marin is subject to state law restrictions on the payment of dividends. For further information on the distribution limit from the Bank to Bancorp, see the section captioned “Bank Regulation” in ITEM 1 above and “Dividends” in Note 8 to the Consolidated Financial Statements in ITEM 8 of this report.

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

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

The Small to Medium-sized Businesses that we Lend to may have Fewer Resources to Weather Adverse Business Developments, which may Impair a Borrower's Ability to Repay a Loan, and such Impairment could Adversely Affect our Results of Operations and Financial Condition

We focus our business development and marketing strategy primarily on small to medium-sized businesses. Small to medium-sized businesses frequently have smaller market shares than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial volatility in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small and medium-sized business often depends on the management talents and efforts of one or two people or a small group of people, and the death, disability or resignation of one or more of these people could adversely affect the business and its ability to repay its loan. If general economic conditions negatively affect the California markets in which we operate and small to medium-sized businesses are adversely affected or our borrowers are otherwise affected by adverse business developments, our business, financial condition and results of operations may be negatively affected.

A Lack of Liquidity could Adversely Affect our Operations and Jeopardize our Business, Financial Condition and Results of Operations

Liquidity is essential to our business. We rely on our ability to generate deposits and effectively manage the repayment and maturity schedules of our loans and investment securities, respectively, to ensure that we have adequate liquidity to fund our operations. An inability to raise funds through deposits, borrowings, securities sales, Federal Home Loan Bank advances, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our most important source of funds consists of deposits. Deposit balances can decrease when customers perceive alternative investments as providing a better risk/return trade-off. If customers move money out of bank deposits and into other investments, then we would lose a relatively low-cost source of funds, increasing our funding costs and reducing our net interest income and net income.

Other primary sources of funds consist of cash flows from operations, investment maturities and sales, loan repayments, and proceeds from the issuance and sale of any equity and debt securities to investors. Additional liquidity is provided by the ability to borrow from the Federal Reserve Bank of San Francisco and the Federal Home Loan Bank and our ability to raise brokered deposits. We also may borrow funds from third-party lenders, such as other financial institutions. Our access to funding sources in amounts adequate to finance or capitalize our activities, or on terms that are acceptable to us, could be impaired by factors that affect us directly or the bank or non-bank financial services industries or the economy in general, such as disruptions in the financial markets or negative views and expectations about the prospects for the bank or non-bank financial services industries. For example, in September 2019, in response to a shortage in liquidity and spikes in the overnight bank funding rate, the New York Federal Reserve began injecting liquidity into the market in the form of overnight market repurchase agreements ("repos") designed to smooth money markets and bring interest rates in line with the central bank's intended range to sustain economic expansion. The availability of liquidity during financial market disruptions such as the repo rate spike is uncertain and the continued liquidity support by the central bank is not guaranteed.

Based on experience, we believe that our deposit accounts are relatively stable sources of funds. If we increase interest rates paid to retain deposits, our earnings may be adversely affected, which could have an adverse effect on our business, financial condition and results of operations.

Any decline in available funding could adversely affect our ability to originate loans, invest in securities, meet our expenses, and pay dividends to our shareholders or fulfill obligations such as repaying our borrowings or meeting deposit withdrawal demands, any of which could have a material adverse impact on our liquidity, business, financial condition and results of operations.

Changes to, or Elimination of, London Interbank Offered Rate (“LIBOR”) Could Adversely Affect our Financial Instruments with Interest Rates Currently Indexed to LIBOR

In 2017, the Financial Conduct Authority of the United Kingdom (the “FCA”) announced its intention to cease sustaining LIBOR after 2021. While the FCA came to an agreement with panel banks to continue receiving submissions to LIBOR until the end of 2021, it is not possible to predict whether and how credible LIBOR will be as an acceptable market benchmark. The FCA is encouraging due diligence and implementation of alternative rates prior to the phase out of LIBOR. While there is no consensus on what rate or rates may become accepted alternatives to LIBOR, the Alternative Reference Rates Committee (“ARRC”), a steering committee comprised of U.S. financial market participants selected by the Federal Reserve Bank of New York, published recommended fall-back language for LIBOR-linked financial instruments and identified recommended alternatives for certain LIBOR rates (e.g., Secured Overnight Financing Rate (“SOFR”), a broad measure of the cost of overnight borrowings collateralized by Treasury securities, for U.S. Dollar LIBOR). At this time, we cannot predict whether ARRC's specific recommendations or proposals will be widely accepted and what effect their implementation will have on floating rate financial instrument markets. Banks like us may need to amend contracts to reference SOFR and identify an acceptable spread to LIBOR or amend the definition of LIBOR through a specific grandfathering protocol.

As of December 31, 2019, we had loans totaling approximately $1 million and investment securities totaling approximately $27 million indexed to LIBOR that mature after December 31, 2021. In addition, our interest rate swap agreements and subordinated debentures are indexed to LIBOR, all of which mature after December 31, 2021. Refer to Note 7 and 14 to the Consolidated Financial Statements in ITEM 8 of this report for more information on our swap agreements and subordinated debentures. The transition from LIBOR could result in additional costs, as well as economic and reputation risk. At this time, we cannot predict any favorable or unfavorable effects the chosen alternative index may have on financial instruments currently indexed to LIBOR.

ITEM 1B UNRESOLVED STAFF COMMENTS

None

ITEM 2 PROPERTIES

We lease our corporate headquarters building in Novato, California, which houses loan production, operations, Wealth Management & Trust and administration. We lease branch and office facilities within our primary market areas in the cities of Corte Madera, San Rafael, Novato, Sausalito, Mill Valley, Tiburon, Greenbrae, Petaluma, Santa Rosa, Healdsburg, Sonoma, Napa, San Francisco, Alameda, Oakland, and Walnut Creek. For additional information on properties, see Notes 4 and 12 to the Consolidated Financial Statements included in ITEM 8 of this report.

ITEM 3 LEGAL PROCEEDINGS

Bancorp may be party to legal actions that arise from time to time as part of the normal course of business. Bancorp's Management is not aware of any pending legal proceedings to which either it or the Bank may be a party or has recently been a party that will have a material adverse effect on the financial condition or results of operations of Bancorp or the Bank.

The Bank is responsible for its proportionate share of certain litigation indemnifications provided to Visa U.S.A. by its member banks in connection with lawsuits related to anti-trust charges and interchange fees. Because Visa funded a litigation escrow account to insulate member banks from financial liability, we do not expect to make any cash settlement payments as a result of Visa's litigation. For further details, see Note 12 to the Consolidated Financial Statements in ITEM 8 of this report.

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

PART II

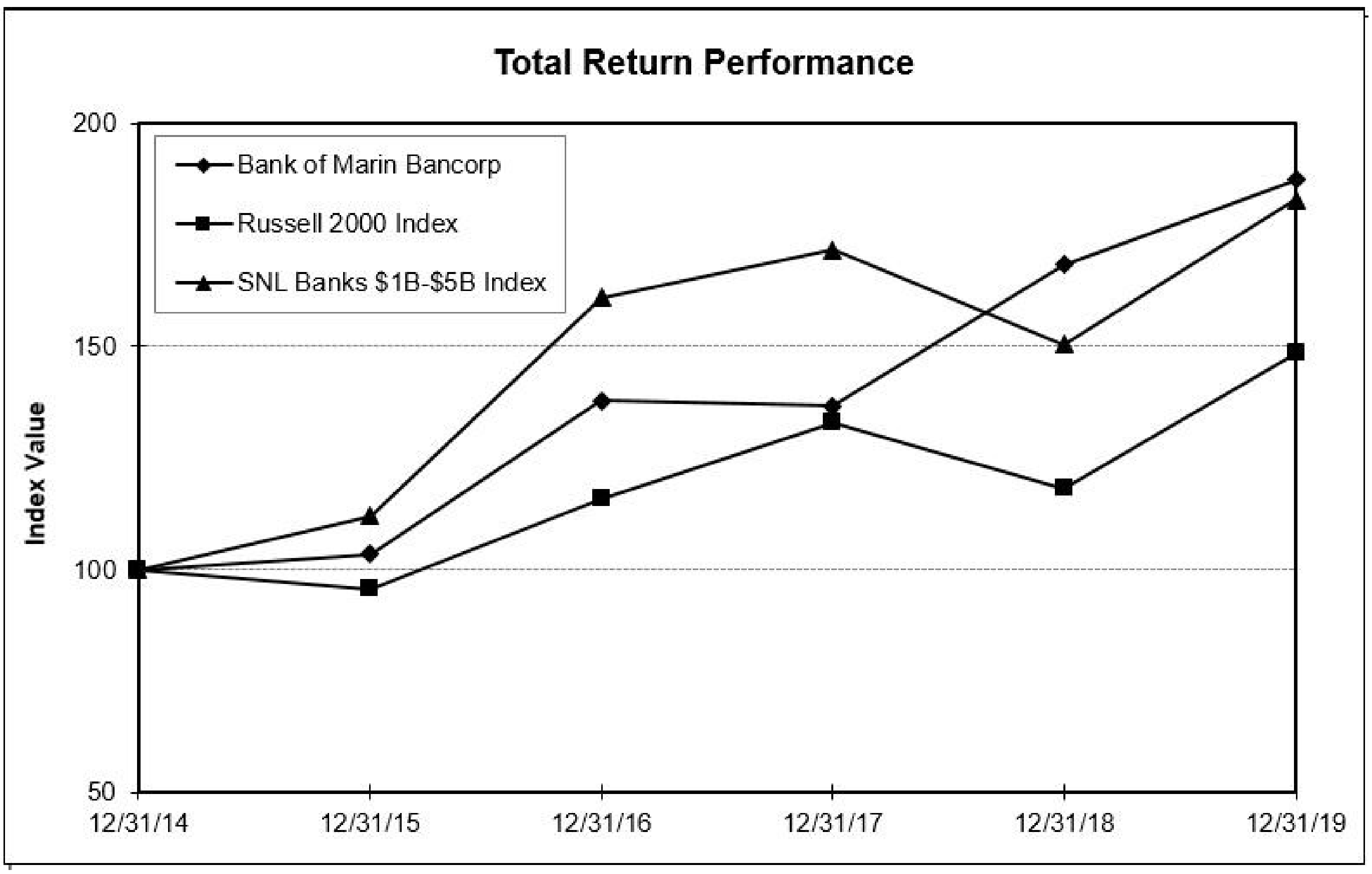
ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information and Holders

Bancorp common stock trades on the Nasdaq Capital Market under the symbol BMRC. On October 22, 2018, Bancorp announced a two-for-one stock split, which occurred on November 27, 2018. All share and per share data have been adjusted to reflect the stock split effective November 27, 2018. At February 29, 2020, 13,596,535 shares of Bancorp's common stock, no par value, were outstanding and held by approximately 2,832 holders of record and beneficial owners.

Five-Year Stock Price Performance Graph

The following graph, compiled by S&P Global Market Intelligence of New York, New York, shows a comparison of cumulative total shareholder return on our common stock during the five fiscal years ended December 31, 2019 compared to the Russell 2000 Stock index and the SNL Bank $1B - $5B Index. The comparison assumes the investment of $100 in our common stock on December 31, 2014 and the reinvestment of all dividends. The graph represents past performance and does not indicate future performance. In addition, total return performance results vary depending on the length of the performance period.



	2014	2015	2016	2017	2018	2019
Bank of Marin Bancorp (BMRC)	**100.00**	**103.37**	**137.81**	**136.63**	**168.40**	**187.45**
Russell 2000 Index	100.00	95.59	115.95	132.94	118.30	148.49
SNL Bank $1B - $5B Index [1]	100.00	111.94	161.04	171.69	150.42	182.85

Source: S&P Global Market Intelligence

[1] Includes all major exchange (NYSE, NYSE MKT, and Nasdaq) banks in S&P Global's coverage universe with $1 billion to $5 billion in assets as of the most recent available financial data.

Shareholder Rights Agreement

On July 6, 2017, Bancorp executed a shareholder rights agreement (“Rights Agreement”), which is designed to discourage takeovers that involve abusive tactics or do not provide fair value to shareholders. For further information, see Note 8 to the Consolidated Financial Statements, under the heading “Preferred Stock and Shareholder Rights Plan” in ITEM 8 of this report.

Securities Authorized for Issuance under Equity Compensation Plans

The following table summarizes information as of December 31, 2019, with respect to equity compensation plans. All plans have been approved by the shareholders.

	Shares to be issued upon exercise of outstanding options[1]	Weighted average exercise price of outstanding options	Shares remaining available for future issuance [2]
Equity compensation plans approved by shareholders	417,382	$ 28.01	1,197,893

[1] Represents shares of common stock issuable upon exercise of outstanding options under the Bank of Marin Bancorp 2017 Equity Plan and 2007 Equity Plan.

[2] Represents remaining shares of common stock available for future grants under the 2017 Equity Plan and the 2010 Director Stock Plan, excluding 417,382 shares to be issued upon exercise of outstanding options and 382,515 shares available to be issued under the Employee Stock Purchase Plan.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On April 23, 2018, Bancorp announced that its Board of Directors approved a Share Repurchase Program under which Bancorp may repurchase up to $25.0 million of its outstanding common stock through May 1, 2019. Bancorp's Board of Directors subsequently extended the Share Repurchase Program, which expired on February 28, 2020 with approximately $1.5 million not utilized for repurchases. On January 24, 2020, Bancorp Board of Directors approved a new Share Repurchase Program under which Bancorp may repurchase up to $25.0 million of its outstanding common stock through February 28, 2022.

During 2019 and 2018, Bancorp repurchased 356,000 and 171,217 shares totaling $15.0 million and $7.0 million, respectively, for a cumulative 527,217 shares totaling $22.0 million repurchased from May 1, 2018 through December 31, 2019. The following table reflects purchases under the Share Repurchase Program for the periods presented. For further information, see Note 8 to the Consolidated Financial Statements, under the heading “Share Repurchase Program” in ITEM 8 of this report.

(in thousands, except per share data) Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value That May yet Be Purchased Under the Program
January 1-31, 2019	33,834	$ 42.11	33,834	$ 16,562
February 1-28, 2019	30,823	42.94	30,823	15,236
March 1-31, 2019	49,247	41.54	49,247	13,188
April 1-30, 2019	37,858	42.23	37,858	11,588
May 1-31, 2019	50,308	41.72	50,308	9,486
June 1-30, 2019	46,454	41.75	46,454	7,544
July 1-31, 2019	19,070	42.62	19,070	6,730
August 1-31, 2019	26,019	41.21	26,019	5,657
September 1-30, 2019	20,038	41.76	20,038	4,819
October 1-30, 2019	19,283	41.88	19,283	4,010
November 1-30, 2019	11,945	44.98	11,945	3,472
December 1-31, 2019	11,121	45.33	11,121	2,967
Total	356,000	$ 42.14	356,000	

ITEM 6 SELECTED FINANCIAL DATA

The following data has been derived from the audited consolidated financial statements of Bank of Marin Bancorp. For additional information, refer to ITEM 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and ITEM 8, Financial Statements and Supplementary Data.

	At December 31,				
(in thousands)	2019	2018	2017	2016	2015
Selected financial condition data:					
Total assets	$ 2,707,280	$ 2,520,892	$ 2,468,154	$ 2,023,493	$ 2,031,134
Loans, net	1,826,609	1,748,043	1,663,246	1,471,174	1,436,299
Deposits	2,336,489	2,174,840	2,148,670	1,772,700	1,728,226
Borrowings and other obligations	2,920	9,640	5,739	5,586	72,395
Stockholders' equity	336,788	316,407	297,025	230,563	214,473

	For the Years Ended December 31,				
(dollars in thousands, except per share data)	2019	2018	2017	2016	2015
Selected operating data:					
Net interest income	$ 95,680	$ 91,544	$ 74,852	$ 73,161	$ 67,187
Provision for (reversal of) loan losses	900	—	500	(1,850)	500
Non-interest income	9,084	10,139	8,268	9,161	9,193
Non-interest expense [1]	57,970	58,266	53,782	47,692	46,949
Net income [1]	34,241	32,622	15,976	23,134	18,441
Net income per common share: [6]					
Basic	$ 2.51	$ 2.35	$ 1.29	$ 1.90	$ 1.55
Diluted	$ 2.48	$ 2.33	$ 1.27	$ 1.89	$ 1.52

	At or for the Years Ended December 31,				
	2019	2018	2017	2016	2015
Performance and other financial ratios:					
Return on average assets	1.34%	1.31%	0.75%	1.15%	0.98%
Return on average equity	10.49%	10.73%	6.49%	10.23%	8.84%
Tax-equivalent net interest margin [2]	3.98%	3.90%	3.80%	3.91%	3.83%
Cost of deposits	0.20%	0.10%	0.07%	0.08%	0.09%
Efficiency ratio	55.33%	57.30%	64.70%	57.93%	61.47%
Loan-to-deposit ratio	78.89%	81.10%	78.14%	83.86%	83.97%
Cash dividend payout ratio on common stock [3]	31.87%	27.23%	43.41%	26.84%	29.03%
Cash dividends per common share [6]	$ 0.80	$ 0.64	$ 0.56	$ 0.51	$ 0.45
Asset quality ratios:					
Allowance for loan losses to total loans	0.90%	0.90%	0.94%	1.04%	1.03%
Allowance for loan losses to non-performing loans [4]	73.86x	22.71x	38.88x	106.5x	6.88x
Non-performing loans to total loans [4]	0.01%	0.04%	0.02%	0.01%	0.15%
Capital ratios:					
Equity to total assets ratio	12.44%	12.55%	12.03%	11.39%	10.60%
Tangible common equity to tangible assets [5]					
Total capital (to risk-weighted assets)	15.07%	14.93%	14.91%	14.32%	13.37%
Tier 1 capital (to risk-weighted assets)	14.24%	14.10%	14.04%	13.37%	12.44%
Tier 1 capital (to average assets)	11.66%	11.54%	12.13%	11.39%	10.67%
Common equity Tier 1 capital (to risk-weighted assets)	14.11%	13.98%	13.75%	13.07%	12.16%
Other data:					
Number of full service offices	22	23	23	20	20
Full time equivalent employees	290	290	291	262	259

[1] 2018 and 2017 included $962 thousand and $2.2 million, respectively, in merger-related expenses.

[2] Tax-equivalent net interest margin is computed by dividing taxable equivalent net interest income, which is adjusted for taxable equivalent income on tax-exempt loans and securities based on federal statutory rate of 21% in 2019 and 2018 and 35% in years prior to 2018, by total average interest-earning assets.

[3] Calculated as dividends on common shares divided by basic net income per common share.

[4] Non-performing loans include loans on non-accrual status and loans past due 90 days or more and still accruing interest.

[5] Tangible common equity to tangible assets is considered to be a meaningful non-GAAP financial measure of capital adequacy and is useful for investors to assess Bancorp's ability to absorb potential losses. Tangible common equity of $302 million, $281 million, $260 million, $222 million, and $205 million at December 31, 2019, 2018, 2017, 2016, and 2015, respectively, includes common stock, retained earnings and unrealized gains (losses) on available-for sale securities, net of tax, less goodwill and intangible assets of $35 million, $36 million, $37 million, $9 million, and $10 million at December 31, 2019, 2018, 2017, 2016, and 2015, respectively.

[6] Share and per share data have been adjusted to reflect the two-for-one stock split effective November 27, 2018.

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

The following discussion of financial condition as of December 31, 2019 and 2018 and results of operations for each of the years in the two-year period ended December 31, 2019 should be read in conjunction with our consolidated financial statements and related notes thereto, included in Part II ITEM 8 of this report. Average balances, including balances used in calculating certain financial ratios, are generally comprised of average daily balances. All share and per share data have been adjusted to reflect the stock split effective November 27, 2018.

Forward-Looking Statements

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

Critical Accounting Policies and Estimates

Critical accounting policies are those that are both very important to the portrayal of our financial condition and results of operations and require Management's most difficult, subjective, or complex judgments, often because of the need to make estimates about the effect of matters that are inherently uncertain and imprecise.

Management has determined the following four accounting policies to be critical:

Allowance for Loan Losses: For information regarding our ALLL methodology, the related provision for loan losses, risks related to asset quality and lending activity, including the transition from the incurred loss model to the current expected loss model under ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* effective January 1, 2020, see ITEM 1A - Risk Factors, the Allowance for Loan Losses section in ITEM 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 1 - Summary of Significant Accounting Policies and Note 3 - Loans and Allowance for Loan Losses in ITEM 8 - Financial Statements and Supplementary Data of this Form 10-K.

Other-than-temporary Impairment of Investment Securities: For information regarding our investment securities, investment activity, and related risks, see ITEM 1A - Risk Factors, Note 1 - Summary of Significant Accounting Policies and Note 2 - Investment Securities in ITEM 8 - Financial Statements and Supplementary Data of this Form 10-K.

Accounting for Income Taxes: For information on our tax assets and liabilities, and related provision for income taxes, see Note 1 - Summary of Significant Accounting Policies and Note 11 - Income Taxes in ITEM 8 - Financial Statements and Supplementary Data of this Form 10-K.

Fair Value Measurements: For information on our use of fair value measurements and our related valuation methodologies, see Note 1 - Summary of Significant Accounting Policies and Note 9 - Fair Value of Assets and Liabilities in ITEM 8 - Financial Statements and Supplementary Data of this Form 10-K.

Executive Summary

Annual earnings were $34.2 million in 2019 compared to $32.6 million in 2018. Diluted earnings were $2.48 per share for the year ended December 31, 2019, compared to $2.33 per share in the same period of 2018.

The following are highlights of operating and financial performance for the year ended December 31, 2019:

- The Bank achieved total loan growth of $79.4 million, or 4.5% in 2019, to $1,843.3 million at December 31, 2019, from $1,763.9 million at December 31, 2018.
- Strong credit quality remains a cornerstone of the Bank's consistent performance. Non-accrual loans represented 0.01% of the Bank's loan portfolio as of December 31, 2019. There was a $900 thousand provision for loan losses recorded in 2019, reflecting loan growth.
- Deposits grew $161.7 million, or 7.4%, to $2,336.5 million at December 31, 2019, compared to $2,174.8 million at December 31, 2018. Non-interest bearing deposits grew by $62.8 million in 2019 and made up 48.3% of total deposits at year-end. For the full year of 2019, cost of total deposits remained low at 0.20%, compared to 0.10% in 2018.
- Net interest income totaled $95.7 million and $91.5 million in 2019 and 2018, respectively. The increase of $4.2 million in 2019 was primarily due to higher average loan balances and asset yields and the early redemption of a high-rate subordinated debenture in the fourth quarter of 2018. Positive variances were partially offset by higher balances and rates on money market accounts. The tax-equivalent net interest margin increased to 3.98% in 2019, compared to 3.90% in 2018 for the same reasons.
- The efficiency ratio was 55.3% in 2019, down from 57.3% in 2018. Notably, 2019 non-interest expenses decreased from the prior year due to higher consulting expenses in 2018 for core processing contract renegotiations and lower FDIC Deposit Insurance Fund expenses in 2019 as discussed in Table 4 below.
- For the year ended December 31, 2019, return on assets and return on equity were 1.34% and 10.49%, respectively, compared to 1.31% and 10.73% in the prior year.
- All capital ratios exceed regulatory requirements. The total risk-based capital ratio for Bancorp was 15.1% at December 31, 2019 up from 14.9% at December 31, 2018.
- The Board of Directors declared a cash dividend of $0.23 per share on January 24, 2019, a $0.02 increase from the prior quarter. This was the 59th consecutive quarterly dividend paid by Bank of Marin Bancorp. The cash dividend was paid on February 14, 2020 to shareholders of record at the close of business on February 7, 2020.

Looking forward into the new year, with a low cost and stable deposit base, opportunities for loan growth, and our unwavering commitment to relationship banking, we believe we are well-positioned to carry our successful performance into 2020. We have ample liquidity and capital to support organic growth and acquisitions in coming years. Acquisitions remain a component of our strategic plan and we will continue to evaluate merger and acquisition opportunities that fit with our culture and add value for our shareholders. Our disciplined credit culture and relationship-focused banking continue to be critical components of our success.

RESULTS OF OPERATIONS

Net Interest Income

Net interest income is the difference between the interest earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and other interest-bearing liabilities. Net interest income is affected by changes in general market interest rates and by changes in the amounts and composition of interest-earning assets and interest-bearing liabilities. Interest rate changes can create fluctuations in net interest income and/or margin due to an imbalance in the timing of repricing or maturity of assets or liabilities. We manage interest rate risk exposure with the goal of minimizing the effect of interest rate volatility on net interest income.

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

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

Table 1 Average Statements of Condition and Analysis of Net Interest Income

	Year ended December 31, 2019			Year ended December 31, 2018		
(dollars in thousands; unaudited)	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
Assets						
Interest-bearing due from banks [1]	$ 67,192	$ 1,321	1.94%	$ 78,185	$ 1,461	1.84%
Investment securities [2, 3]	555,618	15,102	2.72%	566,883	14,512	2.56%
Loans [1, 3, 4]	1,775,193	85,062	4.73%	1,704,390	80,406	4.65%
Total interest-earning assets [1]	2,398,003	101,485	4.17%	2,349,458	96,379	4.05%
Cash and non-interest-bearing due from banks	35,956			41,595		
Bank premises and equipment, net	6,911			8,021		
Interest receivable and other assets, net	109,837			86,709		
Total assets	**$ 2,550,707**			**$ 2,485,783**		
Liabilities and Stockholders' Equity						
Interest-bearing transaction accounts	$ 133,922	$ 347	0.26%	$ 143,706	$ 226	0.16%
Savings accounts	172,273	70	0.04%	178,907	72	0.04%
Money market accounts	680,296	3,439	0.51%	612,372	1,355	0.22%
Time accounts, including CDARS	106,783	595	0.56%	137,339	542	0.39%
Borrowings and other obligations [1]	2,935	77	2.57%	105	2	2.03%
Subordinated debentures [1]	2,673	229	8.44%	5,025	1,339	26.29%
Total interest-bearing liabilities	1,098,882	4,757	0.43%	1,077,454	3,536	0.33%
Demand accounts	1,094,806			1,085,870		
Interest payable and other liabilities	30,578			18,514		
Stockholders' equity	326,441			303,945		
Total liabilities & stockholders' equity	**$ 2,550,707**			**$ 2,485,783**		
Tax-equivalent net interest income/margin [1]		$ 96,728	3.98%		$ 92,843	3.90%
Reported net interest income/margin [1]		$ 95,680	3.94%		$ 91,544	3.84%
Tax-equivalent net interest rate spread			3.74%			3.72%

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

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

[3] Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the federal statutory rate of 21% in 2019 and 2018.

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

Table 2   Analysis of Changes in Net Interest Income

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

	2019 compared to 2018			
(in thousands, unaudited)	Volume	Yield/Rate	Mix	Total
Interest-bearing due from banks	$ (204)	$ 75	$ (11)	$ (140)
Investment securities [1]	(288)	897	(19)	590
Loans [1]	3,340	1,263	53	4,656
Total interest-earning assets	2,848	2,235	23	5,106
Interest-bearing transaction accounts	(15)	147	(11)	121
Savings accounts	(3)	1	—	(2)
Money market accounts	150	1,741	193	2,084
Time accounts, including CDARS	(120)	223	(50)	53
Borrowings and other obligations	58	1	16	75
Subordinated debentures	(627)	(909)	426	(1,110)
Total interest-bearing liabilities	(557)	1,204	574	1,221
	$ 3,405	$ 1,031	$ (551)	$ 3,885

[1] Yields and interest income on tax-exempt securities and loans are presented on a taxable-equivalent basis using the federal statutory rate of 21% in 2019 and 2018.

2019 Compared to 2018

Net interest income totaled $95.7 million and $91.5 million in 2019 and 2018, respectively. The increase of $4.2 million in 2019 was primarily due to higher average loan balances and assets yields across all categories and the early redemption of a high-rate subordinated debenture in the fourth quarter of 2018. Positive variances were partially offset by higher balances and rates on money market accounts. The tax-equivalent net interest margin increased eight basis points to 3.98% in 2019 compared to 3.90% in 2018 for the same reasons.

Market Interest Rates

Market interest rates are, in part, based on the target federal funds interest rate (the interest rate banks charge each other for short-term borrowings) implemented by the Federal Reserve Open Market Committee ("FOMC"). During 2018, the FOMC made four 25-basis-point increases to a range of 2.25% to 2.50% as of December 2018, where it remained during the first half of 2019. In each of its July, September and October 2019 meetings, the FOMC lowered the federal funds target rate by 0.25% to a range of 1.50% to 1.75% at the end of 2019. On March 3, 2020, in light of the coronavirus and its potential to disrupt the U.S. and worldwide economies, the FOMC reduced the federal funds target rate by 50 basis points to a range of 1.0% to 1.25%. Because the Bank is asset sensitive, upward movement in the market rates is projected to have a positive impact on net interest income. However, as a result of the Bank's already low cost of funds, falling rates would provide minimal funding cost relief to offset downward pressure expected on asset yields which could result in lower net interest income. See ITEM 7A. Quantitative and Qualitative Disclosure about Market Risk for further information.

Impact of Acquired Loans on Net Interest Margin

Accretions and gains on payoffs of purchased loans are recorded in interest income. As our acquired loans from prior acquisitions continue to pay off, we expect accretion income from these loans to continue to decline. The positive affect on our net interest margin during the past two years was as follows:

	Years ended December 31,					
	2019			2018		
(dollars in thousands; unaudited)	Dollar Amount		Basis point affect on net interest margin	Dollar Amount		Basis point affect on net interest margin
Accretion on purchased credit impaired ("PCI") loans	$	235	1 bps	$	320	1 bps
Accretion on non-PCI loans	$	118	0 bps	$	487	2 bps
Gains on payoffs of PCI loans	$	—	0 bps	$	135	1 bps

Provision for Loan Losses

Management assesses the adequacy of the allowance for loan losses quarterly based on several factors including growth of the loan portfolio, analysis of probable losses in the portfolio, historical loss experience and the current economic climate. Actual losses on loans are charged against the allowance, and the allowance is increased by loss recoveries and provisions for loan losses charged to expense. For further discussion, see Note 1 to the Consolidated Financial Statements in ITEM 8 of this report.

We recorded a $900 thousand provision for loan losses in 2019, compared to no provision for loan losses in 2018. The allowance for loan losses was 0.90% of loans at both December 31, 2019 and 2018. The provision for loan losses in 2019 is consistent with loan growth. The lack of a provision for loan losses in 2018 was primarily due to a $15.3 million decrease in classified loans, resulting from two borrowing relationships whose risk grades were upgraded from substandard to special mention in the second quarter of 2018. The allowance for loan losses excluding acquired loans was 0.96% and 0.98% of loans at December 31, 2019 and 2018, respectively. Net charge-offs totaled $44 thousand in 2019, compared to net recoveries of $54 thousand in 2018. See the section captioned "Allowance for Loan Losses" below for further analysis of the provision for loan losses.

Non-interest Income

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

Table 3 Components of Non-Interest Income

	Years ended December 31,				2019 compared to 2018	
					Amount	Percent
(dollars in thousands; unaudited)	2019		2018		Increase (Decrease)	Increase (Decrease)
Service charges on deposit accounts	$ 1,865	$	1,891	$	(26)	(1.4)%
Wealth Management and Trust Services	1,907		1,919		(12)	(0.6)%
Debit card interchange fees, net	1,586		1,561		25	1.6 %
Merchant interchange fees, net	331		378		(47)	(12.4)%
Earnings on bank-owned life insurance, net	1,196		913		283	31.0 %
Dividends on FHLB stock	799		959		(160)	(16.7)%
Gains on investment securities, net	55		876		(821)	(93.7)%
Other income	1,345		1,642		(297)	(18.1)%
Total non-interest income	$ 9,084	$	10,139	$	(1,055)	(10.4)%

2019 Compared to 2018

Non-interest income totaled $9.1 million and $10.1 million in 2019 and 2018, respectively. The decrease compared to the prior year primarily related to a $956 thousand pre-tax gain on the sale of 6,500 shares of Visa Inc. Class B restricted common stock, a $180 thousand Federal Home Loan Bank special dividend, and higher fee income from one-way deposit sales to third-party networks in 2018. The decrease in non-interest income was partially offset by a $562 thousand gain from the settlement of death benefits on bank-owned life insurance in 2019, net of underwriting costs associated with two new bank-owned life insurance policies.

Non-interest Expense

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

Table 4 Components of Non-Interest Expense

(dollars in thousands; unaudited)	Years ended December 31, 2019	2018	2019 compared to 2018 Amount Increase (Decrease)	Percent Increase (Decrease)
Salaries and related benefits	$ 34,253	$ 33,335	$ 918	2.8 %
Occupancy and equipment	6,143	5,976	167	2.8 %
Depreciation and amortization	2,228	2,143	85	4.0 %
Federal Deposit Insurance Corporation insurance	361	756	(395)	(52.2)%
Data processing	3,717	4,358	(641)	(14.7)%
Professional services	2,132	3,317	(1,185)	(35.7)%
Directors' expense	735	700	35	5.0 %
Information technology	1,065	1,023	42	4.1 %
Amortization of core deposit intangible	887	921	(34)	(3.7)%
Provision for losses on off-balance sheet commitments	129	—	129	100.0 %
Other non-interest expense:				
Advertising	775	666	109	16.4 %
Other expense	5,545	5,071	474	9.3 %
Total other non-interest expense	6,320	5,737	583	10.2 %
Total non-interest expense	$ 57,970	$ 58,266	$ (296)	(0.5)%

2019 Compared to 2018

In 2019, non-interest expense decreased by $296 thousand to $58.0 million. The decrease was primarily due to $1.0 million in consulting expenses related to core processing contract negotiations in 2018, lower data processing expenses in 2019 as a result of the contract renegotiation, and lower Federal Deposit Insurance Corporation ("FDIC") deposit insurance expenses due to the FDIC Deposit Insurance Fund reserve exceeding its billing threshold in 2019. The decreases in non-interest expense were partially offset by $918 thousand higher salaries and related benefits as a result of annual merit increases, three additional full-time equivalent employees (on average), and personnel severance, as well as higher recruiting fees recorded in other expenses.

Provision for Income Taxes

Income tax provisions reflect accruals for taxes at the applicable rates for federal income tax and California franchise tax based upon reported pre-tax income. Provisions also reflect permanent differences between income for tax and financial reporting purposes (such as earnings on tax exempt loans and municipal securities, BOLI, low-income housing tax credits, and stock-based compensation from the exercise of stock options, disqualifying dispositions of incentive stock options and vesting of restricted stock awards).

The provision for income taxes totaled $11.7 million at an effective tax rate of 25.4% in 2019, compared to $10.8 million at an effective tax rate of 24.9% in 2018. The increase in the provision from the prior year reflected a higher level of pre-tax income and lower tax-exempt interest income. The increase in the effective tax rate was also due to a higher level of tax benefits in 2018 from the exercise of non-qualified stock options and disqualifying dispositions of incentive stock options by former employees of Bank of Napa post-acquisition. The tax benefits from stock-based compensation reduced the effective tax rate approximately 59 basis points in 2018 versus 10 basis points in 2019. Additional fluctuations in the effective tax rate from period to period were due to the relationship of other net permanent differences to income before tax.

We file a consolidated return in the U.S. Federal tax jurisdiction and a combined return in the State of California tax jurisdiction. There were no ongoing federal or state income tax examinations at the issuance of this report. At December 31, 2019 and 2018, neither the Bank nor Bancorp had accruals for interest or penalties related to unrecognized tax benefits.

FINANCIAL CONDITION

Our assets increased $186.4 million from December 31, 2018 to December 31, 2019. Cash increased $149.2 million, mainly due to an increase in deposits of $161.7 million. Additionally, loan growth for 2019 was $79.4 million.

Investment Securities

We maintain an investment securities portfolio to provide liquidity and to generate earnings on funds that have not been loaned to customers. Management determines the maturities and types of securities to be purchased based on liquidity, the interest rate risk position, and the desire to attain a reasonable investment yield balanced with risk exposure. Table 5 shows the composition of the debt securities portfolio by expected maturity at December 31, 2019 and 2018. Expected maturities differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties. We estimate and update expected maturity dates regularly based on current and historical prepayment speeds. The weighted average life of the investment portfolio at December 31, 2019 and 2018 was approximately six and five years, respectively.

Table 5 Investment Securities

December 31, 2019	Within 1 Year		1-5 Years		5-10 Years		After 10 Years		Total		
(dollars in thousands; unaudited)	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Fair Value	Average Yield[2]
Held-to-maturity:											
MBS/CMOs issued by U.S. government agencies	3,763	2.47%	72,861	2.12%	49,277	2.54%	—	—%	$125,901	$127,790	2.30%
SBA-backed securities	—	—	—	—	7,999	3.19	—	—	$ 7,999	8,264	3.19
State and municipal[3]	1,807	4.45	1,706	5.36	—	—	—	—	3,513	3,588	4.89
Total held-to-maturity	5,570	3.11	74,567	2.19	57,276	2.63	—	—	137,413	139,642	2.41
Available-for-sale:											
MBS/CMOs issued by U.S. government agencies	4,157	1.97	126,702	2.67	141,462	3.01	—	—	272,321	278,144	2.83
SBA-backed securities	—	—	5,280	2.54	30,394	2.88	—	—	35,674	36,286	2.83
State and municipal[3]	2,082	2.67	16,619	2.82	47,341	3.03	—	—	66,042	67,282	2.96
Debentures of government sponsored agencies	498	2.05	16,040	2.92	21,881	2.75	9,970	2.91	48,389	49,046	2.83
Corporate bonds	1,497	3.54	—	—	—	—	—	—	1,497	1,502	3.54
Total available-for-sale	8,234	2.44	164,641	2.70	241,078	2.97	9,970	2.91	423,923	432,260	2.85
Total	$ 13,804	2.71%	$239,208	2.54%	$298,354	2.91%	$ 9,970	2.91%	$561,336	$571,902	2.75%

December 31, 2018	Within 1 Year		1-5 Years		5-10 Years		After 10 Years		Total		
(dollars in thousands; unaudited)	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Average Yield[2]	Amortized Cost[1]	Fair Value	Average Yield[2]
Held-to-maturity:											
MBS/CMOs issued by U.S. government agencies	$ —	—%	$ 39,929	2.16%	$ 74,741	2.46%	$ 22,705	2.51%	$137,375	$133,921	2.38%
SBA-backed securities	—	—	—	—	8,720	3.19	—	—	$ 8,720	8,757	3.19
State and municipal[3]	7,557	3.78	3,554	4.93	—	—	—	—	11,111	11,216	4.14
Total held-to-maturity	7,557	3.78	43,483	2.38	83,461	2.53	22,705	2.51	157,206	153,894	2.55
Available-for-sale:											
MBS/CMOs issued by U.S. government agencies	5,927	1.73	135,077	2.51	139,882	3.10	—	—	280,886	278,403	2.79
SBA-backed securities	—	—	2,372	2.77	48,351	2.99	—	—	50,723	50,781	2.98
State and municipal[3]	13,954	1.86	26,640	2.46	37,080	2.56	1,372	4.01	79,046	77,960	2.43
Debentures of government sponsored agencies	—	—	41,460	2.68	11,496	3.35	—	—	52,956	53,018	2.82
Privately issued CMOs	193	3.63	102	4.43	—	—	—	—	295	297	3.91
Corporate bonds	501	2.01	1,503	3.93	—	—	—	—	2,004	2,005	3.45
Total available-for-sale	20,575	1.85	207,154	2.55	236,809	3.01	1,372	4.01	465,910	462,464	2.76
Total	$ 28,132	2.36%	$250,637	2.52%	$320,270	2.88%	$ 24,077	2.59%	$623,116	$616,358	2.70%

[1] Book value reflects cost, adjusted for accumulated amortization and accretion.
[2] Weighted average calculation is based on amortized cost of securities.
[3] Yields on tax-exempt municipal bonds are presented on a taxable equivalent basis, using federal tax rate of 21%.

The amortized cost of our investment securities portfolio decreased $61.8 million or 10% during 2019. We purchased $114.4 million in securities in 2019, including $3.5 million designated as held-to-maturity and $110.9 million designated as available-for-sale to provide flexibility for liquidity and interest rate risk management. These purchases were offset by $109.0 million of paydowns, calls and maturities, and $66.0 million of sales during 2019.

During 2019, we purchased $17.0 million in collateralized mortgage obligations ("CMOs"), $42.2 million in mortgage pass-through securities, $25.3 million in debentures of government sponsored agencies, and $29.9 million in obligations of state and political subdivisions. We consider agency debentures, mortgage-backed securities, and CMOs issued by U.S. government sponsored entities to have low credit risk as they carry the credit support of the U.S. federal government. The debentures, CMOs and MBS issued by U.S. government sponsored agencies, state and municipal securities, and SBA-backed securities made up 79.6%, 12.4% and 7.8% of the portfolio at December 31, 2019, compared to 75.6%, 14.5% and 9.5%, respectively at December 31, 2018. See the discussion in the section captioned “Securities May Lose Value due to Credit Quality of the Issuers” in ITEM 1A Risk Factors above.

At December 31, 2019, distribution of our investment in obligations of state and political subdivisions was as follows:

	December 31, 2019			December 31, 2018		
(dollars in thousands; unaudited)	Amortized Cost	Fair Value	% of state and municipal securities	Amortized Cost	Fair Value	% of state and municipal securities
Within California:						
General obligation bonds	$ 4,597	$ 4,813	6.6%	$ 14,438	$ 14,418	16.0%
Revenue bonds	2,928	2,977	4.2	7,109	7,108	7.9
Tax allocation bonds	3,376	3,456	4.9	4,541	4,601	5.0
Total within California	10,901	11,246	15.7	26,088	26,127	28.9
Outside California:						
General obligation bonds	45,974	46,976	66.1	56,186	55,199	62.3
Revenue bonds	12,680	12,648	18.2	7,883	7,850	8.8
Total outside California	58,654	59,624	84.3	64,069	63,049	71.1
Total obligations of state and political subdivisions	$ 69,555	$ 70,870	100.0%	$ 90,157	$ 89,176	100.0%

The portion of the portfolio outside the state of California is distributed among 17 states. The largest concentrations outside California are in Texas (28.7%), Florida (7.8%), and Maryland (9.8%). Revenue bonds, both within and outside California, primarily consisted of bonds issued for essential services (such as transportation, infrastructure, public services, education and utilities).

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

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

Loans

Table 6 Loans Outstanding by Type at December 31

(in thousands; unaudited)	2019	2018	2017	2016	2015
Commercial loans	$ 246,687	$ 230,739	$ 235,835	$ 218,615	$ 219,452
Real estate					
Commercial owner-occupied	308,824	313,277	300,963	247,713	242,309
Commercial investor	946,317	873,410	822,984	724,228	715,879
Construction	61,095	76,423	63,828	74,809	65,495
Home equity	116,024	124,696	132,467	117,207	112,300
Other residential	136,657	117,847	95,526	78,549	73,134
Installment and other consumer loans	27,682	27,472	27,410	25,495	22,639
Total loans	1,843,286	1,763,864	1,679,013	1,486,616	1,451,208
Allowance for loan losses	(16,677)	(15,821)	(15,767)	(15,442)	(14,999)
Total net loans	$ 1,826,609	$ 1,748,043	$ 1,663,246	$ 1,471,174	$ 1,436,209

Total loans increased by $79.4 million to $1,843.3 million from $1,763.9 million in 2018. Loan originations totaled $259.6 million in 2019, compared to $239.4 million in 2018. Loan originations were partially offset by payoffs totaling $145.7 million in 2019 and $157.3 million in 2018. Payoffs to total loans were 7.9%, 8.9% and 7.9% in 2019, 2018 and 2017, respectively. Approximately 88% of our outstanding loans were secured by real estate at December 31, 2019 and 2018. Also, see ITEM 1A, Risk Factors, regarding our loan concentration risk.

The following table summarizes our commercial real estate loan portfolio by the geographic location in which the property is located as of December 31, 2019 and 2018.

Table 7 Commercial Real Estate Loans Outstanding by Geographic Location

	December 31, 2019		December 31, 2018	
(dollars in thousands; unaudited)	Amount	% of Commercial real estate loans	Amount	% of Commercial real estate loans
Marin	$ 339,917	27.1%	$ 342,163	28.8%
Sonoma	199,717	15.9	177,087	14.9
Alameda	175,664	14.0	167,170	14.1
Napa	175,170	14.0	168,394	14.2
San Francisco	165,205	13.2	155,863	13.1
Contra Costa	46,933	3.7	41,986	3.5
Solano	23,710	1.9	17,503	1.5
San Mateo	22,278	1.8	23,919	2.0
El Dorado	12,957	1.0	13,274	1.1
Sacramento	12,381	1.0	10,759	0.9
Other	81,209	6.4	68,569	5.9
Total	$ 1,255,141	100.0%	$ 1,186,687	100.0%

Commercial real estate loans increased $68.5 million in 2019 and $62.7 million in 2018. The increases in 2019 and 2018 were primarily in Sonoma, Napa, Alameda and San Francisco counties. Of the commercial real estate loans at December 31, 2019, 75% were non-owner occupied and 25% were owner occupied. Almost the entire commercial real estate loan portfolio is comprised of term loans for which the primary source of repayment is the operating cash flow from the leasing activities of the real estate collateral. We believe we applied conservative underwriting standards to our originated loans and both the acquired and originated loans are actively managed.

We occasionally provide interest-only term loans to borrowers who exhibit strong financial capacity and/or for commercial real estate loans during the occupancy stabilization period. These interest-only term loans must meet our stringent underwriting standards. After the initial interest-only payment period, these loans will usually require principal and interest payments. In addition, we may make interest-only concessions in a modified troubled debt restructuring ("TDR"). At December 31, 2019 and 2018, approximately 3.7% and 2.9%, respectively, of our commercial real estate loans contained an interest-only feature as part of the loan terms. All of these loans were current with their payments as of December 31, 2019. Except for two TDR loans to one borrowing relationship totaling $7.0 million as of December 31, 2019, all were considered to have low credit risk (graded "Pass").

The following table shows an analysis of construction loans by type and location as of December 31, 2019 and 2018.

Table 8 Construction Loans Outstanding by Type and Geographic Location

(dollars in thousands; unaudited)	December 31, 2019			December 31, 2018		
Construction loans by type		Amount	% of Construction Loans		Amount	% of Construction Loans
Commercial real estate	$	29,568	48.4%	$	30,603	40.0%
Apartments and multifamily		13,202	21.6		23,583	30.9
1-4 Single family residential		13,257	21.7		15,760	20.6
Land - improved		3,775	6.2		4,046	5.3
Land - unimproved		1,293	2.1		2,431	3.2
Total	$	61,095	100.0%	$	76,423	100.0%

(dollars in thousands; unaudited)	December 31, 2019			December 31, 2018		
Construction loans by geographic location		Amount	% of Construction Loans		Amount	% of Construction Loans
San Francisco	$	19,374	31.7%	$	20,764	27.2%
Marin		18,600	30.5		14,665	19.2
Sonoma		8,808	14.4		14,241	18.6
San Mateo		5,323	8.7		5,110	6.7
Napa		4,284	7.0		3,988	5.2
Alameda		2,092	3.4		11,411	14.9
Other		2,614	4.3		6,244	8.2
Total	$	61,095	100.0%	$	76,423	100.0%

Construction loans decreased by $15.3 million in 2019 and increased by $12.6 million in 2018. The $14.8 million decrease in Sonoma and Alameda construction loans primarily resulted from one loan that converted to a commercial real estate loan and one payoff from a completed apartment building construction project. The increase in 2018 was primarily due to new construction projects, partially offset by payoffs related to completed construction projects. The improving economy resulted in a number of new financing opportunities for existing and new customers who had successfully completed construction projects in the past.

The following table presents the maturity distribution of our commercial and construction loans as of December 31, 2019 based on their contractual maturity dates and does not include scheduled payments or potential prepayments.

Table 9A Commercial and Construction Loan Maturity Distribution

(in thousands; unaudited)		Due within 1 year		Due after 1 but within 5 years		Due after 5 years		Total
Maturity distribution:								
Commercial	$	89,057	$	95,800	$	61,830	$	246,687
Construction[1]		36,910		9,093		15,092		61,095
Total	$	125,967	$	104,893	$	76,922	$	307,782

[1] Construction loans that mature after 5 years are structured to convert to permanent financing after the initial construction period.

The following table shows the mix of variable-rate loans to fixed-rate loans for commercial and construction loans. The large majority of the variable-rate loans are tied to independent indices (such as the Prime Rate or a Treasury Constant Maturity Rate). Most loans with original terms of more than five years have provisions for the fixed rates to reset, or convert to variable rates, after three, five or seven years. These loans are included in variable-rate balances below.

Table 9B Commercial and Construction Loan Interest Rate Sensitivity

(in thousands; unaudited)		Fixed		Variable		Total
Commercial	$	117,997	$	128,690	$	246,687
Construction		35,651		25,444		61,095
Total	$	153,648	$	154,134	$	307,782

Allowance for Loan Losses

Credit risk is inherent in the business of lending. As a result, we maintain an allowance for loan losses to absorb probable losses in our loan portfolio through a provision for loan losses charged against earnings. All specifically identifiable and quantifiable losses are charged off against the allowance. The balance of our allowance for loan losses is Management's best estimate of the remaining probable losses in the portfolio. The ultimate adequacy of the allowance is dependent upon a variety of factors beyond our control, including the real estate market, changes in interest rates and economic and political environments. Based on the current conditions of the loan portfolio, Management believes that the $16.7 million allowance for loan losses at December 31, 2019 is adequate to absorb losses in our loan portfolio under accounting standards in effect at December 31, 2019, but provides no assurance that adverse economic conditions or other circumstances over the life of the loans will not result in increased losses in the portfolio. For information on the adoption of FASB ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, effective January 1, 2020, and potential impact on the Allowance for Loan losses, refer to Note 1 to the Consolidated Financial Statements in ITEM 8, under "Accounting Standards Not Yet Effective."

The Components of the Allowance for Loan Losses

As stated in Note 1 to the Consolidated Financial Statements in ITEM 8 of this report, the overall allowance consists of 1) specific allowances for individually identified impaired loans ("ASC 310-10") and 2) general allowances for pools of loans ("ASC 450-20"), which incorporate quantitative (e.g., historical loan loss rates) and qualitative risk factors (e.g., portfolio growth and trends, credit concentrations, economic and regulatory factors, etc.).

The first component, specific allowances, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Management evaluates these loans individually for impairment. Management considers an originated loan to be impaired when it is probable we will be unable to collect all amounts due according to the contractual terms of the loan agreement. For PCI loans, specific allowances are established to account for credit deterioration subsequent to acquisition if we have probable decreases in cash flows expected to be collected. For loans determined to be impaired, the extent of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate at origination (for originated loans), based on the loan's observable market price, or based on the fair value of the collateral if the loan is collateral dependent or if foreclosure is imminent. Generally, for problem credits that are collateral dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral is subject to market volatility, if a specific event has occurred to the collateral, or if we believe foreclosure is imminent. Impaired loan balances decreased to $11.5 million at December 31, 2019 from $15.0 million at December 31, 2018. The specific allowance for impaired loans decreased to $397 thousand at December 31, 2019 from $778 thousand at December 31, 2018. The decrease in impaired loan balances primarily related to the payoff of a land development loan with recorded investment of $2.7 million at December 31, 2018 and paydowns on other TDR loans. The decrease in reserves for impaired loans was primarily due to two unsecured commercial loans that paid down outstanding balances during 2019 and exhibited improved expected cash flows.

The second component is an estimate of the probable inherent losses in each loan pool with similar risk characteristics. This analysis encompasses the entire loan portfolio, excluding individually identified impaired loans and acquired loans whose purchase discount has not been fully accreted. Under our allowance model, loans are evaluated on a pool basis by federal regulatory reporting codes ("CALL codes" or "segments"), which are further delineated by assigned credit risk ratings, as described in Note 3 to the Consolidated Financial Statements in ITEM 8 of this report. At December 31, 2019 and 2018, the allowance allocated for the second component totaled $16.3 million and $15.0 million, respectively. The increase in the general allowance was almost entirely attributed to growth in loans subject to general allowance reserves (i.e., second component). Loans classified substandard decreased by $2.7 million during 2019 primarily due to the payoff of the land development loan mentioned previously. Loans designated special mention increased by $56.1 million during 2019 due primarily to new commercial loan originations to three borrowing relationships totaling $17.7 million that were experiencing perceived temporary financial conditions that warranted the initial designation, and downgrades of existing commercial real estate loans to two borrowing relationships totaling $26.7 million. These loans are either well-secured or have strong sponsorship and are not indicative of deteriorating credit quality in the loan portfolio.

Table 10 shows the allocation of the allowance by loan type as well as the percentage of total loans in each of the same loan types.

Table 10 Allocation of Allowance for Loan Losses

(dollars in thousands; unaudited)	December 31, 2019		December 31, 2018		December 31, 2017		December 31, 2016		December 31, 2015	
	Allowance balance allocation	Loans as a percent of total loans	Allowance balance allocation	Loans as a percent of total loans	Allowance balance allocation	Loans as a percent of total loans	Allowance balance allocation	Loans as a percent of total loans	Allowance balance allocation	Loans as a percent of total loans
Commercial loans	$ 2,334	13.4 %	$ 2,436	13.1 %	$ 3,654	14.0 %	$ 3,248	14.7 %	$ 3,023	15.1 %
Real Estate:										
Commercial, owner-occupied	2,462	16.8	2,407	17.8	2,294	17.9	1,753	16.7	2,249	16.7
Commercial, investor	8,483	51.3	7,703	49.5	6,475	49.1	6,320	48.7	6,178	49.4
Construction	638	3.3	756	4.3	681	3.8	781	5.0	724	4.5
Home Equity	850	6.3	915	7.1	1,031	7.9	973	7.9	910	7.7
Other residential	973	7.4	800	6.7	536	5.7	454	5.3	394	5.0
Installment and other consumer	284	1.5	310	1.5	378	1.6	372	1.7	425	1.6
Unallocated allowance	653	N/A	494	N/A	718	N/A	1,541	N/A	1,096	N/A
Total allowance for loan losses	$ 16,677		$ 15,821		$ 15,767		$ 15,442		$ 14,999	
Total percent		100.0 %		100.0 %		100.0 %		100.0 %		100.0 %

Table 11 shows the activity in the allowance for loan losses for each of the years in the five-year period ended December 31, 2019.

Table 11 Allowance for Loan Losses

(dollars in thousands; unaudited)	2019	2018	2017	2016	2015
Beginning balance	$ 15,821	$ 15,767	$ 15,442	$ 14,999	$ 15,099
Provision for (reversal of) loan losses	900	—	500	(1,850)	500
Loans charged-off:					
Commercial	(75)	(3)	(289)	(11)	(5)
Real Estate:					
Commercial, owner occupied	—	—	—	(20)	—
Commercial, investor	—	—	—	—	—
Construction	—	—	—	—	(839)
Home equity	—	—	—	—	—
Other residential	—	—	—	—	—
Installment and other consumer	(3)	(2)	(4)	(5)	(20)
Total loans charged-off	(78)	(5)	(293)	(36)	(864)
Loans recovered:					
Commercial	22	17	111	143	236
Real Estate:					
Commercial, owner occupied	—	—	—	—	—
Commercial, investor	12	—	—	2,156	23
Construction	—	—	—	—	—
Home equity	—	—	—	3	3
Other residential	—	—	—	—	—
Installment and other consumer	—	42	7	27	2
Total loans recovered	34	59	118	2,329	264
Net loans recovered (charged-off)	(44)	54	(175)	2,293	(600)
Ending balance	$ 16,677	$ 15,821	$ 15,767	$ 15,442	$ 14,999
Total loans outstanding at end of year, before deducting allowance for loan losses	$1,843,286	$ 1,763,864	$1,679,013	$ 1,486,616	$1,451,208
Average total loans outstanding during year	$1,775,193	$ 1,704,390	$1,511,503	$ 1,452,357	$1,354,564
Ratio of allowance for loan losses to total loans at end of year	0.90 %	0.90%	0.94 %	1.04%	1.03 %
Net recoveries (charge-offs) to average loans	NM	NM	(0.01)%	0.16%	(0.04)%
Ratio of allowance for loan losses to net recoveries (charge-offs)	(37,902.3)%	29,298.1%	(9,009.7)%	673.4%	(2,499.8)%

NM - Not meaningful.

Net charge-offs totaled $44 thousand in 2019, compared to net recoveries of $54 thousand in 2018, and net charge-offs of $175 thousand in 2017. Charge-offs during 2019 were attributable to several small balance loans.

Table 12 shows non-performing assets and impaired loans for each of the years in the five-year period ended December 31, 2019.

Table 12 Non-performing Assets and Impaired Loans

(dollars in thousands; unaudited)	2019	2018	2017	2016	2015
Non-accrual loans:					
Commercial	$ —	$ 319	$ —	$ —	$ 21
Real Estate:					
Commercial, owner-occupied	—	—	—	—	—
Commercial, investor	—	—	—	—	1,903
Construction	—	—	—	—	1
Home equity	168	313	406	91	171
Other residential	—	—	—	—	—
Installment and other consumer	58	65	—	54	83
Total non-accrual loans	226	697	406	145	2,179
Other real estate owned[1]	—	—		408	421
Total non-performing assets	$ 226	$ 697	$ 406	$ 553	$ 2,600
Accruing restructured loans:[2]					
Commercial	$ 1,223	$ 1,506	$ 2,165	$ 2,207	$ 4,562
Real Estate:					
Commercial, owner-occupied	6,998	6,993	6,999	6,993	6,993
Commercial, investor	1,770	1,821	2,171	2,256	513
Construction	—	2,688	2,969	3,245	3,237
Home equity	251	251	347	625	388
Other residential	452	462	1,148	1,965	2,011
Installment and other consumer	580	620	721	877	1,168
Total accruing restructured loans	11,274	14,341	16,520	18,168	18,872
Accreting impaired PCI loans:[3]					
Commercial real estate	—	—	—	—	—
Commercial	—	—	—	—	137
Construction	—	—	—	—	—
Total accreting impaired PCI loans	—	—	—	—	137
Total non-accrual loans (from above)	226	697	406	145	2,179
Total impaired loans	$ 11,500	$ 15,038	$ 16,926	$ 18,313	$ 21,188
Allowance for loan losses to non-accrual loans at period end	7,379%	2,270%	3,883%	10,650%	688%
Non-accrual loans to total loans	0.01%	0.04%	0.02%	0.01%	0.15%

[1] Other real estate owned decreased in 2017 from the sale of two properties obtained from a bank acquisition in 2013.
[2] Excludes TDR loans on non-accrual status.
[3] The expected cash flows on these PCI loans declined post-acquisition, but continued to accrete interest based on the expected cash flows.

The decrease in total impaired loans from 2018 to 2019 primarily related to payoffs (including a $2.7 million TDR land development loan) and paydowns, partially offset by advances on existing impaired loans and the addition of one non-accrual home equity loan. The decrease in total impaired loans from 2017 to 2018 primarily related to payoffs, paydowns, and two loans that were removed from TDR status. The decrease in total impaired loans from 2016 to 2017 primarily related to payoffs and paydowns, and the charge-off of an unsecured commercial loan mentioned above, which were partially offset by an increase in non-accrual loans. The decrease in total impaired loans from 2015 to 2016 primarily related to the resolution and payoff of a commercial real estate credit.

Total accruing TDR loans, whose contractual terms were restructured in a manner that granted a concession to a borrower experiencing financial difficulties, totaled $11.3 million and $14.3 million as of December 31, 2019 and 2018, respectively. The decreases from 2018 to 2019, from 2017 to 2018 and from 2016 to 2017 primarily related to the same changes mentioned above. For more information, refer to Note 3 to the Consolidated Financial Statements in ITEM 8, under “Troubled Debt Restructuring."

Other Assets

BOLI totaled $41.6 million at December 31, 2019, compared to $39.0 million at December 31, 2018, and is recorded in other assets. The increase of $2.6 million was due to the purchase of $3.0 million in new policies and a $634 thousand increase in the cash surrender value from net investment earnings, partially offset by a $971 thousand reduction in BOLI carrying value due to the receipt of death benefits totaling $1.5 million, which resulted in a $562 thousand gain on settlement recorded in non-interest income in 2019.

Other assets also included net deferred tax assets of $8.2 million and $10.4 million at December 31, 2019 and 2018, respectively. Deferred tax assets consist primarily of tax benefits expected to be realized in future periods related to temporary differences such as allowance for loan losses and off-balance sheet credit commitments, net operating loss carryforwards, deferred compensation plan and salary continuation plan, and net unrealized losses on available-for-sale securities. Management believes deferred tax assets will be realizable due to our consistent record of earnings and the expectation that earnings will continue at a level adequate to realize such benefits. Therefore, no valuation allowance was established as of December 31, 2019 or 2018. For additional information, refer to Note 11 to the Consolidated Financial Statements in ITEM 8 of this report.

In addition, we held $11.7 million and $11.1 million of FHLB stock recorded at cost in other assets at December 31, 2019 and 2018, respectively. The increase in 2019 resulted from the purchase of $616 thousand in FHLB stock. The FHLB paid $798 thousand and $959 thousand in cash dividends in 2019 and 2018, respectively. FHLB dividends in 2018 included a special dividend of $180 thousand. For additional information, refer to Note 2 to the Consolidated Financial Statements in ITEM 8 of this report.

Deposits

Deposits grew by $161.6 million, to $2,336.5 million at December 31, 2019, compared to $2,174.8 million at December 31, 2018. Non-interest bearing deposits grew by $62.8 million in 2019 and made up 48% of total deposits at year end. See ITEM 1A, Risk Factors, for a discussion of potential risks associated with concentrations and volatility due to activity of our large deposit customers.

Table 13 Distribution of Average Deposits

Table 13 shows the relative composition of our average deposits for 2019 and 2018. For average rates paid on deposits, refer to Table 1 in ITEM 7- Management's Discussion and Analysis of Financial Condition and Results of Operations.

	Years ended December 31,			
	2019		2018	
(dollars in thousands; unaudited)	Amount	Percent	Amount	Percent
Non-interest bearing	$ 1,094,806	50.0%	$ 1,085,870	50.3%
Interest bearing transaction	133,922	6.1	143,706	6.7
Savings	172,273	7.9	178,907	8.3
Money market [1]	680,296	31.1	612,372	28.4
Time deposits, including CDARS:				
Less than $100,000	32,035	1.5	37,468	1.7
$100,000 or more	74,748	3.4	99,871	4.6
Total time deposits	106,783	4.9	137,339	6.3
Total average deposits	$ 2,188,080	100.0%	$ 2,158,194	100.0%

[1] Money market balances included Insured Cash Sweep® ("ICS") and Demand Deposit Marketplace SM ("DDM") in both 2019 and 2018. DDM and ICS balances are discussed in Note 6 to the Consolidated Financial Statements in ITEM 8 of this report.

Table 14 Maturities of Time Deposits of $100,000 or more at December 31

Table 14 below shows the maturity groupings for time deposits of $100,000 or more at December 31, 2019 and 2018.

(in thousands; unaudited)	December 31, 2019	December 31, 2018
Three months or less	$ 15,720	$ 25,512
Over three months through six months	11,308	13,201
Over six months through twelve months	17,033	13,997
Over twelve months	23,818	29,834
Total	$ 67,879	$ 82,544

Borrowings

As of December 31, 2019 and 2018, respectively, we had $648.0 million and $629.4 million in secured lines of credit with FHLB and $80.3 million and $69.7 million with the Federal Reserve Bank of San Francisco ("FRBSF"). We also had $92.0 million in unsecured lines with correspondent banks to cover any short or long-term borrowing needs at December 31, 2019 and 2018.

There were no FHLB overnight borrowings at December 31, 2019. FHLB overnight borrowings were $7.0 million at a rate of 2.56% on December 31, 2018. The FRBSF and correspondent bank lines were not utilized at December 31, 2019 or 2018.

As part of a bank acquisition in 2013, we assumed two subordinated debentures due to the NorCal Community Bancorp Trusts I and II at fair values totaling $5.0 million at the acquisition date and contractual balances totaling $8.2 million. On October 7, 2018, Bancorp redeemed in full the subordinated debentures due to NorCal Community Bancorp Trust I. The remaining subordinated debenture due to Trust II had been accreted up to $2.7 million and $2.6 million as of December 31, 2019 and 2018, respectively.

For additional information, see Note 7 to the Consolidated Financial Statements in ITEM 8 of this report.

Deferred Compensation Obligations

We maintain a non-qualified, unfunded deferred compensation plan for certain key management personnel. Under this plan, participating employees may defer compensation, which will entitle them to receive certain payments for up to fifteen years commencing upon retirement, death, disability or termination of employment. The participating employee may elect to receive payments over periods not to exceed fifteen years. At December 31, 2019 and 2018, our aggregate payment obligations under this plan totaled $4.4 million and $3.8 million, respectively.

Our Salary Continuation Plan ("Plan") provides a percentage of salary continuation benefits to a select group of Executive Management upon retirement at age sixty-five and reduced benefits upon early retirement. At December 31, 2019 and 2018, our liability under the Plan was $3.0 million and $2.7 million, respectively, and is recorded in interest payable and other liabilities in the Consolidated Statements of Condition. The Plan is unfunded and non-qualified for tax purposes and for purposes of Title I of the Employee Retirement Income Security Act of 1974.

For additional information, see Note 10 to the Consolidated Financial Statements in ITEM 8 of this report.

Table 15 Off-Balance Sheet Arrangements, Commitments and Contractual Obligations

We make commitments to extend credit in the normal course of business to meet the financing needs of our customers. For additional information, see Note 16 to the Consolidated Financial Statements in ITEM 8 of this report.

	Payments due by period				
(in thousands; unaudited)	<1 year	1-3 years	4-5 years	>5 years	Total
Operating leases	$ 4,469	$ 4,758	$ 2,256	$ 2,092	$ 13,575
Finance leases	171	44	1	—	216
Subordinated debentures	—	—	—	4,124	4,124
Certificates of deposit	64,747	24,942	8,121	—	97,810
Other long term liabilities (salary continuation payments)[1]	33	214	357	1,295	1,899
Total	$ 69,249	$ 29,914	$ 10,734	$ 7,511	$ 117,408

[1] Represents future benefit payments under executive salary continuation agreements assumed from the Bank of Napa acquisition whereby participants begin receiving payments upon reaching retirement age. Amounts exclude future benefit payment obligations totaling $4.2 million under Bank of Marin executive salary continuation agreements whereby participants will begin receiving payments upon reaching retirement age and fulfilling their service requirements. Salary continuation obligations are based on retirement date assumptions and may be adjusted upon actual retirement. For additional information, see Note 10 to the Consolidated Financial Statements in ITEM 8 of this report.

The contractual amount of loan commitments not reflected on the consolidated statements of condition was $529.1 million and $491.3 million at December 31, 2019 and 2018, respectively.

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

Capital Adequacy

As discussed in Note 15 to the Consolidated Financial Statements in ITEM 8 of this report, the Bank's capital ratios were above regulatory guidelines to be considered "well capitalized" and Bancorp's ratios exceeded the required minimum ratios for capital adequacy purposes. For further discussion of bank capital requirements and the potential effect of the final rules related to the Community Bank Leverage Ratio under the Economic Growth, Regulatory Relief and Consumer Protection Act, refer to the SUPERVISION AND REGULATION section in ITEM 1 of this report.

The Bank's total risk-based capital ratio increased from 14.0% at December 31, 2018 to 14.6% at December 31, 2019, primarily due to the Bank's $35.4 million 2019 in net income, partially offset by $17.6 million in dividends paid to Bancorp to cover the Share Repurchase Program described below, quarterly common stock dividends, and operating costs. The Bank's total risk-weighted assets increased by $73.6 million to $2.1 billion at December 31, 2019. Bancorp's total risk-based capital ratio was 14.9% at December 31, 2018 and 15.1% at December 31, 2019. Bancorp's 2019 Tier 1 capital included NorCal Community Bancorp Trust II, which is not included at the Bank level.

As discussed in Note 8 to the Consolidated Financial Statements in ITEM 8 of this report, Bancorp's existing $25.0 million Share Repurchase Program expired February 28, 2020. On January 24, 2020, Bancorp’s Board of Directors approved a new repurchase program of up to $25.0 million of Bancorp’s common stock, which expires February 28, 2022. During 2019, Bancorp repurchased 356,000 shares totaling $15.0 million for a cumulative total of 527,217 shares and $22.0 million as of December 31, 2019. We expect to maintain strong capital levels and do not expect that we will be required to raise additional capital in 2020. Our anticipated sources of capital in 2020 include future earnings and shares issued under the stock-based compensation program.

Liquidity

The goal of liquidity management is to provide adequate funds to meet loan demand and to fund operating activities and deposit withdrawals. We accomplish this goal by maintaining an appropriate level of liquid assets and formal lines of credit with the FHLB, FRBSF and correspondent banks that enable us to borrow funds as discussed in Note 7 to the Consolidated Financial Statement in ITEM 8 of this report. Our Asset Liability Management Committee ("ALCO"), which is comprised of independent Bank directors and the Bank's Chief Executive Officer, is responsible for approving and monitoring our liquidity targets and strategies. ALCO has adopted a contingency funding plan that provides early detection of potential liquidity issues in the market or the Bank and institutes prompt responses that may prevent or alleviate a potential liquidity crisis. Management monitors liquidity daily and regularly adjusts our position based on current and future liquidity needs. We also have relationships with third-party deposit networks and can adjust the placement of our deposits via reciprocal or one-way sales as part of our cash management strategy.

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

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

At December 31, 2019 our liquid assets, which included unencumbered available-for-sale securities and cash, totaled $532.2 million, an increase of $99.0 million from December 31, 2018. Our cash and cash equivalents increased $149.2 million from December 31, 2018. Significant sources of liquidity during 2019 included $175.1 million in paydowns, maturities and sales of investment securities, an increase in deposits of $161.6 million, and $40.9 million in net cash provided by operating activities.

Significant uses of liquidity during 2019 were $114.5 million in investment securities purchased, $77.8 million in loan originations and advances, net of repayments, $15.0 million in common stock repurchases, and $10.9 million in cash dividends paid on common stock to our shareholders. Refer to the Consolidated Statement of Cash Flows in this Form 10-K for additional information on our sources and uses of liquidity. Management anticipates that our current strong liquidity position and core deposit base are adequate to fund our operations.

Undrawn credit commitments, as discussed in Note 16 to the Consolidated Financial Statements in ITEM 8 of this report, totaled $529.1 million at December 31, 2019. We expect to fund these commitments to the extent utilized primarily through the repayment of existing loans, deposit growth and liquid assets. Over the next twelve months, $64.7 million of time deposits will mature. We expect to replace these funds with new deposits. Our emphasis on local deposits, combined with our liquid investment portfolio, provides a very stable funding base.

Since Bancorp is a holding company and does not conduct regular banking operations, its primary sources of liquidity are dividends from the Bank. Under the California Financial Code, payment of a dividend from the Bank to Bancorp without advance regulatory approval is restricted to the lesser of the Bank’s retained earnings or the amount of the Bank’s net profits from the previous three fiscal years less the amount of dividends paid during that period. The primary uses of funds for Bancorp are shareholder dividends and ordinary operating expenses. Bancorp held $9.5 million of cash at December 31, 2019. In January 2020, Bancorp obtained a dividend distribution from the Bank totaling $16.2 million, which is deemed sufficient to cover Bancorp's operational needs, share repurchases, and cash dividends to shareholders through the end of 2020. Management anticipates that there will be sufficient earnings at the Bank to provide dividends to Bancorp to meet its funding requirements for the foreseeable future.

ITEM 7A. Quantitative and Qualitative Disclosure about Market Risk

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

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

From time to time, we enter into interest rate swap contracts to mitigate the changes in the fair value of specified long-term fixed-rate loans and firm commitments to enter into long-term fixed-rate loans caused by changes in interest rates. See Note 14 to the Consolidated Financial Statements in ITEM 8 of this report.

ALCO and the Board of Directors review our exposure to interest rate risk at least quarterly. We use simulation models to measure interest rate risk and to evaluate strategies to improve profitability. A simplified static statement of condition is prepared on a quarterly basis as a starting point, using instrument level data of our actual loans, investments, borrowings and deposits as inputs. If potential changes to net equity value and net interest income resulting from hypothetical interest rate changes are not within the limits established by the Board of Directors, Management may adjust the asset and liability mix to bring the risk position within approved limits or take other actions. At December 31, 2019, interest rate risk was within policy guidelines established by ALCO and the Board. One set of interest rates modeled and evaluated against flat interest rates is a series of immediate parallel shifts in the yield curve. These are provided in the following table as an example rather than an expectation of likely interest rate movements.

Table 16 Effect of Interest Rate Change on Net Interest Income (NII)

Immediate Changes in Interest Rates (in basis points)	Estimated Change in NII in Year 1 (as percent of NII)	Estimated Change in NII in Year 2 (as percent of NII)
up 400	(5.0)%	7.1%
up 300	(3.6)%	6.3%
up 200	(2.2)%	5.3%
up 100	(1.0)%	3.5%
down 100	(4.5)%	(9.5)%

Interest rate sensitivity is a function of the repricing characteristics of our assets and liabilities. The Bank runs a combination of scenarios and sensitivities in its attempt to capture the range of interest rate risk including the simulations mentioned above. As with any simulation model or other method of measuring interest rate risk, limitations are inherent in the process and dependent on assumptions. For example, if we choose to pay interest on certain business deposits that are currently non-interest bearing, causing those deposits to become rate sensitive in the future, we would become less asset sensitive than the model currently indicates. Assets and liabilities may react differently to changes in market interest rates in terms of both timing and responsiveness to market rate movements. Important deposit modeling assumptions are the speed of deposit run-off and the amount by which interest-bearing deposit rates increase or decrease when market interest rates change. Further, the actual rates and timing of prepayments on loans and investment securities could vary significantly from the assumptions applied in the various scenarios. Lastly, changes in U.S. Treasury rates accompanied by a change in the shape of the yield curve could produce different results from those presented in the table. Accordingly, the results presented should not be relied upon as indicative of actual results in the event of changing market interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors
Bank of Marin Bancorp

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statements of condition of Bank of Marin Bancorp and subsidiary (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of comprehensive income, changes in stockholders' equity and cash flows for each of the two years in the period ended December 31, 2019, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2019 and 2018, and the consolidated results of its operations and its cash flows for each of the two years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Moss Adams LLP
Los Angeles, California
March 13, 2020

We have served as the Company's auditor since 2004.

March 13, 2020

Management's Report on Internal Control over Financial Reporting

Management of Bank of Marin Bancorp and subsidiary, (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles ("GAAP"). The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company's assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and board of directors; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Management conducted an assessment of the effectiveness of internal control over financial reporting as of December 31, 2019, utilizing the framework established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, Management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2019.

The Company's independent registered public accounting firm, Moss Adams LLP, has issued an attestation report on our internal control over financial reporting, which appears on the previous page.

/s/ Russell A. Colombo
Russell A. Colombo, President and Chief Executive Officer

/s/ Tani Girton
Tani Girton, EVP and Chief Financial Officer

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CONDITION
December 31, 2019 and 2018

(in thousands, except share data)	2019	2018
Assets		
Cash, cash equivalents and restricted cash	$ 183,388	$ 34,221
Investment securities		
Held-to-maturity, at amortized cost	137,413	157,206
Available-for-sale, at fair value	432,260	462,464
Total investment securities	569,673	619,670
Loans, net of allowance for loan losses of $16,677 and $15,821 at December 31, 2019 and 2018, respectively	1,826,609	1,748,043
Bank premises and equipment, net	6,070	7,376
Goodwill	30,140	30,140
Core deposit intangible	4,684	5,571
Operating lease right-of-use assets	11,002	—
Interest receivable and other assets	75,714	75,871
Total assets	**$ 2,707,280**	**$ 2,520,892**
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest bearing	$ 1,128,823	$ 1,066,051
Interest bearing		
Transaction accounts	142,329	133,403
Savings accounts	162,817	178,429
Money market accounts	804,710	679,775
Time accounts	97,810	117,182
Total deposits	2,336,489	2,174,840
Borrowings and other obligations	212	7,000
Subordinated debentures	2,708	2,640
Operating lease liabilities	12,615	—
Interest payable and other liabilities	18,468	20,005
Total liabilities	2,370,492	2,204,485
Stockholders' Equity		
Preferred stock, no par value, Authorized - 5,000,000 shares, none issued	—	—
Common stock, no par value, Authorized - 30,000,000 shares; Issued and outstanding - 13,577,008 and 13,844,353 at December 31, 2019 and 2018, respectively	129,058	140,565
Retained earnings	203,227	179,944
Accumulated other comprehensive income (loss), net of taxes	4,503	(4,102)
Total stockholders' equity	336,788	316,407
Total liabilities and stockholders' equity	**$ 2,707,280**	**$ 2,520,892**

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

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2019 and 2018

(in thousands, except per share amounts)	2019	2018
Interest income		
Interest and fees on loans	$ 84,331	$ 79,527
Interest on investment securities	14,785	14,092
Interest on federal funds sold and due from banks	1,321	1,461
Total interest income	100,437	95,080
Interest expense		
Interest on interest-bearing transaction accounts	347	226
Interest on savings accounts	70	72
Interest on money market accounts	3,439	1,355
Interest on time accounts	595	542
Interest on borrowings and other obligations	77	2
Interest on subordinated debentures	229	1,339
Total interest expense	4,757	3,536
Net interest income	95,680	91,544
Provision for loan losses	900	—
Net interest income after provision for loan losses	94,780	91,544
Non-interest income		
Service charges on deposit accounts	1,865	1,891
Wealth Management and Trust Services	1,907	1,919
Debit card interchange fees, net	1,586	1,561
Merchant interchange fees, net	331	378
Earnings on bank-owned life Insurance, net	1,196	913
Dividends on FHLB stock	799	959
Gains on investment securities, net	55	876
Other income	1,345	1,642
Total non-interest income	9,084	10,139
Non-interest expense		
Salaries and related benefits	34,253	33,335
Occupancy and equipment	6,143	5,976
Depreciation and amortization	2,228	2,143
Federal Deposit Insurance Corporation insurance	361	756
Data processing	3,717	4,358
Professional services	2,132	3,317
Directors' expense	735	700
Information technology	1,065	1,023
Amortization of core deposit intangible	887	921
Provision for losses on off-balance sheet commitments	129	—
Other expense	6,320	5,737
Total non-interest expense	57,970	58,266
Income before provision for income taxes	45,894	43,417
Provision for income taxes	11,653	10,795
Net income	**$ 34,241**	**$ 32,622**
Net income per common share:[1]		
Basic	$ 2.51	$ 2.35
Diluted	$ 2.48	$ 2.33
Weighted average shares:[1]		
Basic	13,620	13,864
Diluted	13,794	14,029
Comprehensive income:		
Net income	$ 34,241	$ 32,622
Other comprehensive income (loss):		
Change in net unrealized gains or losses on available-for-sale securities	11,839	(1,707)
Reclassification adjustment for (gains) losses on available-for-sale securities in net income	(55)	79
Net unrealized losses on securities transferred from available-for-sale to held-to-maturity	—	(278)
Amortization of net unrealized losses on securities transferred from available-for-sale to held-to-maturity	445	516
Subtotal	12,229	(1,390)
Deferred tax expense (benefit)	3,624	(412)
Other comprehensive income (loss), net of tax	8,605	(978)
Comprehensive income	**$ 42,846**	**$ 31,644**

[1] Share and per share data have been adjusted to reflect the two-for-one stock split effective November 27, 2018.

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

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2019 and 2018

	Common Stock				
(in thousands, except share data)	Shares[1]	Amount	Retained Earnings	Accumulated Other Comprehensive (Loss) Income ("AOCL" or "AOCI"), Net of Taxes	Total
Balance at December 31, 2017	13,843,084	$143,967	$155,544	$ (2,486)	$297,025
Net income	—	—	32,622	—	32,622
Other comprehensive loss	—	—	—	(978)	(978)
Reclassification of stranded tax effects in AOCI	—	—	638	(638)	
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	111,714	538	—	—	538
Stock issued under employee stock purchase plan	1,036	39	—	—	39
Stock issued under employee stock ownership plan	29,600	1,173	—	—	1,173
Restricted stock granted	37,040	—	—	—	—
Restricted stock surrendered for tax withholdings upon vesting	(1,316)	(45)	—	—	(45)
Restricted stock forfeited / cancelled	(12,056)	—	—	—	—
Stock-based compensation - stock options	—	651	—	—	651
Stock-based compensation - restricted stock	—	1,013	—	—	1,013
Cash dividends paid on common stock ($0.64 per share[1])	—	—	(8,860)	—	(8,860)
Stock purchased by directors under director stock plan	998	37	—	—	37
Stock issued in payment of director fees	5,470	204	—	—	204
Stock repurchased, including commissions	(171,217)	(7,012)	—	—	(7,012)
Balance at December 31, 2018	13,844,353	$140,565	$179,944	$ (4,102)	$316,407
Net income	—	—	34,241	—	34,241
Other comprehensive income	—	—	—	8,605	8,605
Stock options exercised, net of shares surrendered for cashless exercises and tax withholdings	45,553	669	—	—	669
Stock issued under employee stock purchase plan	1,355	54	—	—	54
Stock issued under employee stock ownership plan	30,075	1,245	—	—	1,245
Restricted stock granted	29,110	—	—	—	—
Restricted stock surrendered for tax withholdings upon vesting	(5,240)	(220)	—	—	(220)
Restricted stock forfeited / cancelled	(18,333)	—	—	—	—
Stock-based compensation - stock options	—	495	—	—	495
Stock-based compensation - restricted stock	—	1,017	—	—	1,017
Cash dividends paid on common stock ($0.80 per share)	—	—	(10,958)	—	(10,958)
Stock purchased by directors under director stock plan	591	24	—	—	24
Stock issued in payment of director fees	5,544	231	—	—	231
Stock repurchased, including commissions	(356,000)	(15,022)	—	—	(15,022)
Balance at December 31, 2019	13,577,008	$129,058	$203,227	$ 4,503	$336,788

[1] Share and per share data have been adjusted to reflect the two-for-one stock split effective November 27, 2018.

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

BANK OF MARIN BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2019 and 2018

(in thousands)	2019	2018
Cash Flows from Operating Activities:		
Net income	$ 34,241	$ 32,622
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	900	—
Provision for losses on off-balance sheet commitments	129	—
Noncash contribution expense to employee stock ownership plan	1,245	1,173
Noncash director compensation expense	301	227
Stock-based compensation expense	1,512	1,664
Amortization of core deposit intangible	887	921
Amortization of investment security premiums, net of accretion of discounts	1,633	2,695
Accretion of discount on acquired loans	(353)	(807)
Accretion of discount on subordinated debentures	68	1,025
Net change in deferred loan origination costs/fees	(348)	183
Gain on sale of investment securities	(55)	(876)
Depreciation and amortization	2,228	2,143
Earnings on bank-owned life insurance policies	(1,196)	(913)
Net change in operating assets and liabilities:		
Interest receivable and other assets	(329)	1,148
Interest payable and other liabilities	70	902
Total adjustments	6,692	9,485
Net cash provided by operating activities	40,933	42,107
Cash Flows from Investing Activities:		
Purchase of held-to-maturity securities	(3,549)	(1,988)
Purchase of available-for-sale securities	(110,934)	(235,873)
Proceeds from sale of available-for-sale securities	66,081	16,972
Proceeds from paydowns/maturities of held-to-maturity securities	23,005	22,891
Proceeds from paydowns/maturities of available-for-sale securities	86,044	57,662
Proceeds from sale of Visa Inc. Class B restricted common stock	—	956
Loans originated and principal collected, net	(77,827)	(84,598)
Purchase of bank-owned life insurance policies	(2,997)	—
Cash receipts from bank-owned life insurance policies	1,533	—
Purchase of premises and equipment	(542)	(907)
Purchase of Federal Home Loan Bank stock	(616)	—
Cash paid for low income housing tax credit investment	(952)	(418)
Net cash used in investing activities	(20,754)	(225,303)
Cash Flows from Financing Activities:		
Net increase in deposits	161,649	26,170
Proceeds from stock options exercised	669	591
Payment of tax withholding for stock options exercised and vesting of restricted stock	(220)	(99)
Federal Home Loan Bank (repayment) borrowings	(7,000)	7,000
Repayment of subordinated debenture including execution costs	—	(4,137)
Repayment of finance lease obligations	(168)	—
Cash dividends paid on common stock	(10,958)	(8,860)
Stock repurchased, net of commissions	(15,062)	(6,869)
Proceeds from stock issued under employee and director stock purchase plans and ESOP	78	76
Net cash provided by financing activities	128,988	13,872
Net increase (decrease) in cash, cash equivalents and restricted cash	149,167	(169,324)
Cash, cash equivalents and restricted cash at beginning of period	34,221	203,545
Cash, cash equivalents and restricted cash at end of period	$ 183,388	$ 34,221
Supplemental disclosure of cash flow information:		
Cash paid in interest	$ 4,659	$ 2,599
Cash paid in income taxes	$ 12,738	$ 8,380
Supplemental disclosure of noncash investing and financing activities:		
Change in net unrealized gain or loss on available-for-sale securities	$ 11,839	$ (1,707)
Securities transferred from available-for-sale to held-to-maturity	$ —	$ 27,422
Amortization of net unrealized loss on available-for-sale securities transferred to held-to-maturity	$ 445	$ 516
Subscription in low income housing tax credit investment	$ —	$ 3,000
Stock issued to employee stock ownership plan	$ 1,245	$ 1,173
Stock issued in payment of director fees	$ 231	$ 204
Repurchase of stock not yet settled	$ 103	$ 143
Restricted cash:		
Federal Reserve Bank reserve requirements included in cash, cash equivalents and restricted cash	$ 4,806	$ 5,971

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Summary of Significant Accounting Policies

Basis of Presentation: The consolidated financial statements include the accounts of Bank of Marin Bancorp ("Bancorp"), a bank holding company, and its wholly-owned bank subsidiary, Bank of Marin (the "Bank"), a California state-chartered commercial bank. References to "we," "our," "us" mean Bancorp and the Bank that are consolidated for financial reporting purposes. All material intercompany transactions have been eliminated. We evaluated subsequent events through the date of filing with the Securities and Exchange Commission ("SEC") and determined that there were no subsequent events that require additional recognition or disclosure.

The NorCal Community Bancorp Trusts I and II, respectively (the "Trusts"), were formed for the sole purpose of issuing trust preferred securities. Bancorp is not considered the primary beneficiary of the Trusts (variable interest entities), therefore the Trusts are not consolidated in our consolidated financial statements, but rather the subordinated debentures are shown as a liability on our consolidated statements of condition. Bancorp's investment in the securities of the Trusts is accounted for under the equity method and is included in interest receivable and other assets on the consolidated statements of condition. Refer to Note 7, Borrowings, for detail on the early redemption on October 7, 2018 of one subordinated debenture due to NorCal Community Bancorp Trust I.

Nature of Operations: Bancorp, headquartered in Novato, CA, conducts business primarily through its wholly-owned subsidiary, the Bank, which provides a wide range of financial services to customers who are predominantly professionals, small and middle-market businesses, and individuals who work and/or reside in Marin, Sonoma, Napa, San Francisco, Alameda and Contra Costa counties. Besides its headquarters located in Novato, CA, the Bank operates ten branches in Marin County, three in Napa County, one in San Francisco, five in Sonoma County, three in Alameda County, and one loan production office in Contra Costa County. Our accounting and reporting policies conform to Generally Accepted Accounting Principles ("GAAP"), general practice, and regulatory guidance within the banking industry. A summary of our significant policies follows.

Cash, Cash Equivalents and Restricted Cash include cash, due from banks, federal funds sold and other short-term investments with maturities of less than three months at the time of purchase. Restricted cash includes reserve requirements held with the Federal Reserve Bank of San Francisco.

Investment Securities are classified as "held-to-maturity," "trading securities" or "available-for-sale." Investments classified as held-to-maturity are those that we have the ability and intent to hold until maturity and are reported at cost, adjusted for the amortization or accretion of premiums or discounts. Investments held for resale in anticipation of short-term market movements are classified as trading securities and are reported at fair value, with unrealized gains and losses included in earnings. Investments that are neither held-to-maturity nor trading are classified as available-for-sale and are reported at fair value. Unrealized gains and losses for available-for-sale securities, net of related taxes, are reported as a separate component of comprehensive income and included in stockholders' equity until realized. For discussion of our methodology in determining fair value, see Note 9, Fair Value of Assets and Liabilities.

Securities transferred from the available-for-sale category to the held-to-maturity category are recorded at fair value at the date of transfer. Unrealized holding gains or losses on the dates of the transfer of securities from available-for-sale to held-to-maturity are included in the balance of accumulated other comprehensive income (loss), net of tax, in the consolidated balance sheets. These unrealized holding gains or losses on the dates of transfer are amortized over the remaining life of the securities as yield adjustments in a manner consistent with the amortization or accretion of the original purchase premium or discount on the associated security.

At each financial statement date, we assess whether declines in the fair values of held-to-maturity and available-for-sale securities below their costs are deemed to be other-than-temporary. We consider, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. Evidence evaluated includes, but is not limited to, the remaining payment terms of the instrument and economic factors that are relevant to the collectability of the instrument, such as: current prepayment speeds, the current financial condition of the issuer(s), industry analyst reports, credit ratings, credit default rates, interest rate trends, the quality of any credit enhancement and the value of any underlying collateral.

For each security in an unrealized loss position ("impaired security"), we assess whether we intend to sell the security or if it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis. If we intend to sell the security or it is more likely than not we will be required to sell the security before recovery of its amortized cost basis, the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date is recognized against earnings.

For impaired securities that are not intended for sale and will not be required to be sold prior to recovery of our amortized cost basis, we determine if the impairment has a credit loss component. For both held-to-maturity and available-for-sale securities, if the amount of cash flows expected to be collected are less than the amortized cost, then other-than-temporary impairment shall be considered to have occurred and the credit loss component is recognized against earnings as the difference between present value of the expected future cash flows and the amortized cost. In determining the present value of the expected cash flows, we discount the expected cash flows at the effective interest rate implicit in the security at the date of purchase. The remaining difference between the fair value and the amortized basis is deemed to be due to factors that are not credit related and is recognized in other comprehensive income, net of applicable taxes.

For held-to-maturity securities, if there is no credit loss component, no impairment is recognized. The portion of other-than-temporary impairment recognized in other comprehensive income for credit impaired debt securities classified as held-to-maturity is accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. For certain callable debt securities purchased at a premium, we amortize the premium to the earliest call date.

Dividend and interest income are recognized when earned. Realized gains and losses on the sale of securities and credit losses related to other-than-temporary impairment on available-for-sale and held-to-maturity securities are included in non-interest income as gains (losses) on investment securities, net. The specific identification method is used to calculate realized gains and losses on sales of securities.

Originated Loans are reported at the principal amount outstanding net of deferred fees (costs), charge-offs and the allowance for loan losses ("ALLL"). Interest income is accrued daily using the simple interest method. Loan origination fees and commitment fees, offset by certain direct loan origination costs, are deferred and amortized as yield adjustments over the contractual lives of the related loans. Loans are placed on non-accrual status when Management believes that there is substantial doubt as to the collection of principal or interest, generally when they become contractually past due by ninety days or more with respect to principal or interest, except for loans that are well-secured and in the process of collection. When loans are placed on non-accrual status, any accrued but uncollected interest is reversed from current-period interest income. We may return non-accrual loans to accrual status when one of the following occurs:

- The borrower has resumed paying the full amount of the principal and interest and we are satisfied with the borrower's financial position. In order to meet this test, we must have received repayment of all past due principal and interest, unless the amounts contractually due are reasonably assured of repayment within a reasonable period of time, and there has been a sustained period of repayment performance (generally, six consecutive monthly payments), according to the original contractual terms or modified terms for loans whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties ("troubled debt restructuring").
- The loan has become well secured and is in the process of collection.

Loan Charge-Off Policy: For all loan types excluding overdraft accounts, we generally make a charge-off determination at or before 90 days past due. A collateral-dependent loan is partially charged down to the fair value of collateral securing it if: (1) it is deemed uncollectable, or (2) it has been classified as a loss by either our internal loan review process or external examiners. A non-collateral-dependent loan is partially charged down to its net realizable value under the same circumstances. Overdraft accounts are generally charged off when they exceed 60 days past due.

Acquired Loans: Acquired loans are recorded at their estimated fair values at the acquisition date in accordance with Accounting Standards Code ("ASC") 805, *Business Combinations*, factoring in credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for loan losses is not carried over or recorded for acquired loans as of the acquisition date.

We estimated the fair value of acquired loans at the acquisition date based on a discounted cash flow methodology that considered factors including the type of loan and related collateral, risk classification, fixed or variable interest rate, term of loan, whether or not the loan was amortizing, and current discount rates. Loans, except for purchased credit impaired ("PCI") loans, were grouped together according to similar risk characteristics and treated in the aggregate when applying various valuation techniques. Expected cash flows incorporated our best estimate of key assumptions at the time, such as property values, default rates, loss severity and prepayment speeds. Discount rates were based on market rates for new originations of comparable loans, where available, and included adjustments for liquidity factors. To the extent comparable market rates were not readily available, a discount rate was derived based on the assumptions of market participants' cost of funds, servicing costs and return requirements for comparable risk assets. In either case, the discount rate did not include a factor for credit losses, as that had been considered in estimating the cash flows. The process of calculating fair values of acquired loans, including estimates of losses expected to be incurred over the estimated remaining lives of the loans at acquisition date and ongoing updates to Management's expectation of future cash flows, requires significant subjective judgments and assumptions. The economic environment and lack of market liquidity and transparency are factors that have influenced, and may continue to affect, these assumptions and estimates.

We acquired loans with evidence of significant credit quality deterioration subsequent to their origination and for which it was probable, at acquisition, that we would be unable to collect all contractually required payments. Management applied significant subjective judgment in determining which loans were PCI loans. Evidence of credit quality deterioration as of the purchase date may include data such as past due and non-accrual status, risk grades and charge-off history.

The difference between the undiscounted expected cash flows expected to be collected and the fair value at the acquisition date ("accretable difference") is accreted into interest income at a level yield of return over the estimated remaining life of the PCI loan, provided that the timing and amount of future cash flows is reasonably estimable. The accretable yield is affected by:

- Changes in interest rate indices for variable rate loans – Expected future cash flows are based on the variable rates in effect at the time of the regular evaluations of cash flows expected to be collected;
- Changes in prepayment assumptions – Prepayments affect the estimated life of the loans which may change the amount of interest income, and possibly principal, expected to be collected; and
- Changes in the expected principal and interest payments over the estimated life – Updates to expected cash flows are driven by the credit outlook and actions taken with borrowers. Changes in expected future cash flows from loan modifications are included in the regular evaluations of cash flows expected to be collected.

The cash flows expected to be collected are updated each quarter based on current assumptions regarding default rates, loss severities, and other factors that are reflective of current financial conditions of the borrowers and the market conditions. Probable decreases in expected cash flows after acquisition result in impairment recorded as a specific allowance for loan losses or a charge-off to the allowance. Impairment is calculated as the present value of the expected future cash flows on the PCI loan, discounted at the loan's effective interest rate implicit in the loan.

The nonaccretable difference on the date of acquisition is defined as the difference between the contractually required payments and the cash flows expected to be collected, considering the result of prepayments, and is not recorded.

For purposes of accounting for the PCI loans from past business combinations, we elected not to apply the pooling method but to account for these loans individually. Disposals of loans, which may include sales of loans to third parties, receipt of payments in full by the borrower, or foreclosure of the collateral, result in removal of the loan from the PCI loan portfolio at its carrying amount. If a PCI loan pays off earlier than expected, a gain is recorded as interest income when the payoff amount exceeds the recorded investment.

For acquired loans not considered credit impaired ("non-PCI"), we recognize the entire fair value discount accretion as interest income, based on contractual cash flows using an effective interest rate method for term loans, and on a straight line basis for revolving lines. When a non-PCI loan is placed on non-accrual status subsequent to acquisition, accretion stops until the loan is returned to accrual status. The level of accretion on non-PCI loans varies from period to period due to maturities and early payoffs of these loans during the reporting periods. Subsequent to acquisition, if the probable and estimable losses for non-PCI loans exceed the amount of the remaining unaccreted discount, the excess is established as an allowance for loan losses. For further information regarding our acquired loans, see Note 3, Loans and Allowance for Loan Losses.

Allowance for Loan Losses is based upon estimates of loan losses and is maintained at a level considered adequate to provide for probable losses inherent in the loan portfolio. The allowance is increased by provisions for loan losses charged against earnings and reduced by charge-offs, net of recoveries.

In periodic evaluations of the adequacy of the allowance balance, Management considers current economic conditions, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, our past loan loss experience and other factors. The ALLL is based on estimates, and ultimate losses may vary from current estimates. Our Board of Directors' Asset/Liability Management Committee (“ALCO”) reviews the adequacy of the ALLL at least quarterly.

The overall allowance consists of 1) specific allowances for individually identified impaired loans ("ASC 310-10") and 2) general allowances for pools of loans ("ASC 450-20"), which incorporate quantitative (e.g., historical loan loss rates) and qualitative risk factors (e.g., portfolio growth and trends, credit concentrations, economic and regulatory factors, etc.).

The first component, specific allowances, results from the analysis of identified problem credits and the evaluation of sources of repayment including collateral, as applicable. Through Management's ongoing loan grading and credit monitoring process, individual loans are identified that have conditions indicating the borrower may be unable to pay all amounts due in accordance with the contractual terms. These loans are evaluated for impairment individually by Management. Management considers an originated loan to be impaired when it is probable we will be unable to collect all amounts due according to the contractual terms of the loan agreement. When the fair value of the impaired loan is less than the recorded investment in the loan, the difference is recorded as an impairment through the establishment of a specific allowance. For loans determined to be impaired, the extent of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate at origination (for originated loans), based on the loan's observable market price, or based on the fair value of the collateral if the loan is collateral dependent or if foreclosure is imminent. Generally, with problem credits that are collateral dependent, we obtain appraisals of the collateral at least annually. We may obtain appraisals more frequently if we believe the collateral value is subject to market volatility, if a specific event has occurred to the collateral, or if we believe foreclosure is imminent.

The second component is an estimate of the probable inherent losses in each loan pool with similar characteristics. This analysis encompasses the entire loan portfolio, excluding individually identified impaired loans and acquired loans whose purchase discount has not been fully accreted. Under our allowance model, loans are evaluated on a pool basis by federal regulatory reporting codes ("CALL codes" or "segments"), which are further delineated by assigned credit risk ratings, as described in Note 3, Loans and Allowance for Loan Losses. Segments include the following:

- Loans secured by real estate:
  - 1-4 family residential construction loans
  - Other construction loans and all land development and other land loans
  - Secured by farmland (including residential and other improvements)
  - Revolving, open-end loans secured by 1-4 family residential properties and extended under lines of credit
  - Closed-end loans secured by 1-4 family residential properties, secured by first liens
  - Closed-end loans secured by 1-4 family residential properties, secured by junior liens
  - Secured by multifamily (5 or more) residential properties
  - Loans secured by owner-occupied non-farm nonresidential properties
  - Loans secured by other non-farm nonresidential properties
- Loans to finance agricultural production and other loans to farmers
- Commercial and industrial loans

- Loans to individuals for household, family and other personal expenditures (i.e., consumer loans)
- Other loans

The model determines general allowances by loan segment based on quantitative (loss history) and qualitative risk factors. The quantitative risk factor for each segment utilizes the greater result of either the historical loss method or migration analysis loss method based on loss history beginning March 2010. Qualitative internal and external risk factors include, but are not limited to, the following:

- Changes in the nature and volume of the loan portfolio
- Changes in the volume and severity of past due loans, the volume of non-accruals loans, and the volume and severity of adversely classified or graded loans
- The existence and effect of individual loan and loan segment concentrations
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in the quality of our systematic loan review processes
- Changes in economic and business conditions, and developments that affect the collectability of the portfolio
- Changes in the value of underlying collateral, where applicable
- The effect of other external factors such as legal and regulatory requirements on the level of estimated credit losses in the portfolio
- The effect of acquisitions of other loan portfolios on our infrastructure, including risk associated with entering new geographic areas as a result of such acquisitions
- The presence of specialized lending segments in the portfolio

Under the historical loss method, quarterly loss rates are calculated for each segment by dividing annualized net charge-offs during each quarter by the quarter's average segment balances. The quarterly loss rates are averaged over the entire loss history period. Under the migration analysis method, loss rates are calculated at the risk grade and segment levels by dividing the net charge-off amount by the total segment balance at the beginning of each migration period where the charged-off loan in question was present. Migration loss rates are averaged for each risk grade and segment for the entire loss history period. For each segment, the loss rates that result in the larger of the migration loss reserves or segment historical loss reserves are applied to the current loan balances. Qualitative factors are combined with these quantitative factors at the segment level to arrive at the overall general allowances.

We establish specific allowances to account for credit deterioration for probable decreases in cash flows for PCI loans subsequent to acquisition. The estimated cash flows expected to be collected on PCI loans are updated quarterly and require the use of key assumptions and estimates based on factors such as the current economic environment, changes in collateral values, loan workout plans, changes in the probability of default, loss severities, and prepayments. Probable decreases in expected cash flows after acquisition result in impairment recorded as a specific allowance for loan losses or a charge-off to the allowance. Impairment is calculated as the present value of the expected future cash flows on the PCI loan, discounted at the loan's effective interest rate implicit in the loan.

While we believe we use the best information available to determine the allowance for loan losses, our results of operations could be significantly affected if circumstances differ substantially from the assumptions used in determining the allowance. A decline in local and national economic conditions, or significant changes in other assumptions, could result in a material increase in the allowance for loan losses and may adversely affect our financial condition and results of operations. In addition, the determination of the amount of the allowance for loan losses is subject to review by bank regulators as part of their routine examination process, which may result in the establishment of additional allowance for loan losses based upon their judgment of information available to them at the time of their examination.

For further information regarding the allowance for loan losses, see Note 3, Loans and Allowance for Loan Losses.

Allowance for Losses on Off-Balance Sheet Commitments: We make commitments to extend credit to meet the financing needs of our customers in the form of loans or standby letters of credit. We are exposed to credit loss in the event that a decline in credit quality of the borrower leads to nonperformance. We record an allowance for losses on these off-balance sheet commitments based on estimates of probability that these commitments will be drawn upon according to the historical utilization experience of different types of commitments and expected loss severity. This allowance is included in interest payable and other liabilities on the consolidated statements of condition.

Transfers of Financial Assets: We have entered into certain loan participation agreements with other organizations. We account for these transfers of financial assets as sales when control over the transferred financial assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets and liabilities have been isolated from us, (2) the transferee has the right to pledge or exchange the assets (or beneficial interests) it received, free of conditions that constrain it from taking advantage of that right, beyond a trivial benefit and (3) we do not maintain effective control over the transferred financial assets or third-party beneficial interests related to those transferred assets. No gain or loss has been recognized by us on the sale of these participation interests in 2019 and 2018.

Premises and Equipment: Premises and equipment consist of leasehold improvements, furniture, fixtures, software and equipment and are stated at cost, less accumulated depreciation and amortization, which are calculated on a straight-line basis. Furniture and fixtures are depreciated over eight years and equipment is generally depreciated over three to twenty years. Leasehold improvements are amortized over the lesser of their estimated useful lives or the terms of the leases. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred.

Business Combinations: Business combinations are accounted for under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*. A business is defined as a set of activities and assets that is both self-sustaining and managed to provide a return to investors and generally has three elements: inputs, processes and outputs. Under the acquisition method, the acquiring entity in a business combination recognizes the acquired assets and assumed liabilities at their estimated fair values as of the date of acquisition. Any excess of the purchase price over the fair value of net assets and other identifiable intangible assets acquired is recorded as goodwill. To the extent the fair value of net assets acquired, including other identifiable assets, exceed the purchase price, a bargain purchase gain is recognized. Assets acquired and liabilities assumed from a business combination are recognized at fair value, if the fair value can be determined during the measurement period. Results of operations of an acquired business are included in the consolidated statements of operations from the date of acquisition. Business acquisition-related costs, including conversion and restructuring charges, are expensed as incurred. If substantially all of an acquisition is made up of one asset or several similar assets, or without a substantive process that together contributes to the ability to create outputs, the acquisition is accounted for as an asset acquisition and acquisition costs will be capitalized as part of the assets acquired, rather than expensed in a business combinations.

Goodwill and Other Intangible Assets: Goodwill is determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill that arises from a business combination is periodically evaluated for impairment at the reporting unit level, at least annually. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Core deposit intangible ("CDI") represents the estimated future benefit of deposits related to an acquisition and is booked separately from the related deposits and evaluated periodically for impairment. The CDI asset is amortized on an accelerated method over its estimated useful life of ten years. At December 31, 2019, the future estimated amortization expense for the CDI arising from our past acquisitions is as follows:

(in thousands)	2020	2021	2022	2023	2024	Thereafter	Total
Core deposit intangible amortization	$ 853	$ 818	$ 782	$ 719	$ 422	$ 1,090	$ 4,684

We make a qualitative assessment of whether it is more likely than not that the fair value of a reporting unit where goodwill is assigned is less than its carrying amount. If we conclude that it is more likely than not that the fair value is more than its carrying amount, no impairment is recorded. Goodwill is tested for impairment on an interim basis if circumstances change or an event occurs between annual tests that would more likely than not reduce the fair value of the reporting unit below its carrying amount. The qualitative assessment includes adverse events or circumstances identified that could negatively affect the reporting units' fair value as well as positive and mitigating events. Such indicators may include, among others, significant changes in legal factors or in the general business climate, significant changes in our stock price and market capitalization, unanticipated competition, and an action or assessment by a regulator. If the fair value of a reporting unit is less than its carrying amount, an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value is recognized. The loss recognized should not exceed the total amount of goodwill allocated to that reporting unit.

Other Real Estate Owned ("OREO"): OREO is comprised of property acquired through foreclosure, in substance repossession or acceptance of deeds-in-lieu of foreclosure when the related loan receivable is de-recognized. OREO is recorded at fair value of the collateral less estimated costs to sell, establishing a new cost basis, and subsequently accounted for at the lower of cost or fair value less estimated costs to sell. Any shortfall of collateral value from the recorded investment of the related loan is recognized as loss at the time of foreclosure and is charged against the allowance for loan losses. Fair value of collateral is generally based on an independent appraisal of the property. Revenues and expenses associated with OREO, and subsequent adjustments to the fair value of the property and to the estimated costs of disposal, are realized and reported as a component of non-interest income and expense when incurred.

Bank Owned Life Insurance ("BOLI"): The Bank owns life insurance policies on certain key current and former officers. BOLI is recorded in interest receivable and other assets on the consolidated statements of condition at the amount that can be realized under the insurance contract at period-end, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement.

Federal Home Loan Bank of San Francisco ("FHLB") Stock: The Bank is a member of the FHLB. Members are required to own a certain amount of stock based on the level of borrowings and other factors. As of December 31, 2019, our investment in FHLB stock was carried at cost, as there was no impairment or changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. As of December 31, 2018, our investment in FHLB stock was carried at cost. We periodically evaluate FHLB stock for impairment based on ultimate recovery of par value. FHLB stock is included as part of interest receivable and other assets on the consolidated statements of condition. Both cash and stock dividends are reported as non-interest income.

Investments in Low Income Housing Tax Credit Funds: We have invested in limited partnerships that were formed to develop and operate affordable housing projects for low or moderate-income tenants throughout California. Our ownership percentage in each limited partnership ranges from 1.0% to 3.5%. We account for the investments in qualified affordable housing tax credit funds using the proportional amortization method, where the initial cost of the investment is amortized in proportion to the tax credits and other tax benefits received. Low income housing tax credits and other tax benefits received, net of the amortization of the investment is recognized as part of income tax benefit. Each of the partnerships must meet the regulatory minimum requirements for affordable housing for a minimum 15-year compliance period to fully utilize the tax credits. If the partnerships cease to qualify during the compliance period, the credit may be denied for any period in which the project is not in compliance and a portion of the credit previously taken is subject to recapture with interest. We record an impairment charge if the value of the future tax credits and other tax benefits is less than the carrying value of the investments.

Employee Stock Ownership Plan (“ESOP”): We recognize compensation cost for ESOP contributions when funds become committed for the purchase of Bancorp's common shares into the ESOP in the year in which the employees render service entitling them to the contribution. If we contribute stock, the compensation cost is the fair value of the shares when they are committed to be released (i.e., when the number of shares becomes known and formally approved). In 2019 and 2018, the Bank only made stock contributions to the ESOP.

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

We recognize the financial statement effect of a tax position when it is more likely than not, based on the technical merits and all available evidence, that the position will be sustained upon examination, including the resolution through protests, appeals or litigation processes. For tax positions that meet the more likely than not threshold, we measure and record the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with the taxing authority. The remainder of the benefits associated with tax positions taken is recorded as unrecognized tax benefits, along with any related interest and penalties. Interest and penalties related to unrecognized tax benefits are recorded in tax expense.

In deciding whether or not our tax positions taken meet the more likely than not recognition threshold, we must make judgments and interpretations about the application of inherently complex state and federal tax laws. To the extent tax authorities disagree with tax positions taken by us, our effective tax rates could be materially affected in the period of settlement with the taxing authorities. Revision of our estimate of accrued income taxes also may result from our own income tax planning, which may affect effective tax rates and results of operations for any reporting period.

We present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss ("NOL") carryforward, or similar tax loss or tax credit carryforward, rather than as a liability, when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) we intend to and are able to use the deferred tax asset for that purpose. Otherwise, the unrecognized tax benefit is presented as a liability instead of being netted with deferred tax assets.

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

(in thousands, except per share data)[1]	2019	2018
Weighted average basic shares outstanding	13,620	13,864
Potentially dilutive common shares related to:		
Stock options	148	136
Unvested restricted stock awards	26	29
Weighted average diluted shares outstanding	13,794	14,029
Net income	$ 34,241	$ 32,622
Basic EPS	$ 2.51	$ 2.35
Diluted EPS	$ 2.48	$ 2.33
Weighted average anti-dilutive shares not included in the calculation of diluted EPS	35	44

[1] Share and per share data have been adjusted to reflect the two-for-one stock split effective November 27, 2018.

Share-Based Compensation: All share-based payments, including stock options and restricted stock, are recognized as stock-based compensation expense in the consolidated statements of comprehensive income based on the grant-date fair value of the award with a corresponding increase in common stock. The grant-date fair value of the award is amortized on a straight-line basis over the requisite service period, which is generally the vesting period. The stock-based compensation expense excludes stock grants to directors as compensation for their services, which are recognized as director expenses separately based on the grant-date value of the stock. We account for forfeitures as they occur. See Note 8, *Stockholders' Equity and Stock Option Plans* for further discussion.

We determine the fair value of stock options at the grant date using a Black-Scholes pricing model that takes into account the stock price at the grant date, exercise price, expected life of the option, volatility of the underlying stock, expected dividend yield and risk-free interest rate over the expected life of the option. The expected term of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. Expected volatility is based on the historical volatility of the common stock over the most recent period that is generally commensurate with the expected life of the options. The Black-Scholes option valuation model requires the input of highly subjective assumptions, including the expected life of the stock-based award and stock price volatility. The assumptions used represent Management's best estimates based on historical information, but these estimates involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, the recorded stock-based compensation expense could have been materially different from that recorded in the consolidated financial statements. The fair value of restricted stock is based on the stock price on the grant date.

We record excess tax benefits resulting from the exercise of non-qualified stock options, the disqualifying disposition of incentive stock options and vesting of restricted stock awards as tax benefits in the consolidated statements of comprehensive income with a corresponding decrease to current taxes payable. In addition, we reflect excess tax benefits as an operating activity in the consolidated statements of cash flows.

Cash paid for tax withholdings when shares are surrendered in a cashless stock option exchange is classified as a financing activity in the consolidated statements of cash flows.

In June 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-07, *Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. This update simplifies the accounting for share-based payment transactions for acquiring goods and services from nonemployees, applying some of the same requirements as employee share-based payment transactions. The ASU will not affect the accounting for share-based payment awards to nonemployee directors, which will continue to be treated as employee share-based transactions under the current standards. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We adopted the requirements of this ASU effective January 1, 2019, which did not impact our financial condition or results of operations, as it is not our practice to issue stock-based awards to pay for goods and services from nonemployees, other than nonemployee directors.

<u>Derivative Financial Instruments and Hedging Activities - Fair Value Hedges</u>**:** All of our interest rate swap contracts are designated and qualified as fair value hedges. The terms of our interest rate swap contracts are closely aligned to the terms of the designated fixed-rate loans. The hedging relationships are tested for effectiveness on a quarterly basis using a qualitative approach. The qualitative analysis includes verification that there are no changes to the derivative's or hedged item's key terms and conditions and no adverse developments regarding risk of counterparty default, and validation that we continue to have fair value hedge designation. The interest rate swaps are carried on the consolidated statements of condition at their fair value in other assets (when the fair value is positive) or in other liabilities (when the fair value is negative). The changes in the fair value of the interest rate swaps are recorded in interest income. The unrealized gains or losses due to changes in fair value of the hedged fixed-rate loans due to changes in benchmark interest rates are recorded as an adjustment to the hedged loans and offset in interest income. For derivative instruments executed with the same counterparty under a master netting arrangement, we do not offset fair value amounts of interest rate swaps in liability positions with the ones in asset positions.

From time to time, we make firm commitments to enter into long-term fixed-rate loans with borrowers backed by yield maintenance agreements and simultaneously enter into forward interest rate swap agreements with correspondent banks to mitigate the change in fair value of the yield maintenance agreement. Prior to loan funding, yield maintenance agreements with net settlement features that meet the definition of a derivative are considered as non-designated hedges and are carried on the consolidated statements of condition at their fair value in other assets (when the fair value is positive) or in other liabilities (when the fair value is negative). The offsetting changes in the fair value of the forward swap and the yield maintenance agreement are recorded in interest income. When the fixed-rate loans are originated, the forward swaps are designated to offset the change in fair value in the loans. Subsequent to the point of the swap designations, the fair value of the related yield maintenance agreements at the designation date that was recorded in other assets is amortized using the effective yield method over the life of the respective designated loans.

The net effect of the change in fair value of interest rate swaps, the amortization of the yield maintenance agreement and the change in the fair value of the hedged loans due to changes in benchmark interest rates result in an insignificant amount recognized in interest income. For further detail, see Note 14, Derivative Financial Instruments and Hedging Activities.

In October 2018, the FASB issued ASU No. 2018-16, *Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. This update adds an alternative fifth permissible U.S. benchmark rate to be used for hedge accounting purposes. The amendments should be adopted for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, on a prospective basis for qualifying new or re-designated hedging relationships entered into on or after the date of adoption. We adopted this ASU effective January 1, 2019, which did not impact our financial condition or results of operations, as we did not have new or re-designated hedging relationships since adoption.

Revenue Recognition: We utilize the following five-step model for non-financial instrument related revenue that is in scope for Topic 606, *Revenue from Contracts with Customers*: 1) identify the contract, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and, 5) recognize revenue when (or as) the entity satisfies the performance obligation. Our main revenue streams in scope for Topic 606 include:

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

- Deposit account service charges - Service charges on deposit accounts consist of monthly maintenance fees, business account analysis fees, business online banking fees, check order charges, and other deposit account-related fees. Performance obligations for monthly maintenance fees and account analysis fees are satisfied, and the related revenue recognized, when we complete our performance obligation each month. Performance obligations related to transaction-based services (such as check orders) are satisfied, and the related revenue recognized, at a point in time typically when the transaction is completed, except for business accounts subject to analysis where the transaction-based fees are part of the monthly account analysis fees.

- Debit card interchange fees - We issue debit cards to our consumer and small business customers that allow them to purchase goods and services from merchants in person, online, or via mobile devices using funds held in their demand deposit accounts held with us. Debit cards issued to our customers are part of global electronic payment networks (such as Visa) who pass a portion of the merchant interchange fees to debit card-issuing member banks like us when our customers make purchases through their networks. Performance obligations for debit card services are satisfied and revenue is recognized daily as the payment networks process transactions. Because we act in an agent capacity, we recognize network costs on a net basis with interchange fees in non-interest income.

Advertising Costs are expensed as incurred. For the years ended December 31, 2019 and 2018, advertising costs totaled $775 thousand and $666 thousand, respectively.

Comprehensive Income (Loss) includes net income, changes in the unrealized gains or losses on available-for-sale investment securities, and amortization of net unrealized gains or losses on securities transferred from available-for-sale to held-to-maturity, net of related taxes, reported on the consolidated statements of comprehensive income and as components of stockholders' equity.

Fair Value Measurements: We use fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. We base our fair values on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., exit price notion) reflecting factors such as a liquidity premium. Securities available-for-sale and derivatives are recorded at fair value on a recurring basis. Our equity investments that do not have readily determinable fair values are recorded at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. FHLB stock and Visa Inc. Class B common stock are carried at cost as of December 31, 2019 and 2018, as there was no impairment or changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. Additionally, from time to time, we may be required to record certain assets and liabilities at fair value on a non-recurring basis, such as purchased loans and acquired deposits recorded at acquisition date, certain impaired loans, other real estate owned and securities held-to-maturity that are other-than-temporarily impaired. These non-recurring fair value adjustments typically involve write-downs of individual assets due to application of lower-of-cost or market accounting.

When we develop our fair value measurement process, we maximize the use of observable inputs. Whenever there is no readily available market data, we use our best estimates and assumptions in determining fair value, but these estimates involve inherent uncertainties and the application of Management's judgment. As a result, if other assumptions had been used, our recorded earnings or disclosures could have been materially different from those reflected in these consolidated financial statements.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant accounting estimates reflected in the consolidated financial statements include ALLL, other-than-temporary impairment of investment securities, accrued liabilities, accounting for income taxes and fair value measurements (including fair values of acquired assets and assumed liabilities at acquisition dates) as discussed in the Notes herein.

Other Recently Adopted Accounting Standards

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This amendment helped organizations address certain stranded income tax effects in accumulated other comprehensive income ("AOCI") resulting from the enactment of the Tax Cuts and Jobs Act of 2017. The ASU required financial statement preparers to disclose a description of the accounting policy for releasing income tax effects from AOCI, whether or not they elect to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act of 2017, and information about the other income tax effects that are reclassified. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We early adopted this ASU in the first quarter of 2018 by reclassifying $638 thousand from AOCI to retained earnings. This amount represented the stranded income tax effects related to the unrealized loss on available-for-sale securities in AOCI on the date of the enactment of the Tax Cuts and Jobs Act of 2017.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (the "new lease accounting standard"). The amendments in this ASU intended to increase transparency and comparability among organizations by recognizing an operating lease or finance lease right-of-use asset for the lease term, and a lease liability, which is a lessee's obligation to make lease payments, recorded based on discounting future lease payments under the lease terms. This ASU generally applies to leasing arrangements exceeding a twelve-month term. ASU 2016-02 is effective for annual periods, including interim periods within those annual periods beginning after December 15, 2018 and requires a modified retrospective method of adoption. In July 2018, the FASB issued two amendments to ASU 2016-02: ASU No. 2018-10, *Codification Improvements to Topic 842, Leases*, which provided various corrections and clarifications to ASU 2016-02; and ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which permitted optional transition methods and provided lessors with a practical expedient for separating lease and non-lease components of a lease. The ASU allowed entities to apply either a modified retrospective approach at the beginning of the earliest period presented or at the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings. We adopted the ASU under the latter approach.

As a result of the adoption of ASU 2016-02 on January 1, 2019, we recorded operating and finance lease right-of-use assets totaling $13.4 million, net of deferred rent and unaccreted lease incentives, operating and finance lease liabilities totaling $15.4 million, and no cumulative-effect adjustments to retained earnings. Under the standard's transition guidance, we elected the package of practical expedients, which allowed us to carry forward existing lease classifications and did not require us to reassess initial direct costs for any existing leases. In addition, we elected the hindsight practical expedient when determining the lease term (i.e., considering whether we are reasonably certain to exercise options to extend or terminate the lease). We made accounting policy elections not to separate non-lease components from lease components and to exclude short-term leases (i.e., lease term of 12 months or less at the commencement date) from right-of-use assets and lease liabilities for all lease classifications. See Note 12, *Commitments and Contingencies* for further information.

In March 2019, the FASB issued ASU No. 2019-01, *Leases (Topic 842): Codification Improvements*. This ASU addresses two lessor implementation issues and clarifies that lessees and lessors are exempt from certain interim disclosure requirements associated with adopting ASU 2016-02. The amendments related to the lessor implementation issues are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early application is permitted. As the ASU's amendments applicable to us only relate to disclosures, the adoption of ASU 2019-01 did not impact our financial condition or results of operations.

Accounting Standards Not Yet Effective

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The standard will replace today's "incurred loss" model with a "current expected credit loss" ("CECL") model. The CECL model will apply to estimated credit losses on loans receivable, held-to-maturity debt securities, unfunded loan commitments, and certain other financial assets measured at amortized cost. The CECL model is based on lifetime expected losses, rather than incurred losses, and requires the recognition of credit loss expense in the consolidated statement of income and a related allowance for credit losses on the consolidated statement of condition at the time of origination or purchase of a loan receivable or held-to-maturity debt security. In addition, CECL will modify the accounting for purchased loans and will require that an allowance for credit losses be established at the date of acquisition. However, for purchased financial assets with a more--than-insignificant amount of credit deterioration since origination ("PCD assets") that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through credit loss expense.

Under ASU 2016-13, available-for-sale debt securities are evaluated for impairment if fair value is less than amortized cost. Estimated credit losses are recorded through a credit loss expense and an allowance, rather than a write-down of the investment. Changes in fair value that are not credit-related will continue to be recorded in other comprehensive income. The ASU also expands the disclosure requirements regarding assumptions, models, and methods for estimating the allowance for loan losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.

Early CECL implementation activities focused on, among other things, capturing and validating data, segmenting the loan portfolio, evaluating various credit loss estimation methodologies, sourcing tools to forecast future economic conditions, running multiple loan loss driver analyses that correlate our credit loss experience with one or more economic factors, and evaluating the qualitative factor framework and assumptions. Based on these activities, we determined that our primary credit loss methodology will utilize a discounted cash flow approach that considers the probability of default and loss given default. Continuing implementation activities include model validation, drafting policies and disclosures, and evaluating, documenting and testing internal controls. Parallel testing occurred throughout 2019 and we estimate that our adoption of the CECL standards will result in a 5% to 15% increase to our allowance for credit losses, which will be recorded as a cumulative-effect adjustment to retained earnings, net of tax as of January 1, 2020.

In April 2019, the FASB issued ASU No. 2019-04, *Codification Improvements to Topic 326, Financial Instruments - Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments* that clarifies and improves areas of guidance related to recently issued standards on credit losses, hedging and recognition and measurement. The provisions of this ASU are effective January 1, 2020 and contain various methods of adoption. We will evaluate this ASU in conjunction with ASU 2016-13 to determine its impact on our financial condition and results of operations. At this time, we do not expect the ASU to have a material impact on our financial condition or results of operations.

In May 2019, the FASB issued ASU No. 2019-05, *Financial Instruments - Credit Losses (Topic 326): Targeted Transition Relief*. This ASU allows an option for entities to irrevocably elect the fair value option on an instrument-by-instrument basis for eligible financial assets measured at amortized cost basis upon adoption of the credit loss standards. This amendment provides relief for those entities electing the fair value option on newly originated or purchased financial assets, while maintaining existing similar financial assets at amortized cost, avoiding the requirement to maintain dual measurement methods for similar assets. The fair value option does not apply to held-to-maturity debt securities. This ASU is effective for us in fiscal year 2020, including interim periods within the fiscal year. At this time, we do not expect to elect the fair value option for our financial assets.

In November 2019, the FASB issued ASU No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments - Credit Losses*. This ASU, among other narrow -scope improvements, clarifies guidance around how to report expected recoveries. "Expected recoveries" describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. This ASU permits organizations to record expected recoveries on PCD assets. Additionally, this ASU reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities. ASU 2019-11 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The amendments should be applied on a modified retrospective basis by means of a cumulative-effect adjustment to the opening retained earnings balance in the statement of financial position as of the date of adoption. We adopted the requirements of this ASU on January 1, 2020 and do not expect the ASU to have a material impact on our financial condition or results of operations.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in this ASU remove, modify, and add disclosure requirements for the fair value reporting of assets and liabilities. The modifications and additions relate to Level 3 fair value measurements at the end of the reporting period. ASU 2018-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Entities should disclose and describe the range and weighted-average of significant observable inputs used to develop Level 3 fair value measurements prospectively. We adopted the requirements of this ASU on January 1, 2020. As the ASU's requirements only relate to disclosures, the amendments will not impact our financial condition or results of operations.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This standard aligns the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software, regardless of whether they convey a license to the hosted software. The accounting for the service element of a hosting arrangement that is a service contract is not affected by this ASU. The amendments are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. An entity has the option to apply amendments in the ASU either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We adopted the requirements of this ASU on January 1, 2020. We do not expect that the ASU will have a material impact on our financial condition or results of operations.

In December 2019, the FASB issued ASU No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for* Income Taxes. This ASU is intended to reduce the cost and complexity related to accounting for income taxes by removing certain exceptions to the guidance in Topic 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and simplifying aspects of the accounting for franchise taxes and enacted changes in tax laws or rates. This ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. As this ASU is narrow in scope and applicability to us will likely be minimal, we do not expect that the ASU will have a material impact on our financial condition or results of operations.

In January 2020, the FASB issued ASU No. 2020-01, *Investments - Equity Securities (Topic 321), Investments - Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) - Clarifying the Interactions between Topic 321, Topic 323, and Topic 815*. Among other things, this ASU clarifies that a company should consider observable transactions that require a company to either apply or discontinue the equity method of accounting under Topic 323, for the purposes of applying the measurement alternative in accordance with Topic 321. This ASU is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted. ASU No. 2020-01 should be applied prospectively at the beginning of the interim period that includes adoption. We do not expect that the ASU will have a material impact on our financial condition or results of operations.

Note 2: Investment Securities

Our investment securities portfolio consists of obligations of state and political subdivisions, U.S. corporations, U.S. federal government agencies such as Government National Mortgage Association ("GNMA") and Small Business Administration ("SBA"), U.S. government-sponsored enterprises ("GSEs") such as Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC), Federal Farm Credit Banks Funding Corporation and FHLB. We also invest in residential and commercial mortgage-backed securities ("MBS"/"CMBS") and collateralized mortgage obligations ("CMOs") issued or guaranteed by the GSEs, as reflected in the following table:

(in thousands)	December 31, 2019 Amortized Cost	Fair Value	Gross Unrealized Gains	(Losses)	December 31, 2018 Amortized Cost	Fair Value	Gross Unrealized Gains	(Losses)
Held-to-maturity:								
Securities of U.S. government-sponsored enterprises:								
MBS pass-through securities issued by FHLMC and FNMA	$ 80,451	$ 81,325	$ 1,018	$ (144)	$ 88,606	$ 85,804	$ 7	$ (2,809)
SBA-backed securities	7,999	8,264	265	—	8,720	8,757	37	—
CMOs issued by FNMA	10,210	10,492	282	—	11,447	11,327	—	(120)
CMOs issued by FHLMC	31,477	32,157	685	(5)	33,583	33,021	8	(570)
CMOs issued by GNMA	3,763	3,816	53	—	3,739	3,769	30	—
Obligations of state and political subdivisions	3,513	3,588	75	—	11,111	11,216	128	(23)
Total held-to-maturity	137,413	139,642	2,378	(149)	157,206	153,894	210	(3,522)
Available-for-sale:								
Securities of U.S. government-sponsored enterprises:								
MBS pass-through securities issued by FHLMC and FNMA	98,502	100,071	1,617	(48)	95,339	94,467	358	(1,230)
SBA-backed securities	35,674	36,286	688	(76)	50,722	50,781	465	(406)
CMOs issued by FNMA	22,702	23,092	390	—	28,275	28,079	134	(330)
CMOs issued by FHLMC	139,398	143,226	3,892	(64)	145,979	144,836	454	(1,597)
CMOs issued by GNMA	11,719	11,755	42	(6)	11,294	11,021	1	(274)
Debentures of government-sponsored agencies	48,389	49,046	727	(70)	52,956	53,018	185	(123)
Privately issued CMOs	—	—	—	—	295	297	2	—
Obligations of state and political subdivisions	66,042	67,282	1,386	(146)	79,046	77,960	134	(1,220)
Corporate bonds	1,497	1,502	6	(1)	2,004	2,005	15	(14)
Total available-for-sale	423,923	432,260	8,748	(411)	465,910	462,464	1,748	(5,194)
Total investment securities	$ 561,336	$ 571,902	$ 11,126	$ (560)	$ 623,116	$ 616,358	$ 1,958	$ (8,716)

The amortized cost and fair value of investment debt securities by contractual maturity at December 31, 2019 and 2018 are shown below. Expected maturities may differ from contractual maturities if the issuers of the securities have the right to call or prepay obligations with or without call or prepayment penalties.

(in thousands)	December 31, 2019 Held-to-Maturity Amortized Cost	Fair Value	Available-for-Sale Amortized Cost	Fair Value	December 31, 2018 Held-to-Maturity Amortized Cost	Fair Value	Available-for-Sale Amortized Cost	Fair Value
Within one year	$ 1,807	$ 1,811	$ 6,699	$ 6,706	$ 6,194	$ 6,182	$ 9,863	$ 9,795
After one but within five years	2,256	2,296	48,706	49,619	5,481	5,492	84,871	84,435
After five years through ten years	56,221	57,544	208,806	214,277	59,231	58,120	252,274	250,055
After ten years	77,129	77,991	159,712	161,658	86,300	84,100	118,902	118,179
Total	$ 137,413	$ 139,642	$ 423,923	$ 432,260	$ 157,206	$ 153,894	$ 465,910	$ 462,464

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

(in thousands)	2019	2018
Available-for-sale:		
Sales proceeds	$ 66,081	$ 16,972
Gross realized gains	$ 214	$ 27
Gross realized losses	$ (159)	$ (106)

Pledged investment securities are shown in the following table:

(in thousands)	December 31, 2019	December 31, 2018
Pledged to the State of California:		
Secure public deposits in compliance with the Local Agency Security Program	$ 126,598	$ 125,696
Collateral for trust deposits	742	734
Total investment securities pledged to the State of California	$ 127,340	$ 126,430
Collateral for Wealth Management and Trust Services ("WMTS') checking account	$ 622	$ 2,000

As part of our ongoing review of our investment securities portfolio, we reassessed the classification of certain securities issued by government sponsored agencies. During 2018, we transferred $27.4 million, from available-for-sale to held-to-maturity at fair value. We intend and have the ability to hold these securities to maturity. The net unrealized pre-tax loss of $278 thousand, remained in accumulated other comprehensive income and is amortized over the remaining life of the securities along with amortization of any prior transfers. Amortization of the net unrealized pre-tax loss totaled $445 thousand and $516 thousand in 2019 and 2018, respectively. There were no securities transferred from available-for-sale to held-to-maturity at fair value in 2019.

There were 40 and 229 securities in unrealized loss positions at December 31, 2019 and 2018, respectively. Those securities are summarized and classified according to the duration of the loss period in the tables below:

December 31, 2019	< 12 continuous months		≥ 12 continuous months		Total securities in a loss position	
(in thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity:						
MBS pass-through securities issued by FHLMC and FNMA	$ 14,203	$ (60)	$ 6,073	$ (84)	$ 20,276	$ (144)
CMOs issued by FHLMC	—	—	1,725	(5)	1,725	(5)
Total held-to-maturity	14,203	(60)	7,798	(89)	22,001	(149)
Available-for-sale:						
MBS pass-through securities issued by FHLMC and FNMA	4,367	(34)	4,464	(14)	8,831	(48)
SBA-backed securities	9,227	(14)	2,448	(62)	11,675	(76)
CMOs issued by FHLMC	14,918	(58)	2,981	(6)	17,899	(64)
CMOs issued by GNMA	7,139	(6)	—	—	7,139	(6)
Debentures of government-sponsored agencies	25,228	(70)	—	—	25,228	(70)
Obligations of state and political subdivisions	20,579	(145)	659	(1)	21,238	(146)
Corporate bonds	500	(1)	—	—	500	(1)
Total available-for-sale	81,958	(328)	10,552	(83)	92,510	(411)
Total temporarily impaired securities	$ 96,161	$ (388)	$ 18,350	$ (172)	$ 114,511	$ (560)

December 31, 2018	< 12 continuous months		> 12 continuous months		Total securities in a loss position	
(in thousands)	Fair value	Unrealized loss	Fair value	Unrealized loss	Fair value	Unrealized loss
Held-to-maturity:						
MBS pass-through securities issued by FHLMC and FNMA	$ 198	$ (9)	$ 83,990	$ (2,800)	$ 84,188	$ (2,809)
CMOs issued by FNMA	—	—	11,327	(120)	$ 11,327	$ (120)
CMOs issued by FHLMC	2,880	(3)	28,171	(567)	31,051	(570)
Obligations of state and political subdivisions	—	—	3,565	(23)	3,565	(23)
Total held-to-maturity	3,078	(12)	127,053	(3,510)	130,131	(3,522)
Available-for-sale:						
MBS pass-through securities issued by FHLMC and FNMA	19,971	(128)	50,077	(1,102)	70,048	(1,230)
SBA-backed securities	13,175	(122)	20,123	(284)	33,298	(406)
CMOs issued by FNMA	2,345	(8)	16,138	(322)	18,483	(330)
CMOs issued by FHLMC	24,094	(330)	74,243	(1,267)	98,337	(1,597)
CMOs issued by GNMA	1,666	(7)	9,112	(267)	10,778	(274)
Debentures of government- sponsored agencies	4,992	(8)	11,349	(115)	16,341	(123)
Obligations of state and political subdivisions	15,290	(54)	52,804	(1,166)	68,094	(1,220)
Corporate bonds	—	—	1,004	(14)	1,004	(14)
Total available-for-sale	81,533	(657)	234,850	(4,537)	316,383	(5,194)
Total temporarily impaired securities	$ 84,611	$ (669)	$ 361,903	$ (8,047)	$ 446,514	$ (8,716)

As of December 31, 2019, the investment portfolio included 16 investment securities that had been in a continuous loss position for twelve months or more and 24 investment securities had been in a loss position for less than twelve months.

Securities issued by government-sponsored agencies, such as FNMA and FHLMC, usually have implicit credit support by the U.S. federal government. However, since 2008, FNMA and FHLMC have been under government conservatorship and, therefore, contractual cash flows for these investments carry explicit guarantees by the U.S. federal government. Securities issued by the SBA and GNMA have explicit credit guarantees by the U.S. federal government, which protects us from credit losses on the contractual cash flows of the securities.

Other temporarily impaired securities, including obligations of state and political subdivisions and corporate bonds, were deemed credit worthy after our internal analysis of the issuers' latest financial information, credit ratings by major credit agencies, and/or credit enhancements. Based on our comprehensive analyses, we determined that the decline in the fair values of these securities was primarily driven by factors other than credit, such as changes in market interest rates and liquidity spreads subsequent to purchase. At December 31, 2019, Management determined that it did not intend to sell investment securities with unrealized losses, and it is more than likely than not that we will not have to sell any of the securities with unrealized losses before recovery of their amortized cost. Therefore, we do not consider these investment securities to be other-than-temporarily impaired at December 31, 2019.

Non-Marketable Securities

As a member of the FHLB, we are required to maintain a minimum investment in FHLB capital stock determined by the Board of Directors of the FHLB. The minimum investment requirements can increase in the event we increase our total asset size or borrowings with the FHLB. Shares cannot be purchased or sold except between the FHLB and its members at the $100 per share par value. We held $11.7 million and $11.1 million of FHLB stock included in other assets on the consolidated statements of condition at December 31, 2019 and 2018, respectively. The carrying amounts of these investments are reasonable estimates of fair value because the securities are restricted to member banks and they do not have a readily determinable market value. Based on our analysis of FHLB's financial condition and certain qualitative factors, we determined that the FHLB stock was not impaired at December 31, 2019 and 2018. On February 20, 2020, FHLB announced a cash dividend for the fourth quarter of 2019 at an annualized dividend rate of 7.00% to be distributed in mid-March 2020. Cash dividends paid on FHLB capital stock are recorded as non-interest income.

As a member bank of Visa U.S.A., we held 10,439 shares of Visa Inc. Class B common stock at both December 31, 2019 and 2018. These shares have a carrying value of zero and are restricted from resale to non-member banks of Visa U.S.A. until their conversion into Class A (voting) shares upon the termination of Visa Inc.'s Covered Litigation escrow account. Because of the restriction and the uncertainty on the conversion rate to Class A shares, these shares lack a readily determinable fair value. When converting this Class B common stock to Class A common stock based on the conversion rate of 1.6228, as of December 31, 2019 and 1.6298 as of December 31, 2018, and the closing stock price of Class A shares at those respective dates, the converted value of our shares of Class B common stock would have been $3.2 million and $2.2 million at December 31, 2019 and 2018, respectively. The conversion rate is subject to further adjustment upon the final settlement of the covered litigation against Visa Inc. and its member banks. As such, the fair value of these Class B shares can differ significantly from their converted values. For further information, refer to Note 12, Commitments and Contingencies.

In October 2018, we sold 6,500 shares of our holdings of Visa Inc. Class B common stock to a member bank of Visa U.S.A. The pre-tax gain from the sale, net of sales commission, was $956 thousand.

We invest in low income housing tax credit funds as a limited partner, which totaled $4.1 million and $4.6 million recorded in other assets as of December 31, 2019 and 2018, respectively. In 2019, we recognized $603 thousand of low income housing tax credits and other tax benefits, net of $515 thousand of amortization expense of low income housing tax credit investment, as a component of income tax expense. As of December 31, 2019, our unfunded commitments for these low income housing tax credit funds totaled $2.2 million. We did not recognize any impairment losses on these low income housing tax credit investments during 2019 or 2018, as the value of the future tax benefits exceeds the carrying value of the investments.

Note 3: Loans and Allowance for Loan Losses

Credit Quality of Loans

Virtually all of our loans are from customers located in California, primarily in Marin, Alameda, Sonoma, San Francisco, Napa, and Contra Costa counties. Approximately 88% of total loans were secured by real estate at December 31, 2019 and 2018. At December 31, 2019 and 2018, 68% and 67%, respectively, of our loans were for commercial real estate, 84% and 85% of which were secured by real estate located in Marin, Sonoma, Alameda, San Francisco and Napa counties (California).

The following table shows outstanding loans by class and payment aging as of December 31, 2019 and 2018.

Loan Aging Analysis by Class

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
December 31, 2019								
30-59 days past due	$ 1	$ —	$ 1,001	$ —	$ 279	$ —	$ 7	$ 1,288
60-89 days past due	—	—	—	—	98	—	95	193
90 days or more past due	—	—	—	—	167	—	—	167
Total past due	1	—	1,001	—	544	—	102	1,648
Current	246,686	308,824	945,316	61,095	115,480	136,657	27,580	1,841,638
Total loans [2]	$ 246,687	$ 308,824	$ 946,317	$ 61,095	$ 116,024	$ 136,657	$ 27,682	$ 1,843,286
Non-accrual loans [1]	$ —	$ —	$ —	$ —	$ 168	$ —	$ 58	$ 226
December 31, 2018								
30-59 days past due	$ 5	$ —	$ 1,004	$ —	$ —	$ —	$ 112	$ 1,121
60-89 days past due	—	—	—	—	—	—	—	—
90 days or more past due	—	—	—	—	—	—	—	—
Total past due	5	—	1,004	—	—	—	112	1,121
Current	230,734	313,277	872,406	76,423	124,696	117,847	27,360	1,762,743
Total loans [2]	$ 230,739	$ 313,277	$ 873,410	$ 76,423	$ 124,696	$ 117,847	$ 27,472	$ 1,763,864
Non-accrual loans [1]	$ 319	$ —	$ —	$ —	$ 313	$ —	$ 65	$ 697

[1] Includes no purchased credit impaired ("PCI") loans at December 31, 2019 or 2018. Amounts exclude accreting PCI loans of with carrying values totaling $2.0 million at December 31, 2019 and $2.1 million at December 31, 2018, as we have a reasonable expectation about future cash flows to be collected and we continue to recognize accretable yield on these loans in interest income. There were no accruing loans past due more than ninety days at December 31, 2019 or 2018.

[2] Amounts include net deferred loan origination costs of $983 thousand and $635 thousand at December 31, 2019 and 2018, respectively. Amounts are also net of unaccreted purchase discounts on non-PCI loans of $589 thousand and $708 thousand at December 31, 2019 and 2018, respectively.

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

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

Construction loans are generally made to developers and builders to finance construction, renovation and occasionally land acquisitions in anticipation of near-term development. Construction loan borrowers provide for interest reserves that are used for the payment of interest during the development and marketing periods and capitalized as part of the loan balance. When a construction loan is placed on nonaccrual status before the depletion of the interest reserve, we apply the interest funded by the interest reserve against the loan's principal balance. These loans are underwritten after evaluation of the borrower's financial strength, reputation, prior track record, and independent appraisals. We monitor all construction projects to determine whether they are on schedule, completed as planned and in accordance with the approved construction budgets. Significant events can affect the construction industry, including: the inherent volatility of real estate markets and vulnerability to delays due to weather, change orders, inability to obtain construction permits, labor or material shortages, and price changes. Estimates of construction costs and value associated with the completed project may be inaccurate. Repayment of construction loans is largely dependent on the ultimate success of the project.

Consumer loans primarily consist of home equity lines of credit, other residential loans and floating homes along with a small number of installment loans. Our other residential loans include tenancy-in-common fractional interest loans ("TIC") located almost entirely in San Francisco County. We originate consumer loans utilizing credit score information, debt-to-income ratio and loan-to-value ratio analysis. Diversification among consumer loan types, coupled with relatively small loan amounts that are spread across many individual borrowers, mitigates risk. We do not originate sub-prime residential mortgage loans, nor is it our practice to underwrite loans commonly referred to as "Alt-A mortgages," the characteristics of which are reduced documentation, borrowers with low FICO scores or collateral with high loan-to-value ratios.

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

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

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

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

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

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

The following table represents an analysis of the carrying amount in loans, net of deferred fees and costs and purchase premiums or discounts, by internally assigned risk grades, including PCI loans, at December 31, 2019 and 2018.

Credit Risk Profile by Internally Assigned Risk Grade

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Purchased credit-impaired	Total
December 31, 2019									
Pass	$ 209,209	$ 263,625	$ 944,924	$ 61,095	$ 114,864	$ 136,657	$ 27,538	$ 2,049	$ 1,759,961
Special Mention	37,065	35,016	560	—	750	—	—	—	73,391
Substandard	409	9,042	—	—	339	—	144	—	9,934
Total loans	$ 246,683	$ 307,683	$ 945,484	$ 61,095	$ 115,953	$ 136,657	$ 27,682	$ 2,049	$ 1,843,286
December 31, 2018									
Pass	$ 219,625	$ 299,998	$ 870,443	$ 73,735	$ 122,844	$ 117,847	$ 27,312	$ 2,112	$ 1,733,916
Special Mention	9,957	4,106	2,156	—	1,121	—	—	—	17,340
Substandard	1,126	7,986	—	2,688	648	—	160	—	12,608
Total loans	$ 230,708	$ 312,090	$ 872,599	$ 76,423	$ 124,613	$ 117,847	$ 27,472	$ 2,112	$ 1,763,864

Troubled Debt Restructuring

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

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

- The loan is subsequently refinanced or restructured at current market interest rates and the new terms are consistent with the treatment of creditworthy borrowers under regular underwriting standards;
- The borrower is no longer considered to be in financial difficulty;
- Performance on the loan is reasonably assured; and
- Existing loan did not have any forgiveness of principal or interest.

The same Management level that approved the loan classification upgrade must approve the removal of TDR status. After meeting all of the conditions above, there was one commercial loan with a recorded investment of $3 thousand removed from TDR designation during 2019, and one TIC loan and one home equity loan with recorded investments totaling $247 thousand removed from TDR designation during 2018.

The following table summarizes the carrying amount of TDR loans by loan class as of December 31, 2019 and December 31, 2018.

(in thousands)	As of	
Recorded investment in Troubled Debt Restructurings[1]	December 31, 2019	December 31, 2018
Commercial and industrial	$ 1,223	$ 1,506
Commercial real estate, owner-occupied	6,998	6,993
Commercial real estate, investor	1,770	1,821
Construction[2]	—	2,688
Home equity	251	251
Other residential	452	462
Installment and other consumer	639	685
Total	$ 11,333	$ 14,406

[1] There were no acquired TDR loans as of December 31, 2019 or December 31, 2018. TDR loans on non-accrual status totaled $58 thousand at December 31, 2019 and $65 thousand at December 31, 2018.

[2] The construction TDR loan outstanding as of December 31, 2018 paid off during 2019.

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

(dollars in thousands)	Number of Contracts Modified	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment at Period End
TDRs modified during 2019:				
Commercial and industrial	1	$ 298	$ 298	$ 150
TDRs modified during 2018:				
Commercial and industrial	2	$ 254	$ 245	$ 172

The loan modified during 2019 reflected a maturity extension and interest rate concession. The two loans modified during 2018 were to the same borrower and included maturity extensions and other changes to loan terms. During 2019 and 2018, there were no defaults on loans that had been modified in a TDR within the prior twelve-month period. We report defaulted TDRs based on a payment default definition of more than ninety days past due.

Impaired Loans

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

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Total
December 31, 2019								
Recorded investment in impaired loans:								
With no specific allowance recorded	$ 349	$ —	$ —	$ —	$ 167	$ 452	$ 98	$ 1,066
With a specific allowance recorded	874	6,998	1,770	—	251	—	541	10,434
Total recorded investment in impaired loans	$ 1,223	$ 6,998	$ 1,770	$ —	$ 418	$ 452	$ 639	$ 11,500
Unpaid principal balance of impaired loans	$ 1,209	$ 6,992	$ 1,764	$ —	$ 417	$ 451	$ 638	$ 11,471
Specific allowance	$ 103	$ 195	$ 41	$ —	$ 5	$ —	$ 53	$ 397
Average recorded investment in impaired loans during 2019	$ 1,441	$ 6,998	$ 1,797	$ 1,350	$ 481	$ 457	$ 663	$ 13,187
Interest income recognized on impaired loans during 2019 [1]	$ 73	$ 266	$ 79	$ 466	$ 42	$ 22	$ 25	$ 973
December 31, 2018								
Recorded investment in impaired loans:								
With no specific allowance recorded	$ 303	$ —	$ —	$ 2,688	$ 313	$ 462	$ 111	$ 3,877
With a specific allowance recorded	1,522	6,993	1,821	—	251	—	574	11,161
Total recorded investment in impaired loans	$ 1,825	$ 6,993	$ 1,821	$ 2,688	$ 564	$ 462	$ 685	$ 15,038
Unpaid principal balance of impaired loans	$ 1,813	$ 6,993	$ 1,812	$ 2,688	$ 562	$ 461	$ 684	$ 15,013
Specific allowance	$ 466	$ 189	$ 45	$ —	$ 5	$ —	$ 73	$ 778
Average recorded investment in impaired loans during 2018	$ 1,980	$ 7,000	$ 1,904	$ 2,803	$ 671	$ 915	$ 704	$ 15,977
Interest income recognized on impaired loans during 2018 [1]	$ 239	$ 266	$ 83	$ 156	$ 19	$ 45	$ 29	$ 837

[1] Interest income recognized on a cash basis of $417 thousand during 2019 was related to a principal payment applied to interest collected but unrecognized on a former non-accrual land development loan and the pay-off of four non-accruals. Interest income recognized on a cash basis of $135 thousand during 2018 was primarily related to the pay-off of non-accrual commercial PCI loans.

Management monitors delinquent loans continuously and identifies problem loans, generally loans graded Substandard or worse, loans on non-accrual status and loans modified in a TDR, to be evaluated individually for impairment testing. Generally, the recorded investment in impaired loans is net of any charge-offs from estimated losses related to specifically-identified impaired loans when they are deemed uncollectible. There were no charged-off amounts on impaired loans at December 31, 2019 or 2018. In addition, the recorded investment in impaired loans is net of purchase discounts or premiums on acquired loans and deferred fees and costs. At December 31, 2019 and 2018, unused commitments to extend credit on impaired loans, including performing loans to borrowers whose terms have been modified in TDRs, totaled $534 thousand and $1.1 million, respectively.

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

Allowance for Loan Losses Rollforward for the Year Ended

(in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
Year ended December 31, 2019									
Beginning balance	$ 2,436	$ 2,407	$ 7,703	$ 756	$ 915	$ 800	$ 310	$ 494	$ 15,821
Provision (reversal)	(49)	55	768	(118)	(65)	173	(23)	159	900
Charge-offs	(75)	—	—	—	—	—	(3)	—	(78)
Recoveries	22	—	12	—	—	—	—	—	34
Ending balance	$ 2,334	$ 2,462	$ 8,483	$ 638	$ 850	$ 973	$ 284	$ 653	$ 16,677
Year ended December 31, 2018									
Beginning balance	$ 3,654	$ 2,294	$ 6,475	$ 681	$ 1,031	$ 536	$ 378	$ 718	$ 15,767
Provision (reversal)	(1,232)	113	1,228	75	(116)	264	(108)	(224)	—
Charge-offs	(3)	—	—	—	—	—	(2)	—	(5)
Recoveries	17	—	—	—	—	—	42	—	59
Ending balance	$ 2,436	$ 2,407	$ 7,703	$ 756	$ 915	$ 800	$ 310	$ 494	$ 15,821

Allowance for Loan Losses and Recorded Investment In Loans

(dollars in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
December 31, 2019									
Ending ALLL related to loans collectively evaluated for impairment	$ 2,231	$ 2,267	$ 8,442	$ 638	$ 845	$ 973	$ 231	$ 653	$ 16,280
Ending ALLL related to loans individually evaluated for impairment	103	195	41	—	5	—	53	—	397
Ending ALLL related to purchased credit-impaired loans	—	—	—	—	—	—	—	—	—
Total ALLL	$ 2,334	$ 2,462	$ 8,483	$ 638	$ 850	$ 973	$ 284	$ 653	$ 16,677
Recorded Investment:									
Collectively evaluated for impairment	$245,460	$300,685	$943,714	$ 61,095	$115,535	$136,205	$ 27,043	$ —	$ 1,829,737
Individually evaluated for impairment	1,223	6,998	1,770	—	418	452	639	—	11,500
Purchased credit-impaired	4	1,141	833	—	71	—	—	—	2,049
Total	$246,687	$308,824	$946,317	$ 61,095	$116,024	$136,657	$ 27,682	$ —	$ 1,843,286
Ratio of allowance for loan losses to total loans	0.95%	0.80%	0.90%	1.04%	0.73%	0.71%	1.03%	NM	0.90%
Allowance for loan losses to non-accrual loans	NM	NM	NM	NM	506%	NM	490%	NM	7,379%

NM - Not Meaningful

Allowance for Loan Losses and Recorded Investment In Loans

(dollars in thousands)	Commercial and industrial	Commercial real estate, owner-occupied	Commercial real estate, investor	Construction	Home equity	Other residential	Installment and other consumer	Unallocated	Total
December 31, 2018									
Ending ALLL related to loans collectively evaluated for impairment	$ 1,970	$ 2,218	$ 7,658	$ 756	$ 910	$ 800	$ 237	$ 494	$ 15,043
Ending ALLL related to loans individually evaluated for impairment	466	189	45	—	5	—	73	—	778
Ending ALLL related to purchased credit-impaired loans	—	—	—	—	—	—	—	—	—
Total ALLL	$ 2,436	$ 2,407	$ 7,703	$ 756	$ 915	$ 800	$ 310	$ 494	$ 15,821
Loans outstanding:									
Collectively evaluated for impairment	$228,883	$305,097	$870,778	$ 73,735	$124,049	$ 117,385	$ 26,787	$ —	$ 1,746,714
Individually evaluated for impairment	1,825	6,993	1,821	2,688	564	462	685	—	15,038
Purchased credit-impaired	31	1,187	811	—	83	—	—	—	2,112
Total	$230,739	$313,277	$873,410	$ 76,423	$124,696	$ 117,847	$ 27,472	$ —	$ 1,763,864
Ratio of allowance for loan losses to total loans	1.06%	0.77%	0.88%	0.99%	0.73%	0.68%	1.13%	NM	0.90%
Allowance for loan losses to non-accrual loans	764%	NM	NM	NM	292%	NM	477%	NM	2,270%

NM - Not Meaningful

Purchased Credit-Impaired Loans

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

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

PCI Loans	December 31, 2019		December 31, 2018	
(in thousands)	Unpaid Principal Balance	Carrying Value	Unpaid Principal Balance	Carrying Value
Commercial and industrial	$ 34	$ 4	$ 89	$ 31
Commercial real estate, owner occupied	1,194	1,141	1,247	1,187
Commercial real estate, investor	1,001	833	1,033	811
Home equity	188	71	210	83
Total purchased credit-impaired loans	$ 2,417	$ 2,049	$ 2,579	$ 2,112

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

Accretable Yield	Years ended	
(in thousands)	December 31, 2019	December 31, 2018
Balance at beginning of period	$ 934	$ 1,254
Accretion	(234)	(320)
Balance at end of period	$ 700	$ 934

Pledged Loans

Our FHLB line of credit is secured under terms of a blanket collateral agreement by a pledge of certain qualifying loans with unpaid principal balances of $1,133.4 million and $1,027.4 million at December 31, 2019 and 2018, respectively. In addition, we pledge eligible TIC loans, which totaled $115.7 million and $94.5 million at December 31, 2019 and 2018, respectively, to secure our borrowing capacity with the Federal Reserve Bank ("FRB"). Also, see Note 7, Borrowings.

Related Party Loans

The Bank has, and expects to have in the future, banking transactions in the ordinary course of its business with directors, officers, principal shareholders and their businesses or associates. These transactions, including loans, are granted on substantially the same terms, including interest rates and collateral on loans, as those prevailing at the same time for comparable transactions with persons not related to us. Likewise, these transactions do not involve more than the normal risk of collectability or present other unfavorable features.

The following table shows changes in net loans to related parties for each of the two years ended December 31, 2019 and 2018:

(in thousands)		2019		2018
Balance at beginning of year	$	10,635	$	11,852
Additions		—		863
Advances		—		—
Repayments		(2,320)		(2,080)
Reclassified due to a change in borrower status		18		—
Balance at end of year	$	8,333	$	10,635

Undisbursed commitments to related parties totaled $9.2 million and $9.1 million as of December 31, 2019 and 2018, respectively.

Note 4: Bank Premises and Equipment

A summary of Bank premises and equipment at December 31 follows:

(in thousands)		2019		2018
Leasehold improvements	$	15,287	$	15,024
Furniture and equipment		10,986		10,839
Subtotal		26,273		25,863
Accumulated depreciation and amortization		(20,203)		(18,487)
Bank premises and equipment, net	$	6,070	$	7,376

The amount of depreciation and amortization totaled $2.2 million and $2.1 million the years ended December 31, 2019 and 2018, respectively.

Note 5: Bank Owned Life Insurance

We own life insurance policies on the lives of certain current and former officers designated by the Board of Directors to fund our employee benefit programs. Death benefits provided under the specific terms of these insurance policies are estimated to be $88.4 million at December 31, 2019. The benefits to employees' beneficiaries are limited to each employee's active service period. The investment in bank owned life insurance policies are reported in interest receivable and other assets at their cash surrender value, net of surrender charges, of $41.6 million and $39.0 million at December 31, 2019 and 2018, respectively. The cash surrender value includes both the original premiums paid for the life insurance policies and the accumulated accretion of policy income since inception of the policies, net of mortality costs and other fees. Income of $1.2 million and $913 thousand was recognized on these life insurance policies in 2019 and 2018, respectively. We regularly monitor the financial information and credit ratings of our insurance carriers to ensure that they are credit worthy and comply with our policy.

Note 6: Deposits

A stratification of time deposits at December 31, 2019 and 2018 is presented in the following table:

(in thousands)	December 31, 2019	December 31, 2018
Time deposits of less than $100 thousand	$ 29,931	$ 34,638
Time deposits of $100 thousand to $250 thousand	39,377	51,690
Time deposits of more than $250 thousand	28,502	30,854
Total time deposits	$ 97,810	$ 117,182

Interest on time deposits was $595 thousand and $542 thousand in 2019 and 2018, respectively.

Scheduled maturities of time deposits at December 31, 2019 are presented as follows:

(in thousands)	2020	2021	2022	2023	2024	Thereafter	Total
Scheduled maturities of time deposits	$ 64,747	$ 17,401	$ 7,541	$ 3,681	$ 4,440	$ —	$ 97,810

As of December 31, 2019, $126.6 million in securities were pledged as collateral for our local agency deposits.

Our deposit portfolio includes deposits offered through the Promontory Interfinancial Network that are comprised of Certificate of Deposit Account Registry Service® ("CDARS") balances included in time deposits and Insured Cash Sweep® ("ICS") balances included in money market deposits. In addition, we offer deposits through Reich & Tang Deposit Networks, LLC, comprised of Demand Deposit Marketplace℠ ("DDM") balances. Through these two networks we are able to offer our customers access to FDIC-insured deposit products in aggregate amounts exceeding current insurance limits. When we place funds through CDARS, ICS and DDM, on behalf of a customer, we have the option of receiving matching deposits through the network's reciprocal deposit program, or placing deposits "one-way" for which we receive no matching deposits. We consider the reciprocal deposits to be in-market deposits as distinguished from traditional out-of-market brokered deposits. The following table shows the composition of our network deposits for 2019 and 2018.

(in thousands)	December 31, 2019		December 31, 2018	
	Reciprocal	One-Way	Reciprocal	One-Way
CDARS	$ 5,011	$ 7,453	$ 7,661	$ 10,428
ICS	56,681	27,220	44,123	4,808
DDM	41,636	—	22,687	—
Total network deposits	$ 103,328	$ 34,673	$ 74,471	$ 15,236

The aggregate amount of deposit overdrafts that have been reclassified as loan balances was $155 thousand and $131 thousand at December 31, 2019 and 2018, respectively. Collectability of these overdrafts is subject to the same credit review process as other loans.

The Bank accepts deposits from shareholders, directors and employees in the normal course of business, and the terms are comparable to those with non-affiliated parties. The total deposits from directors and their businesses, and executive officers were $39.6 million and $33.3 million at December 31, 2019 and 2018, respectively.

Note 7: Borrowings and Other Obligations

Federal Funds Purchased – The Bank had unsecured lines of credit with correspondent banks for overnight borrowings totaling $92.0 million at December 31, 2019 and 2018. In general, interest rates on these lines approximate the federal funds target rate. We had no overnight borrowings under these credit facilities at December 31, 2019 or December 31, 2018.

Federal Home Loan Bank Borrowings – As of December 31, 2019 and 2018, the Bank had lines of credit with the FHLB totaling $648.0 million and $629.4 million, respectively, based on eligible collateral of certain loans. There were no

FHLB overnight borrowings at December 31, 2019. FHLB overnight borrowings were $7.0 million at a rate of 2.56% on December 31, 2018.

Federal Reserve Line of Credit – The Bank has a line of credit with the FRBSF secured by certain residential loans. At December 31, 2019 and 2018, the Bank had borrowing capacity under this line totaling $80.3 million and $69.7 million, respectively, and had no outstanding borrowings with the FRBSF.

Subordinated Debentures - As part of an acquisition, Bancorp assumed two subordinated debentures due to NorCal Community Bancorp Trusts I and II, established for the sole purpose of issuing trust preferred securities. The trust preferred securities were sold and issued in private transactions pursuant to an exemption from registration under the Securities Act of 1933, as amended. On October 7, 2018, Bancorp redeemed in full the subordinated debenture due to NorCal Community Bancorp Trust I, resulting in $916 thousand of accelerated accretion. The Trust II subordinated debenture was recorded at fair value totaling $2.14 million at acquisition date with a contractual balance of $4.12 million. The difference between the contractual balance and the fair value at acquisition date is accreted into interest expense over the life of the debenture. Accretion on the subordinated debentures totaled $68 thousand (Trust II) and $1.0 million (Trusts I and II) for the years ended December 31, 2019 and 2018, respectively. Bancorp has the option to defer payment of interest on the subordinated debenture for a period of up to five years, as long as there is no event of default. In the event of interest deferral, dividends to Bancorp common stockholders are prohibited. Bancorp has guaranteed, on a subordinated basis, distributions and other payments due on trust preferred securities totaling $4.0 million issued by Trust II, which have identical maturity, repricing and payment terms as the subordinated debenture. The subordinated debenture due to NorCal Community Bancorp Trust II on March 15, 2036 with interest payable quarterly (repricing quarterly, based on 3-month LIBOR plus 1.40%, or 3.30% as of December 31, 2019) is redeemable in whole or in part on any interest payment date.

Other Obligations - The Bank leases certain equipment under finance leases, which are included in borrowings and other obligations in the consolidated statements of condition. See Note 12, Commitments and Contingencies, for additional information.

Borrowings and other obligations at December 31, 2019 and 2018 are summarized as follows:

	2019			2018		
(dollars in thousands)	Carrying Value	Average Balance	Average Rate	Carrying Value	Average Balance	Average Rate
FHLB overnight borrowings	$ —	$ 2,656	2.55%	$ 7,000	$ 105	2.03%
Other obligations	$ 212	$ 279	2.85%	$ —	$ —	—%
Subordinated debentures	$ 2,708	$ 2,673	8.44%	$ 2,640	$ 5,025	26.29% [1]

[1] Subordinated debentures average rate in 2018 included the impact of the $916 thousand accelerated accretion due to early redemption of subordinated debentures due to NorCal Community Bancorp Trust I.

Note 8: Stockholders' Equity and Stock Plans

Stock Split

On October 22, 2018, Bancorp announced a two-for-one stock split, which occurred on November 27, 2018. All share and per share data have been adjusted to reflect the stock split effective November 27, 2018.

Share-Based Awards

On May 11, 2010, our shareholders approved the 2010 Director Stock Plan to pay director fees in shares of Bancorp common stock up to 300,000 shares. In addition to cash compensation, we issued 5,544 and 5,470 shares of common stock under the 2010 Director Stock Plan to directors in 2019 and 2018, respectively. As of December 31, 2019, 208,263 shares were available for future grants through the 2010 Director Stock Plan's May 12, 2020 expiration date.

On September 27, 2017, the Board of Directors adopted the 2017 Employee Stock Purchase Plan, effective July 1, 2017. Under the plan, our employees may purchase up to 385,370 of Bancorp's common shares through payroll deductions of between one percent and fifteen percent of pay in each pay period. Shares are purchased quarterly at a five percent discount from the closing market price on the last day of the quarter. As of December 31, 2019, 382,515 shares were available for future purchases under the plan.

On March 17, 2017, the Board of Directors approved the 2017 Equity Plan, which was affirmed by Bancorp's shareholders on May 16, 2017 and replaced the 2007 Equity Plan. The Compensation Committee of the Board of Directors has the discretion to determine which employees, advisors and non-employee directors will receive an award, the timing of awards, the vesting schedule for each award, the type of award to be granted, the number of shares of Bancorp stock to be subject to each option and restricted stock award, and any other terms and conditions. As of December 31, 2019, there were 989,630 shares available for future grants to employees, advisors and non-employee directors.

Options are issued at an exercise price equal to the fair value of the stock at the date of grant. Options and restricted stock awarded to officers and employees during 2007 through 2014 vest 20% on each anniversary of the grant date for five years and expire ten years from the grant date. In general, option awards granted after 2014 for employees generally vest by one-third on each anniversary of the grant for three years and expire ten years from the grant date. Options granted to non-employee directors prior to 2016 vest 20% immediately and 20% on each anniversary of the grant date for four years and expire seven years from the grant date. Options granted to non-employee directors in 2016 vest by one-third on each anniversary of the grant for three years and expire ten years from the grant date. Options granted to non-employee directors after 2016 vest immediately and expire ten years from the grant date.

Stock options and restricted stock may be net settled in a cashless exercise by a reduction in the number of shares otherwise deliverable upon exercise or vesting in satisfaction of the exercise payment and/or applicable tax withholding requirements. During 2019, we withheld 7,795 shares totaling $326 thousand at a weighted-average price of $41.84 for cashless exercises. During 2018, we withheld 46,794 shares totaling $1.7 million at a weighted-average price of $36.28 for cashless exercises. Shares withheld under net settlement arrangements are available for future grants.

Performance-based stock awards (restricted stock) are issued to a selected group of employees. Stock award vesting is contingent upon the achievement of pre-established long-term performance goals set by the Compensation Committee of the Board of Directors. Performance is measured over a three-year period and cliff vested. These performance-based stock awards were granted at a maximum opportunity level, and based on the achievement of the pre-established goals, the actual payouts can range from 0% to 200% of the target award. For performance-based stock awards, an estimate is made of the number of shares expected to vest based on the probability that the performance criteria will be achieved to determine the amount of compensation expense to be recognized. The estimate is re-evaluated quarterly and total compensation expense is adjusted for any change in the current period.

A summary of stock option activity for the years ended December 31, 2019 and 2018 is presented in the following table. The intrinsic value of options outstanding and exercisable is calculated as the number of in-the-money options times the difference between the market price of our stock and the exercise prices of the in-the-money options as of each year-end period presented.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in thousands)	Weighted Average Grant-Date Fair Value	Weighted Average Remaining Contractual Term (in years)
Options outstanding at December 31, 2017	517,936	$ 20.42	$ 7,075		5.34
Granted	74,096	33.97		$ 7.17	
Cancelled, expired or forfeited	(9,140)	28.25			
Exercised	(157,192)	13.93	3,462		
Options outstanding at December 31, 2018	425,700	25.01	6,910		5.85
Exercisable (vested) at December 31, 2018	311,050	22.57	5,809		4.94
Options outstanding at December 31, 2018	425,700	25.01	6,910		5.85
Granted	53,370	44.01		9.37	
Cancelled, expired or forfeited	(13,580)	38.88			
Exercised	(48,108)	16.11	1,247		
Options outstanding at December 31, 2019	417,382	28.01	7,112		5.50
Exercisable (vested) at December 31, 2019	333,870	25.34	6,581		4.76

The following table summarizes non-vested restricted stock awards and changes during the years ended December 31, 2019 and 2018.

	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested awards at December 31, 2017	91,216	$ 28.16
Granted	37,040	33.58
Vested	(28,812)	26.06
Cancelled or forfeited	(12,056)	27.32
Non-vested awards at December 31, 2018	87,388	31.26
Granted	29,110	44.45
Vested	(28,099)	27.88
Cancelled or forfeited	(18,333)	32.34
Non-vested awards at December 31, 2019	70,066	37.81

A summary of the options outstanding and exercisable by price range as of December 31, 2019 is presented in the following table:

	Stock Options Outstanding as of December 31, 2019			Stock Options Exercisable as of December 31, 2019	
Range of Exercise Prices	Stock Options Outstanding	Remaining Contractual Life (in years)	Weighted Average Exercise Price	Stock Options Exercisable	Weighted Average Exercise Price
$10.01 - $20.00	84,618	1.8	18.63	84,618	18.63
$20.01 - $30.00	166,454	4.8	23.88	166,454	23.88
$30.01 - $40.00	114,976	7.7	33.89	69,384	33.88
$40.01 - $50.00	51,334	8.9	43.71	13,414	41.61
	417,382			333,870	

We determine the fair value of stock options at the grant date using the Black-Scholes pricing model that takes into account the stock price at the grant date, exercise price, and the following assumptions (weighted-average shown).

	Years ended December 31, 2019	2018
Risk-free interest rate	2.51%	2.60%
Expected dividend yield on common stock	1.75%	1.76%
Expected life in years	5.8	5.9
Expected price volatility	22.71%	22.47%

The fair value of stock options as of the grant date is recorded as a stock-based compensation expense in the consolidated statements of comprehensive income over the requisite service period, which is generally the vesting period, with a corresponding increase in common stock. Stock-based compensation also includes compensation expense related to the issuance of restricted stock awards. The grant-date fair value of the restricted stock awards, which equals the grant date price, is recorded as compensation expense over the requisite service period with a corresponding increase in common stock as the shares vest. Beginning in 2018, stock option and restricted stock awards issued include a retirement eligibility clause whereby the requisite service period is satisfied at the retirement eligibility date. For those awards, we accelerate the recording of stock-based compensation when the award holder is eligible to retire. However, retirement eligibility does not affect the vesting of the restricted stock or the exercisability of the stock options, which are based on the scheduled vesting period. Total compensation expense for stock options and restricted stock awards was $1.5 million and $1.7 million during 2019 and 2018, respectively, and the total recognized deferred tax benefits related thereto were $389 thousand and $404 thousand, respectively.

As of December 31, 2019, there was $783 thousand of total unrecognized compensation expense related to non-vested stock options and restricted stock awards, which is expected to be recognized over a weighted-average period of approximately 1.7 years. The total grant-date fair value of stock options vested during the years ended December 31, 2019 and 2018 was $473 thousand and $543 thousand, respectively. The total grant-date fair value of restricted stock awards vested during 2019 and 2018 was $1.2 million and $967 thousand, respectively.

We record excess tax benefits (deficiencies) resulting from the exercise of non-qualified stock options, the disqualifying disposition of incentive stock options and vesting of restricted stock awards as income tax benefits (expense) in the consolidated statements of comprehensive income with a corresponding decrease (increase) to current taxes payable. In 2019 and 2018, we recognized $145 thousand and $484 thousand, respectively, in excess tax benefits recorded as a reduction to income tax expense related to these types of transactions. The tax benefits realized from disqualifying dispositions of incentive stock options were recognized in tax expense to the extent of the book compensation cost recorded.

Dividends

Presented below is a summary of cash dividends paid in 2019 and 2018 to common shareholders, recorded as a reduction from retained earnings. On January 24, 2020, the Board of Directors declared a $0.22 per share cash dividend, paid February 14, 2020 to the shareholders of record at the close of business on February 7, 2020.

	Years ended December 31,	
(in thousands except per share data)	2019	2018
Cash dividends to common stockholders	$ 10,958	$ 8,860
Cash dividends per common share	$ 0.80	$ 0.64

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

Under the California Corporations Code, payment of dividends by Bancorp to its shareholders is restricted to the amount of retained earnings immediately prior to the distribution or the amount of assets that exceeds the total liabilities immediately after the distribution. As of December 31, 2019, Bancorp's retained earnings and amount of total assets that exceeds total liabilities were $203.2 million and $336.8 million, respectively.

Under the California Financial Code, payment of dividends by the Bank to Bancorp is restricted to the lesser of retained earnings or the amount of undistributed net profits of the Bank from the three most recent fiscal years. Under this restriction, approximately $25.2 million of the Bank's retained earnings balance was available for payment of dividends to Bancorp as of December 31, 2019. Bancorp held $9.5 million in cash at December 31, 2019. This cash, combined with the $25.2 million dividends available to be distributed from the Bank, is considered adequate to cover Bancorp's estimated operational needs, cash dividends to shareholders in 2020, and the Share Repurchase Program discussed below.

Preferred Stock and Shareholder Rights Plan

On July 6, 2017, Bancorp adopted a new shareholder rights agreement (“Rights Agreement”), which replaced the existing Rights Agreement that expired on July 23, 2017. The Rights Agreement, which expires on July 23, 2022, is designed to discourage takeovers that involve abusive tactics or do not provide fair value to shareholders. The Rights Agreement defines the percentage of share ownership of an "acquiring person" as 10% of the outstanding common shares. Currently, each right entitles the registered holder to purchase from Bancorp one two-hundredth of a share of Series A Junior Participating Preferred Stock, no par value, of Bancorp at an initial price of $90 per one one-hundredth of a preferred share, subject to adjustment upon the occurrence of certain events. As of December 31, 2019, Bancorp was authorized to issue five million shares of preferred stock with no par value, one million shares of which have been designated as Series A Junior Participating Preferred Stock, with no par value under the Rights Agreement. In the event of a proposed merger, tender offer or other attempt to gain control of Bancorp that the Board of Directors does not approve, the Board of Directors may authorize the issuance of shares of common or preferred stock that would impede the completion of such a transaction. An effect of the possible issuance of common or preferred stock, therefore, may be to deter a future takeover attempt. The Board of Directors has no present plans or understandings for the issuance of any common or preferred stock in connection with the Rights Agreement.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

We early adopted ASU No. 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* in the first quarter of 2018 and reclassified $638 thousand from AOCI to retained earnings. This amount represented the stranded income tax effects related to the unrealized loss on available-for-sale securities in AOCI on the date of the enactment of the Tax Cuts and Jobs Act of 2017. For more information on ASU No. 2018-02, refer to Note 1, Summary of Significant Accounting Policies.

Share Repurchase Program

On April 23, 2018, Bancorp announced that its Board of Directors approved a Share Repurchase Program under which Bancorp may repurchase up to $25.0 million of its outstanding common stock through May 1, 2019. Bancorp's Board of Directors subsequently extended the Share Repurchase Program through February 28, 2020. On January 24, 2020, Bancorp Board of Directors approved a new Share Repurchase Program under which Bancorp may repurchase up to $25.0 million of its outstanding common stock through February 28, 2022.

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

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

During 2019 and 2018, Bancorp repurchased 356,000 and 171,217 shares totaling $15.0 million and $7.0 million, respectively, for a cumulative 527,217 shares totaling $22.0 million repurchased from May 1, 2018 through December 31, 2019.

Note 9: Fair Value of Assets and Liabilities

Fair Value Hierarchy and Fair Value Measurement

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

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

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

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

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

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

(in thousands) Description of Financial Instruments	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Measurement Categories: Changes in Fair Value Recorded In[1]
December 31, 2019					
Securities available for sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government-sponsored agencies	$ 278,144	$ —	$ 278,144	$ —	OCI
SBA-backed securities	$ 36,286	$ —	$ 36,286	$ —	OCI
Debentures of government sponsored agencies	$ 49,046	$ —	$ 49,046	$ —	OCI
Obligations of state and political subdivisions	$ 67,282	$ —	$ 67,282	$ —	OCI
Corporate bonds	$ 1,502	$ —	$ 1,502	$ —	OCI
Derivative financial assets (interest rate contracts)	$ —	$ —	$ —	$ —	NI
Derivative financial liabilities (interest rate contracts)	$ 1,178	$ —	$ 1,178	$ —	NI
December 31, 2018					
Securities available for sale:					
Mortgage-backed securities and collateralized mortgage obligations issued by U.S. government-sponsored agencies	$ 278,403	$ —	$ 278,403	$ —	OCI
SBA-backed securities	$ 50,781	$ —	$ 50,781	$ —	OCI
Debentures of government sponsored agencies	$ 53,018	$ —	$ 53,018	$ —	OCI
Privately-issued collateralized mortgage obligations	$ 297	$ —	$ 297	$ —	OCI
Obligations of state and political subdivisions	$ 77,960	$ —	$ 77,960	$ —	OCI
Corporate bonds	$ 2,005	$ —	$ 2,005	$ —	OCI
Derivative financial assets (interest rate contracts)	$ 161	$ —	$ 161	$ —	NI
Derivative financial liabilities (interest rate contracts)	$ 375	$ —	$ 375	$ —	NI

[1]Other comprehensive income ("OCI") or net income ("NI").

Available-for-sale securities are recorded at fair value on a recurring basis. When available, quoted market prices (Level 1) are used to determine the fair value of available-for-sale securities. If quoted market prices are not available, we obtain pricing information from a reputable third-party service provider, who may utilize valuation techniques that use current market-based or independently sourced parameters, such as bid/ask prices, dealer-quoted prices, interest rates, benchmark yield curves, prepayment speeds, probability of default, loss severity and credit spreads (Level 2). Level 2 securities include obligations of state and political subdivisions, U.S. agencies or government-sponsored agencies' debt securities, mortgage-backed securities, government agency-issued, privately-issued collateralized mortgage obligations and corporate bonds. As of December 31, 2019 and 2018, there were no Level 1 or Level 3 securities.

Securities held-to-maturity may be written down to fair value (determined using the same techniques discussed above for securities available-for-sale) as a result of an other-than-temporary impairment, and we did not record any write-downs during 2019 or 2018.

On a recurring basis, derivative financial instruments are recorded at fair value, which is based on the income approach using observable Level 2 market inputs, reflecting market expectations of future interest rates as of the measurement date. Standard valuation techniques are used to calculate the present value of the future expected cash flows assuming an orderly transaction. Valuation adjustments may be made to reflect both our own credit risk and the counterparties' credit risk in determining the fair value of the derivatives. Level 2 inputs for the valuations are limited to observable market prices for London Interbank Offered Rate ("LIBOR") and Overnight Index Swap ("OIS") rates (for the very short term), quoted prices for LIBOR futures contracts, observable market prices for LIBOR and OIS swap rates, and one-month and three-month LIBOR basis spreads at commonly quoted intervals. Mid-market pricing of the inputs is used as a practical expedient in the fair value measurements. We project spot rates at reset days specified by each swap contract to determine future cash flows, then discount to present value using OIS curves as of the measurement date. When the value of any collateral placed with counterparties is less than the interest rate derivative liability, a credit valuation adjustment ("CVA") is applied to reflect the credit risk we pose to counterparties. We have used the spread between the Standard & Poor's BBB rated U.S. Bank Composite rate and LIBOR for the closest maturity term corresponding to the duration of the swaps to derive the CVA. A similar credit risk adjustment, correlated to the credit standing of the counterparty, is made when collateral posted by the counterparty does not fully cover their liability to the Bank. For further discussion on our methodology in valuing our derivative financial instruments, refer to Note 14, *Derivative Financial Instruments and Hedging Activities*.

Certain financial assets may be measured at fair value on a non-recurring basis. These assets are subject to fair value adjustments that result from the application of the lower of cost or fair value accounting or write-downs of individual assets, such as impaired loans that are collateral dependent and other real estate owned ("OREO"). As of December 31, 2019 and 2018, we did not carry any assets measured at fair value on a non-recurring basis.

Disclosures about Fair Value of Financial Instruments

The table below is a summary of fair value estimates for financial instruments as of December 31, 2019 and 2018, excluding financial instruments recorded at fair value on a recurring basis (summarized in the first table in this note). The carrying amounts in the following table are recorded in the consolidated statements of condition under the indicated captions. Further, we have not disclosed the fair value of financial instruments specifically excluded from disclosure requirements such as bank-owned life insurance policies ("BOLI") and non-maturity deposit liabilities. Additionally, we held shares of FHLB stock and Visa Inc. Class B common stock, both recorded at cost, as there was no impairment or changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer as of December 31, 2019 and 2018. See further discussion on values within Note 2, *Investment Securities*, above.

	December 31, 2019			December 31, 2018		
(in thousands)	Carrying Amounts	Fair Value	Fair Value Hierarchy	Carrying Amounts	Fair Value	Fair Value Hierarchy
Financial assets (recorded at amortized cost)						
Cash and cash equivalents	$ 183,388	$ 183,388	Level 1	$ 34,221	$ 34,221	Level 1
Investment securities held-to-maturity	137,413	139,642	Level 2	157,206	153,894	Level 2
Loans, net	1,826,609	1,839,666	Level 3	1,748,043	1,700,971	Level 3
Interest receivable	7,732	7,732	Level 2	8,292	8,292	Level 2
Financial liabilities (recorded at amortized cost)						
Time deposits	97,810	97,859	Level 2	117,182	116,584	Level 2
Federal Home Loan Bank borrowing	—	—	Level 2	7,000	7,000	Level 2
Subordinated debentures	2,708	3,182	Level 3	2,640	3,268	Level 3
Interest payable	134	134	Level 2	104	104	Level 2

Commitments - The value of unrecognized financial instruments is estimated based on the fee income associated with the commitments which, in the absence of credit exposure, is considered to approximate their settlement value. The fair value of commitment fees was not material as of December 31, 2019 and 2018.

Note 10: Benefit Plans

In 2003, we established a Deferred Compensation Plan that allows certain key Management personnel designated by the Board of Directors of the Bank to defer up to 80% of their salary and 100% of their annual bonus. The plan was amended in 2007 in order to comply with changes to Internal Revenue Code Section 409A. Under the amended plan, amounts deferred earn interest that is equal to the prime rate as published in the Wall Street Journal, on the first business day of the year, which was 5.50% on January 1, 2019 and 4.50% on January 1, 2018. Our deferred compensation obligation totaled $4.4 million and $3.8 million at December 31, 2019 and 2018, respectively, and is included in interest payable and other liabilities.

Our 401(k) Defined Contribution Plan (the “401(k) Plan”) commenced in May 1990 and is available to all regular employees at least eighteen years of age who complete ninety days of service, and enter the plan during one of the four open enrollment dates (January 1, April 1, July 1, and October 1) of each year. Under the 401(k) Plan, employees can defer between 1% and 50% of their eligible compensation, up to the maximum amount allowed by the Internal Revenue Code. Contributions to the 401(k) Plan for the employer match vest at a rate of 20% per year over five years, per plan provisions. Starting 2017, the Bank increased the employer match to 70% of each participant's contribution, with a maximum of $5 thousand of matching contribution per participant per year. Employer contributions totaled $874 thousand and $851 thousand for the years ended December 31, 2019 and 2018, respectively.

In 1999, the 401(k) Plan was amended to include an employee stock ownership component and was renamed the Bank of Marin Employee Stock Ownership and Savings Plan (the “Plan”). Under the terms of the Plan, as amended, the Board of Directors determines a specific portion of the Bank's profits to be contributed to the employee stock ownership each year either in common stock or in cash for the purchase of Bancorp stock to be allocated to all eligible employees based on a percentage of their salaries, regardless of whether an employee is participating in the 401(k) plan or not. In January 2010, the Bank of Marin Employee Stock Ownership and Savings Plan was split into two plans: Bank of Marin 401(k) Plan and Bank of Marin Employee Stock Ownership Plan ("ESOP"). The same eligibility criteria apply under the ESOP, while employees' contributions are not permitted. For all participants, employer contributions vest over a five year service period, per plan provisions. After five years of service, all employer contributions vest immediately. The Bank of Marin 401(k) Plan was amended in early 2016 to incorporate recent changes in the pension laws, and was amended again in November 2016 to include a Roth 401(k) option.

Starting 2017, Bancorp issued shares of common stock and contributed them to the ESOP and recognized $1.2 million in expense in both 2019 and 2018, based on the quoted market price on the date of contribution. Cash dividends paid on Bancorp stock held by the ESOP are used to purchase additional shares in the open market. All shares of Bancorp stock held by the ESOP are included in the calculations of basic and diluted earnings per share. The employer contributions to the ESOP and the 401(k) Plan are included in salaries and benefits expense.

On January 1, 2011, we established a Salary Continuation Plan for a select group of Executive Management, who, upon retirement, will receive twenty-five percent of their estimated salary at retirement as salary continuation benefit payments that are fixed and will be made between seven to fifteen years, depending on the executives' service period at the Bank. Each participant will need to participate in this plan for five years before vesting begins. After five years, the participant will vest ratably in the benefit over the remaining period until age 65. This Plan is unfunded and nonqualified for tax purposes and for purposes of Title I of the Employee Retirement Income Security Act of 1974. As part of the acquisition of Bank of Napa in November 2017, we assumed the salary continuation agreements for four former executive officers of Bank of Napa, under which, fixed annual retirement benefit payments will be made for ten years beginning the first day of the month following the executive reaching the age of 65. At December 31, 2019 and 2018, respectively, our liability under the Salary Continuation Plan was $3.0 million and $2.7 million recorded in interest payable and other liabilities.

Note 11: Income Taxes

The current and deferred components of the income tax provision for each of the two years ended December 31 are as follows:

(in thousands)	2019	2018
Current tax provision		
Federal	$ 7,838	$ 7,289
State	5,183	4,722
Total current	13,021	12,011
Deferred tax benefit		
Federal	(907)	(898)
State	(461)	(318)
Total deferred	(1,368)	(1,216)
Total income tax provision	$ 11,653	$ 10,795

The following table shows the tax effect of our cumulative temporary differences as of December 31:

(in thousands)	2019	2018
Deferred tax assets:		
Allowance for loan losses and off-balance sheet credit commitments	$ 5,252	$ 4,960
Operating and finance lease liabilities	3,792	—
Deferred compensation plan and salary continuation plan	2,188	1,940
Net operating loss carryforwards	1,914	2,271
Net unrealized losses on securities available-for-sale	—	1,800
Accrued but unpaid expenses	1,067	1,153
State franchise tax	1,015	993
Stock-based compensation	623	517
Depreciation and disposals on premises and equipment	562	584
Fair value adjustment on acquired loans	299	364
Deferred rent and lease incentives	—	224
Interest received on non-accrual loans	12	114
Other	154	215
Total gross deferred tax assets	**16,878**	**15,135**
Deferred tax liabilities:		
Operating and finance lease right-of-use assets	(3,314)	—
Net unrealized gains on securities available-for-sale	(1,738)	—
Deferred loan origination costs and fees	(1,619)	(2,360)
Core deposit intangible assets	(1,385)	(1,647)
Unaccreted discount on subordinated debentures	(418)	(439)
Accretion on investment securities	(70)	(67)
Other	(172)	(204)
Total gross deferred tax liabilities	**(8,716)**	**(4,717)**
Net deferred tax assets	**$ 8,162**	**$ 10,418**

As of December 31, 2019, federal and California net operating loss carryforwards ("NOLs") of $2.7 million and $15.7 million, respectively, corresponded to the total $1.9 million deferred tax asset above. If not fully utilized, the federal NOLs will begin to expire in 2031, and the California NOLs will begin to expire in 2028. Based upon the level of historical taxable income and projections for future taxable income over the periods during which the deferred tax assets are expected to be deductible, Management believes it is more likely than not we will realize the benefit of the remaining deferred tax assets. Accordingly, no valuation allowance has been established as of December 31, 2019 or 2018.

The effective tax rate for 2019 and 2018 differs from the current federal statutory income tax rate as follows:

	2019	2018
Federal statutory income tax rate	21.0 %	21.0 %
Increase (decrease) due to:		
California franchise tax, net of federal tax benefit	8.2 %	8.0 %
Tax exempt interest on municipal securities and loans	(1.8)%	(2.4)%
Tax exempt earnings on bank owned life insurance	(0.6)%	(0.4)%
Low income housing and qualified zone academy bond tax credits	(0.4)%	(0.5)%
Stock-based compensation and excess tax benefits	(0.1)%	(0.6)%
Other	(0.9)%	(0.2)%
Effective Tax Rate	25.4 %	24.9 %

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

We file a consolidated return in the U.S. federal tax jurisdiction and a combined return in the State of California tax jurisdiction. There were no ongoing federal or state income tax examinations at the issuance of this report. We are no longer subject to examinations by tax authorities for years before 2016 for federal income tax and before 2015 for California. At December 31, 2019 and 2018, there were no unrecognized tax benefits, and neither the Bank nor Bancorp had accruals for interest and penalties related to unrecognized tax benefits.

Note 12: Commitments and Contingencies

Leases

We lease premises under long-term non-cancelable operating leases with remaining terms of 5 months to 12 years, most of which include escalation clauses and one or more options to extend the lease term, and some of which contain lease termination clauses. Lease terms may include certain renewal options that were considered reasonably certain to be exercised.

We lease certain equipment under finance leases with initial terms of 3 years to 5 years. The equipment finance leases do not contain renewal options, bargain purchase options or residual value guarantees.

The following table shows the balances of operating and finance lease right-of-use assets and lease liabilities as of December 31, 2019.

(in thousands)		December 31, 2019
Operating leases:		
Operating lease right-of-use assets	$	11,002
Operating lease liabilities	$	12,615
Finance leases:		
Finance lease right-of-use assets	$	379
Accumulated amortization		(170)
Finance lease right-of-use assets, net[1]	$	209
Finance lease liabilities[2]	$	212

[1] Included in premises and equipment in the consolidated statements of condition.

[2] Included in borrowings and other obligations in the consolidated statements of condition.

The following table shows supplemental disclosures of noncash investing and financing activities for the year ended December 31, 2019.

(in thousands)		2019
Right-of-use assets obtained in exchange for operating lease liabilities	$	1,661
Right-of-use assets obtained in exchange for finance lease liabilities	$	31
Reclassification of deferred rent and unamortized lease incentives from other liabilities to operating lease right-of-use assets upon adoption of ASC 842	$	1,967

There were no lease-related noncash investing and financing activities for the year ended December 31, 2018.

The following table shows components of operating and finance lease cost for the year ended December 31, 2019.

(in thousands)		2019
Operating lease cost[1]	$	4,144
Finance lease cost:		
Amortization of right-of-use assets[2]	$	172
Interest on finance lease liabilities[3]		8
Total finance lease cost	$	180
Total lease cost	$	4,324

[1] Included in occupancy and equipment expense in the consolidated statements of comprehensive income.

[2] Included in depreciation and amortization in the consolidated statements of comprehensive income.

[3] Included in interest on borrowings and other obligations in the consolidated statements of comprehensive income.

Operating lease rent expense totaled $4.6 million for the year ended December 31, 2018.

The following table shows the future minimum lease payments, weighted average remaining lease terms, and weighted average discount rates under operating and finance lease arrangements as of December 31, 2019. Total minimum lease payments do not include obligations of approximately $13.6 million for operating lease modifications related to our existing headquarter offices and an operating lease agreement for a retail branch location that commenced subsequent to December 31, 2019. The discount rates used to calculate the present value of lease liabilities were based on the collateralized FHLB borrowing rates that were commensurate with lease terms and minimum payments on the later of the date we adopted the new lease accounting standards or lease commencement date.

(in thousands)	December 31, 2019	
Year	Operating Leases	Finance Leases
2020	$ 4,469	$ 171
2021	2,806	36
2022	1,952	8
2023	1,464	1
2024	792	—
Thereafter	2,092	—
Total minimum lease payments	13,575	216
Amounts representing interest (present value discount)	(960)	(4)
Present value of net minimum lease payments (lease liability)	$ 12,615	$ 212
Weighted average remaining term (in years)	5.0	1.4
Weighted average discount rate	2.79%	2.87%

Litigation Matters

Bancorp may be party to legal actions that arise from time to time in the normal course of business. Bancorp's Management is not aware of any pending legal proceedings to which either it or the Bank may be a party or has recently been a party that will have a material adverse effect on the financial condition or results of operations of Bancorp or the Bank.

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

In 2012, Visa had reached a $4.0 billion interchange multidistrict litigation class settlement agreement with plaintiffs representing a class of U.S. retailers. On September 17, 2018, Visa signed an amended settlement agreement with the putative class action plaintiffs of the U.S. interchange multidistrict litigation that superseded the 2012 settlement agreement. Visa's share of the settlement amount under the amended class settlement agreement increased to $4.1 billion. On September 27, 2019, Visa deposited an additional $300 million into the litigation escrow account. Certain merchants chose to opt out of the class settlement agreement and on December 13, 2019, the court entered the final judgment order approving the amended settlement agreement. On December 27, 2019, Visa received a takedown payment of approximately $467 million, which was deposited into the litigation escrow account with a corresponding increase in accrued litigation to address opt-out claims. The escrow balance of $1.6 billion as of December 31, 2019, combined with funds previously deposited with the court, are expected to cover the settlement payment obligations.

The outcome of the Covered Litigation affects the conversion rate of Visa Class B common stock held by us to Visa Class A common stock, as discussed above and in Note 2, *Investment Securities*. The final conversion rate might change depending on the final settlement payments, and the full effect on member banks is still uncertain. Litigation is ongoing and until the court approval process is complete, there is no assurance that Visa will resolve the claims as contemplated by the amended class settlement agreement, and additional lawsuits may arise from individual merchants who opted out of the class settlement. However, until the escrow account is fully depleted and the conversion rate of Class B to Class A common stock is reduced to zero, no future cash settlement payments are required by the member banks, such as us, on the Covered Litigation. Therefore, we are not required to record any contingent liabilities for the indemnification related to the Covered Litigation, as we consider the probability of losses to be remote. For further information, including a discussion of a reduction to our holdings of Class B Visa shares, refer to Note 2, *Investment Securities.*

Note 13: Concentrations of Credit Risk

Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing us to greater risks resulting from adverse economic, political, regulatory, geographic, industrial or credit developments. Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents, investment securities and loans.

Our cash in correspondent bank accounts, at times, may exceed FDIC insured limits. We place cash and cash equivalents with the Federal Reserve Bank and other high credit quality financial institutions, periodically monitor their credit worthiness and limit the amount of credit exposure to any one institution according to regulations. Concentrations of credit risk with respect to investment securities primarily related to the U.S. Government and GSEs, which accounted for $497.4 million, or 87% of our total investment portfolio at December 31, 2019 and $528.3 million, or 85% at December 31, 2018. Our largest investment security issued by a non-GSE issuer accounted for approximately 1% of our total investment portfolio at December 31, 2019.

We also manage our credit exposure related to our loan portfolio to avoid the risk of undue concentration of credits in a particular industry by reducing significant exposure to highly leveraged transactions or to any individual customer or counterparty, and by obtaining collateral as appropriate. No individual borrower accounts for more than 3% of loans held in the portfolio. The largest loan concentration group by industry of the borrowers is real estate, which accounts for 83% of our loan portfolio at both December 31, 2019 and 2018.

Note 14: Derivative Financial Instruments and Hedging Activities

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

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

As of December 31, 2019, we had five interest rate swap agreements, which are scheduled to mature in June 2031, October 2031, July 2032, August 2037 and October 2037. All of our derivatives are accounted for as fair value hedges. The notional amounts of the interest rate contracts are equal to the notional amounts of the hedged loans. Our interest rate swap payments are settled monthly with counterparties. Accrued interest on the swaps totaled $6 thousand and $3 thousand as of December 31, 2019 and 2018, respectively. Information on our derivatives follows:

	Asset derivatives		Liability derivatives	
(in thousands)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Fair value hedges:				
Interest rate contracts notional amount	$ —	$ 8,895	$ 16,956	$ 9,016
Interest rate contracts fair value [1]	$ —	$ 161	$ 1,178	$ 375

[1] See Note 9, Fair Value of Assets and Liabilities for valuation methodology.

The following table presents the carrying amount associated cumulative basis adjustment related to the application of fair value hedge accounting that is included in the carrying amount of hedged assets as of December 31, 2019 and 2018:

	Carrying Amounts of Hedged Assets		Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Loans	
(in thousands)	December 31, 2019	December 31, 2018	December 31, 2019	December 31, 2018
Loans	$ 17,900	$ 17,917	$ 944	$ 6

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

	Years ended December 31,	
(in thousands)	2019	2018
Interest and fees on loans [1]	$ 84,331	$ 79,527
(Decrease) increase in value of designated interest rate swaps due to LIBOR interest rate movements	$ (964)	$ 452
Payment on interest rate swaps	(90)	(149)
Increase (decrease) in value of hedged loans	938	(425)
Decrease in value of yield maintenance agreement	(13)	(14)
Net losses on fair value hedging derivatives recognized in interest income [2]	$ (129)	$ (136)

[1] Represents the income line item in the statements of comprehensive income in which the effects of fair value hedges are recorded.

[2] Includes hedge ineffectiveness loss of $39 thousand and gain of $13 thousand for the years ended December 31, 2019, and 2018, respectively. Changes in value of swaps were included in the assessment of hedge effectiveness. Hedge ineffectiveness is the measure of the extent to which the change in the fair value of the hedging instruments does not exactly offset the change in the fair value of the hedged items from period to period.

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

Information on financial instruments that are eligible for offset in the consolidated statements of condition follows:

Offsetting of Financial Assets and Derivative Assets

				Gross Amounts Not Offset in the Statements of Condition		
(in thousands)	Gross Amounts of Recognized Assets[1]	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition[1]	Financial Instruments	Cash Collateral Received	Net Amount
December 31, 2019						
Derivatives by Counterparty:						
Counterparty A	$ —	$ —	$ —	$ —	$ —	$ —
Total	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**	**$ —**
December 31, 2018						
Derivatives by Counterparty:						
Counterparty A	$ 161	$ —	$ 161	$ (161)	$ —	$ —
Total	**$ 161**	**$ —**	**$ 161**	**$ (161)**	**$ —**	**$ —**

[1] Amounts exclude accrued interest totaling less than $1 thousand at December 31, 2018.

Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)	Gross Amounts of Recognized Liabilities[2]	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition[2]	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Cash Collateral Pledged	Net Amount
December 31, 2019						
Derivatives by Counterparty:						
Counterparty A	$ 1,178	$ —	$ 1,178	$ —	(1,178)	$ —
Total	**$ 1,178**	**$ —**	**$ 1,178**	**$ —**	**$ (1,178)**	**$ —**
December 31, 2018						
Derivatives by Counterparty:						
Counterparty A	$ 375	$ —	$ 375	$ (161)	—	$ 214
Total	**$ 375**	**$ —**	**$ 375**	**$ (161)**	**$ —**	**$ 214**

[2] Amounts exclude accrued interest totaling $6 thousand and $3 thousand at December 31, 2019 and 2018, respectively.

Note 15: Regulatory Matters

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

Management reviews capital ratios on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet our anticipated future needs. For all periods presented, the Bank's ratios exceed the regulatory definition of “well capitalized” under the regulatory framework for prompt corrective action and Bancorp's ratios exceed the required minimum ratios to be considered a well capitalized bank holding company. In addition, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action as of December 31, 2019. There are no conditions or events since that notification that Management believes have changed the Bank's categories and we expect the Bank to remain well capitalized for prompt corrective action purposes.

In July 2013, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency ("Agencies") finalized regulatory capital rules known as “Basel III.” Fully phased in on January 1, 2019, Basel III required the Bank to maintain (i) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 8.5%, and (ii) a minimum ratio of common equity Tier 1 capital to risk-weighted assets of at least 7.0%, both inclusive of a 2.50% “capital conservation buffer." The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased in over a four-year period (increasing by 0.625% each subsequent January 1, until it reached 2.50% on January 1, 2019). In August 2018, the Board of Governors of the Federal Reserve System changed the definition of a "Small Bank Holding Company" by increasing the asset threshold from $1.0 billion to $3.0 billion. As a result, Bancorp is no longer subject to separate minimum capital requirements. However, we disclose comparative capital ratios for Bancorp, which would have exceeded well-capitalized levels had Bancorp been subject to the same minimum capital requirements.

The Bancorp's and Bank's capital adequacy ratios as of December 31, 2019 and 2018 are presented in the following tables. Bancorp's Tier 1 capital includes the subordinated debentures, which are not included at the Bank level.

Capital Ratios for Bancorp (dollars in thousands)	Actual Ratio		Adequately Capitalized Threshold [1]		Ratio to be a Well Capitalized Bank Holding Company	
December 31, 2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk-weighted assets)	$ 319,317	15.07%	≥ $ 222,430	≥ 10.500%	≥ $ 211,838	≥ 10.000%
Tier 1 Capital (to risk-weighted assets)	$ 301,553	14.24%	≥ $ 180,063	≥ 8.500%	≥ $ 169,471	≥ 8.000%
Tier 1 Capital (to average assets)	$ 301,553	11.66%	≥ $ 103,489	≥ 4.000%	≥ $ 129,361	≥ 5.000%
Common Equity Tier 1 (to risk-weighted assets)	$ 298,845	14.11%	≥ $ 148,287	≥ 7.000%	≥ $ 137,695	≥ 6.500%
December 31, 2018						
Total Capital (to risk-weighted assets)	$ 305,224	14.93%	≥ $ 201,943	≥ 9.875%	≥ $ 204,499	≥ 10.000%
Tier 1 Capital (to risk-weighted assets)	$ 288,445	14.10%	≥ $ 161,043	≥ 7.875%	≥ $ 163,599	≥ 8.000%
Tier 1 Capital (to average assets)	$ 288,445	11.54%	≥ $ 100,011	≥ 4.000%	≥ $ 125,013	≥ 5.000%
Common Equity Tier 1 (to risk-weighted assets)	$ 285,805	13.98%	≥ $ 130,368	≥ 6.375%	≥ $ 132,925	≥ 6.500%

[1] The adequately capitalized threshold includes the capital conservation buffer that was effective in 2018 and fully phased-in on January 1, 2019.

Capital Ratios for the Bank (dollars in thousands)	Actual Ratio		Adequately Capitalized Threshold [1]		Ratio to be Well Capitalized under Prompt Corrective Action Provisions	
December 31, 2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to risk-weighted assets)	$ 309,875	14.63%	≥ $ 222,437	≥ 10.500%	≥ $ 211,844	≥ 10.000%
Tier 1 Capital (to risk-weighted assets)	$ 292,111	13.79%	≥ $ 180,068	≥ 8.500%	≥ $ 169,476	≥ 8.000%
Tier 1 Capital (to average assets)	$ 292,111	11.29%	≥ $ 103,488	≥ 4.000%	≥ $ 129,360	≥ 5.000%
Common Equity Tier 1 (to risk-weighted assets)	$ 292,111	13.79%	≥ $ 148,291	≥ 7.000%	≥ $ 137,699	≥ 6.500%
December 31, 2018						
Total Capital (to risk-weighted assets)	$ 285,969	13.98%	≥ $ 201,927	≥ 9.875%	≥ $ 204,483	≥ 10.000%
Tier 1 Capital (to risk-weighted assets)	$ 269,191	13.16%	≥ $ 161,031	≥ 7.875%	≥ $ 163,587	≥ 8.000%
Tier 1 Capital (to average assets)	$ 269,191	10.77%	≥ $ 99,994	≥ 4.000%	≥ $ 124,992	≥ 5.000%
Common Equity Tier 1 (to risk-weighted assets)	$ 269,191	13.16%	≥ $ 130,358	≥ 6.375%	≥ $ 132,914	≥ 6.500%

[1] The adequately capitalized threshold includes the capital conservation buffer that was effective in 2018 and fully phased-in on January 1, 2019.

Note 16: Financial Instruments with Off-Balance Sheet Risk

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

Our credit loss exposure is equal to the contractual amount of the commitment in the event of nonperformance by the borrower. We use the same credit underwriting criteria for all credit exposure. The amount of collateral obtained, if deemed necessary by us, is based on Management's credit evaluation of the borrower. Collateral types pledged may include accounts receivable, inventory, other personal property and real property.

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

(in thousands)	December 31, 2019	December 31, 2018
Commercial lines of credit	$ 287,533	$ 238,361
Revolving home equity lines	189,035	189,971
Undisbursed construction loans	41,033	46,229
Personal and other lines of credit	9,567	14,109
Standby letters of credit	1,964	2,636
Total commitments and standby letters of credit	$ 529,132	$ 491,306

We record an allowance for losses on these off-balance sheet commitments based on an estimate of probabilities of the utilization of these commitments according to our historical experience on different types of commitments and expected loss. The allowance for losses on off-balance sheet commitments totaled $1.1 million as of December 31, 2019 and $958 thousand as of December 31, 2018, which is recorded in interest payable and other liabilities in the consolidated statements of condition. Approximately 33% of the commitments expire in 2020, approximately 55% expire between 2021 and 2027 and approximately 12% expire thereafter.

Note 17: Condensed Bank of Marin Bancorp Parent Only Financial Statements

Presented below is financial information for Bank of Marin Bancorp, parent holding company only.

CONDENSED UNCONSOLIDATED STATEMENTS OF CONDITION
December 31, 2019 and 2018

(in thousands)	2019	2018
Assets		
Cash and due from Bank of Marin	$ 9,539	$ 19,144
Investment in bank subsidiary	330,053	299,953
Other assets	332	331
Total assets	$ 339,924	$ 319,428
Liabilities and Stockholders' Equity		
Subordinated debentures	$ 2,708	$ 2,640
Accrued expenses payable	71	51
Other liabilities	357	330
Total liabilities	3,136	3,021
Stockholders' equity	336,788	316,407
Total liabilities and stockholders' equity	$ 339,924	$ 319,428

CONDENSED UNCONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2019 and 2018

(in thousands)		2019		2018
Income				
Dividends from bank subsidiary	$	17,600	$	36,700
Miscellaneous Income		5		9
Total income		17,605		36,709
Expense				
Interest expense		229		1,339
Non-interest expense		1,399		1,275
Total expense		1,628		2,614
Income before income taxes and equity in undistributed net income of subsidiary		15,977		34,095
Income tax benefit		480		770
Income before equity in undistributed net income of subsidiary		16,457		34,865
Earnings of bank subsidiary greater (less) than dividends received from bank subsidiary		17,784		(2,243)
Net income	$	34,241	$	32,622

CONDENSED UNCONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2019 and 2018

(in thousands)		2019		2018
Cash Flows from Operating Activities:				
Net income	$	34,241	$	32,622
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Earnings of bank subsidiary (greater) less than dividends received from bank subsidiary		(17,784)		2,243
Net change in operating assets and liabilities:				
Accretion of discount on subordinated debentures		68		1,025
Other assets		—		36
Other liabilities		80		(86)
Noncash director compensation expense - common stock		30		23
Net cash provided by operating activities		16,635		35,863
Cash Flows from Investing Activities:				
Capital contribution to subsidiary		(747)		(667)
Net cash used in investing activities		(747)		(667)
Cash Flows from Financing Activities:				
Proceeds from stock options exercised and stock issued under employee and director stock purchase plans and ESPP		747		667
Repayment of subordinate debenture including execution costs		—		(4,137)
Payment of tax withholdings for stock options exercised		(220)		(99)
Dividends paid on common stock		(10,958)		(8,860)
Stock repurchased, net of commissions		(15,062)		(6,869)
Net cash used by financing activities		(25,493)		(19,298)
Net increase (decrease) in cash and cash equivalents		(9,605)		15,898
Cash and cash equivalents at beginning of period		19,144		3,246
Cash and cash equivalents at end of period	$	9,539	$	19,144
Supplemental schedule of non-cash investing and financing activities:				
Stock issued in payment of director fees	$	231	$	204
Repurchase of stock not yet settled	$	103	$	143
Stock issued to ESOP	$	1,245	$	1,173

End of 2019 Audited Consolidated Financial Statements

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(A) Evaluation of Disclosure Controls and Procedures

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

(B) Management's Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting (as defined in Rules 13a-15(f) promulgated under the 1934 Act). The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. Management conducted an assessment of the effectiveness of internal control over financial reporting as of December 31, 2019, utilizing the framework established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, Management has concluded that the Company maintained effective internal control over financial reporting as of December 31, 2019.

There are inherent limitations to the effectiveness of any system of internal control over financial reporting. These limitations include the possibility of human error, the circumvention or overriding of the system and reasonable resource constraints. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's report on internal control over financial reporting is set forth in ITEM 8 and is incorporated herein by reference.

(C) Audit Report of the Registered Public Accounting Firm

The Company's independent registered public accounting firm, Moss Adams, LLP, has audited the effectiveness of internal control over financial reporting as of December 31, 2019 as stated in their audit report, which is included in ITEM 8 and incorporated herein by reference.

(D) Changes in Internal Control Over Financial Reporting

During the quarter ended December 31, 2019, there were no significant changes that materially affected, or are reasonably likely to affect, our internal control over financial reporting identified in connection with the evaluation mentioned in (B) above.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference from our Proxy Statement for the 2019 Annual Meeting of Shareholders. Bancorp and the Bank have adopted a Code of Ethics that applies to all staff including the Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer. A copy of the Code of Ethical Conduct, which is also included on our website, will be provided to any person, without charge, upon written request to Corporate Secretary, Bank of Marin Bancorp, 504 Redwood Boulevard, Suite 100, Novato, CA 94947. During 2019 there were no changes in the procedures for the election or nomination of directors.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference from our Proxy Statement for the 2019 Annual Meeting of Shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference from ITEM 5 above, Note 8 to our audited consolidated financial statements and our Proxy Statement for the 2019 Annual Meeting of Shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference from our Proxy Statement for the 2019 Annual Meeting of Shareholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from our Proxy Statement for the 2019 Annual Meeting of Shareholders.

PART IV

ITEM 15. Exhibits, Financial Statement Schedules

(A) Documents Filed as Part of this Report:

1. Financial Statements

The financial statements and supplementary data listed below are filed as part of this report under ITEM 8, captioned *Financial Statements and Supplementary Data*.

Report of Independent Registered Public Accounting Firm for the years ended December 31, 2019 and 2018

Management's Report on Internal Control over Financial Reporting

Consolidated Statements of Condition as of December 31, 2019 and 2018

Consolidated Statements of Comprehensive Income for the years ended December 31, 2019 and 2018

Consolidated Statement of Changes in Stockholders' Equity for the years ended December 31, 2019 and 2018

Consolidated Statement of Cash Flows for the years ended December 31, 2019 and 2018

Notes to Consolidated Financial Statements

2. Financial Statement Schedules

All financial statement schedules have been omitted, as they are inapplicable or the required information is included in the financial statements or notes thereto.

(B) Exhibits Filed:

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

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Herewith
2.01	Agreement to Merger and Plan of Reorganization with Bank of Napa, dated July 31, 2017	8-K	001-33572	2.1	August 2, 2017	
3.01	Articles of Incorporation, as amended	10-Q	001-33572	3.01	November 7, 2007	
3.02	Bylaws	10-Q	001-33572	3.02	May 9, 2011	
3.02a	Bylaws Amendment	8-K	001-33572	3.03	July 6, 2015	
4.01	Rights Agreement, dated July 6, 2017	8-A12B	001-33572	4.1	July 7, 2017	
4.02	Description of Capital Stock					Filed
10.01	Employee Stock Ownership Plan	S-8	333-218274	4.1	May 26, 2017	
10.02	2017 Employee Stock Purchase Plan	S-8	333-221219	4.1	October 30, 2017	
10.03	2017 Equity Plan, as amended	S-8	333-227840	4.1	October 15, 2018	
10.04	2010 Director Stock Plan	S-8	333-167639	4.1	June 21, 2010	
10.05	Form of Indemnification Agreement for Directors and Executive Officers, dated August 9, 2007	10-Q	001-33572	10.06	November 7, 2007	
10.06	Form of Employment Agreement, dated January 23, 2009	8-K	001-33572	10.1	January 26, 2009	
10.07	2010 Annual Individual Incentive Compensation Plan	8-K	001-33572	99.1	October 21, 2010	
10.08	Salary Continuation Agreement for executive officer Russell Colombo, Chief Executive Officer, dated January 1, 2011	8-K	001-33572	10.1	January 6, 2011	
10.09	Salary Continuation Agreement for executive officer Peter Pelham, Director of Retail Banking, dated January 1, 2011	8-K	001-33572	10.4	January 6, 2011	
10.10	Salary Continuation Agreement for executive officer Tani Girton, Chief Financial Officer, dated October 18, 2013	8-K	001-33572	10.2	November 4, 2014	
10.11	Salary Continuation Agreement for executive officer Elizabeth Reizman, Chief Credit Officer, dated July 20, 2014	8-K	001-33572	10.3	November 4, 2014	
10.12	Salary Continuation Agreement for executive officer Timothy Myers, Executive Vice President and Commercial Banking Manager, dated May 28, 2015	8-K	001-33572	10.4	June 2, 2015	
10.13	2007 Form of Change in Control Agreement	8-K	001-33572	10.1	October 31, 2007	
14.02	Code of Ethical Conduct, dated December 13, 2018	10-K	001-33572	14.02	March 14, 2019	
23.01	Consent of Moss Adams LLP					Filed
31.01	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					Filed
31.02	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					Filed
32.01	Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002					Filed
101.INS	Inline XBRL Instance Document					Filed
101.SCH	Inline XBRL Taxonomy Extension Schema Document					Filed
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document					Filed
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document					Filed
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document					Filed
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document					Filed

ITEM 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Bank of Marin Bancorp (registrant)
March 13, 2020	*/s/ Tani Girton*
Date	Tani Girton Executive Vice President & Chief Financial Officer (Principal Financial Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Dated: March 13, 2020	*/s/ Russell A. Colombo* Russell A. Colombo President & Chief Executive Officer, Director (Principal Executive Officer)
Dated: March 13, 2020	*/s/ Tani Girton* *Tani Girton* Executive Vice President & Chief Financial Officer (Principal Financial Officer)
Dated: March 13, 2020	*/s/ David A. Merck* *David A. Merck* Vice President & Financial Reporting Manager (Principal Accounting Officer)
	Members of Bank of Marin Bancorp's Board of Directors
Dated: March 13, 2020	*/s/ Brian M. Sobel* *Brian M. Sobel* Chairman of the Board
Dated: March 13, 2020	*/s/ Steven I. Barlow* Steven I. Barlow
Dated: March 13, 2020	*/s/ James C. Hale* *James C. Hale*
Dated: March 13, 2020	*/s/ Robert Heller* *Robert Heller*
Dated: March 13, 2020	*/s/ Norma J. Howard* *Norma J. Howard*
Dated: March 13, 2020	*/s/ Kevin R. Kennedy* *Kevin R. Kennedy*
Dated: March 13, 2020	*/s/ William H. McDevitt, Jr.* *William H. McDevitt, Jr.*
Dated: March 13, 2020	*/s/ Leslie E. Murphy* *Leslie E. Murphy*
Dated: March 13, 2020	*/s/ Joel Sklar* *Joel Sklar, M.D.*

Exhibit 4.02

DESCRIPTION OF MARIN CAPITAL STOCK

The following summary of the current terms of the capital stock of Bank of Marin Bancorp ("Marin") is not meant to be complete and is qualified in its entirety by reference to the California General Corporation Law, federal law, the Marin articles of incorporation, and the Marin bylaws, copies of which have been filed with the Securities Exchange Commission ("Commission") and are also available upon request from Marin.

Common Stock

The Marin articles of incorporation authorize 15,000,000 shares of common stock, no par value. Holders of Marin common stock are entitled to one vote, in person or by proxy, for each share of Marin common stock held of record in the shareholder's name on the books of Marin as of the record date on any matter submitted to the vote of the shareholders except that, for the election of directors, each shareholder has cumulative voting rights and is entitled to as many votes as shall equal the number of shares held by such shareholder multiplied by the number of directors to be elected. Each shareholder may cast all his or her votes for a single candidate or distribute such votes among any or all of the candidates as he or she chooses. However, no shareholder shall be entitled to cumulate votes (in other words, cast for any candidate a number of votes greater than the number of shares of stock held by such shareholder) unless such candidate's name has been placed in nomination prior to the voting and the shareholder has given notice at the meeting prior to the voting of the shareholder's intention to cumulate his or her votes. If any shareholder has given such notice, all shareholders may cumulate their votes for candidates in nomination.

Each share of Marin common stock has the same rights, privileges and preferences as every other share and will share equally in Marin's net assets upon liquidation or dissolution. Marin common stock has no preemptive, conversion or redemption rights or sinking fund provisions and all of the issued and outstanding shares of Marin common stock, when issued, will be fully paid and nonassessable.

Preferred Stock

The Marin articles of incorporation authorize 5,000,000 shares of preferred stock, no par value. The preferred stock may be issued from time to time in one or more series without action by the shareholders. The board of directors is authorized to designate and to fix the number of shares of any such series of preferred stock and to determine and alter the rights, preferences, privileges and restrictions granted to or imposed upon any wholly unissued series of preferred stock, including, but not limited to, dividend rate, voting, liquidation preference and conversion rights. The board of directors, within the limits stated in any resolution of the board of directors originally fixing the number of shares constituting any series, may increase or decrease the number of shares in such series (but not below the number of shares of any series subsequent to the issue of shares of that series). The preferred stock has no preemptive rights.

Dividends

Marin's shareholders are entitled to dividends when, as and if declared by Marin's board of directors out of funds legally available therefor (subject to certain restrictions on payment of dividends imposed by the laws of California).

Shareholder Rights Plan

On July 6, 2017, Marin's board of directors adopted a shareholder rights plan which provides one preferred share purchase right (a "Right") for each outstanding share of common stock, no par value of Marin, including shares of common stock that may be issued by Marin from time to time after such date as, for example, in a merger. The description and terms of the Rights are set forth in a Rights Agreement dated as of July 6, 2017 (the "Rights Agreement") between Marin and Computershare, as Rights Agent.

The Rights Agreement is designed to discourage takeovers that involve abusive tactics and or do not provide fair value to shareholders.

Pursuant to the Rights Agreement, upon the occurrence of certain "triggering events," each registered holder of Marin common stock is entitled to purchase from Marin one two-hundredth of a share of Series A Junior Participating Preferred Stock, no par value, of Marin at a price of $90.00 per one one-hundredth of a Preferred Share, subject to adjustment.

At any time before the occurrence of a "triggering event", the board of directors of Marin may redeem the Rights in whole, but not in part, at a price of $0.001 per Right.

A copy of the Rights Agreement has been filed with the Commission as an Exhibit to a Registration Statement on Form 8-A. This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement.

Anti-takeover Provisions

In addition to the shareholder rights plan described above, Marin's articles of incorporation and bylaws, or Marin's charter documents, contain certain provisions that deal with matters of corporate governance and certain rights of shareholders which might be deemed to have a potential "anti-takeover" effect. Such provisions will also render the removal of an incumbent board of directors or management more difficult.

The following description of certain of the provisions of Marin's charter documents is necessarily general, and reference should be made in each case to such documents, which are contained as exhibits to Marin's previous filings with the Commission or available upon request from Marin.

Directors. Certain provisions of Marin's charter documents will impede changes in majority control of the board of directors. Marin's charter documents provide that:

- shareholders must comply with certain prior notice provisions in connection with nominations of persons to become directors of Marin. Failure to comply with these provisions may result in the nominations being disregarded.

- the size of the board of directors may be increased or decreased within a specified range by a majority vote of the board;

- any vacancy occurring in the board of directors, including a vacancy created by an increase in the number of directors, shall be filled for the remainder of the unexpired term by a majority vote of the directors then in office; and

- a director, in general, may only be removed by the affirmative vote of a majority of the shares eligible to vote.

Authorized Shares. Marin's articles of incorporation authorize the issuance of 15,000,000 shares of common stock and 5,000,000 shares of preferred stock. The shares of common stock and preferred stock were authorized to provide Marin's board of directors with as much flexibility as possible to effect, among other transactions, financings, acquisitions, stock dividends, and the exercise of employee stock options. However, these authorized shares may also be used by the board of directors, to the extent consistent with its fiduciary duty, to deter future attempts to gain control of Marin. As a result of the ability to fix voting rights for a series of preferred stock and to issue additional shares of common stock, the board has the power to issue stock to persons friendly to management in order to attempt to block a tender offer, merger or other transaction by which a third party seeks control of Marin, and thereby allow members of management to retain their positions.

Purpose and Takeover Defensive Effects of Marin's Charter Documents and Shareholder Rights Plan. Marin's board believes that the provisions described above are prudent and will reduce Marin's vulnerability to takeover attempts and certain other transactions which have not been negotiated with and approved by its board of directors. The board of directors believes these provisions are in the best interest of Marin and its shareholders. In the judgment of the board of directors, Marin's board will be in the best position to determine the true value of Marin and to negotiate more effectively for terms that will be in the best interest of its shareholders. Accordingly, the board of directors believes that it is in the best interest of Marin and its shareholders to encourage a potential acquirer to negotiate directly with the board of directors, and that these provisions will encourage such negotiations and discourage hostile takeover attempts. It is also the view of the board of directors that these provisions should not discourage persons from proposing a merger or other transaction at a price reflective of the true value of Marin and otherwise in the best interest of all shareholders.

Despite the belief of Marin as to the benefits to shareholders of these provisions, these provisions may also have the effect of discouraging a future takeover attempt which would not be approved by Marin's board of directors, but pursuant to which shareholders may receive a substantial premium for their shares over then current market prices. As a result, shareholders who might desire to participate in such a transaction may not have any opportunity to do so.

Restrictions on Ownership

The Bank Holding Company Act generally prohibits any company that is not engaged in banking activities and activities that are permissible for a bank holding company or a financial holding company from acquiring control of a bank holding company, such as Marin. "Control" is generally defined as ownership of 25% or more of the voting stock or other exercise of a controlling influence. Any existing bank holding company would need the prior approval of the Federal Reserve before acquiring 5% or more of the voting stock of Marin. In addition, the Change in Bank Control Act of 1978, as amended, prohibits a person or group of persons from acquiring control of a bank holding company unless the Federal Reserve has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as Marin, could constitute acquisition of control of the bank holding company.

EXHIBIT 23.01

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statements No. 333-167639, No. 333-218274, No. 333-227840 and No. 333-221219 on Form S-8 of our report dated March 13, 2020, relating to the consolidated financial statements and the effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K, of Bank of Marin Bancorp for the year ended December 31, 2019.

/s/ Moss Adams LLP
Los Angeles, California
March 13, 2020

EXHIBIT 31.01

Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002

I, Russell A. Colombo, certify that:

1. I have reviewed this annual report on Form 10-K of Bank of Marin Bancorp (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a -15(f) and 15d-15(f)) for the Registrant and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
   (d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

March 13, 2020	/s/ Russell A. Colombo
Date	Russell A. Colombo Chief Executive Officer

EXHIBIT 31.02

Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002

I, Tani Girton, certify that:

1. I have reviewed this annual report on Form 10-K of Bank of Marin Bancorp (the Registrant);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;

4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:

   (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
   (d) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors (or persons performing the equivalent functions):

   (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting, which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
   (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

March 13, 2020	/s/ Tani Girton
Date	Tani Girton
	Chief Financial Officer

EXHIBIT 32.01

Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002

In connection with the annual report on Form 10-K of Bank of Marin Bancorp (the Registrant) for the year ended December 31, 2019, as filed with the Securities and Exchange Commission, the undersigned hereby certify pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1) such Form 10-K fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2) the information contained in such Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

March 13, 2020	/s/ Russell A. Colombo
Date	Russell A. Colombo President & Chief Executive Officer
March 13, 2020	/s/ Tani Girton
Date	Tani Girton Executive Vice President & Chief Financial Officer

This certification accompanies each report pursuant to §906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Registrant for purposes of §18 of the Securities Exchange Act of 1934, as amended.