AUBURN NATIONAL BANCORPORATION, INC
Form 10-Q
August 15, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended June 30, 2011

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the transition period to

Commission File Number: 0-26486

Auburn National Bancorporation, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**63-0885779**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

100 N. Gay Street

Auburn, Alabama 36830

(334) 821-9200

(Address and telephone number of principal executive offices)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Outstanding at July 31, 2011**
Common Stock, $0.01 par value per share	3,642,738 shares

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands, except share data)	**June 30, 2011**	**December 31, 2010**
Assets:		
Cash and due from banks	$ 15,654	$ 11,432
Federal funds sold	40,835	7,500
Interest bearing bank deposits	1,091	2,492
Cash and cash equivalents	57,580	21,424
Securities available-for-sale	296,443	315,220
Loans held for sale	2,278	4,281
Loans, net of unearned income	373,795	374,215
Allowance for loan losses	(7,746)	(7,676)
Loans, net	366,049	366,539
Premises and equipment, net	8,237	8,105
Bank-owned life insurance	16,385	16,171
Other real estate owned	9,361	8,125
Other assets	23,392	23,964
Total assets	$ 779,725	$ 763,829
Liabilities:		
Deposits:		
Noninterest-bearing	$ 96,888	$ 87,660
Interest-bearing	531,081	519,467
Total deposits	627,969	607,127
Federal funds purchased and securities sold under agreements to repurchase	2,314	2,685
Long-term debt	85,322	93,331
Accrued expenses and other liabilities	3,020	4,318
Total liabilities	718,625	707,461
Stockholders equity:		
Preferred stock of $.01 par value; authorized 200,000 shares; no issued shares		
Common stock of $.01 par value; authorized 8,500,000 shares; issued 3,957,135 shares	39	39
Additional paid-in capital	3,753	3,752
Retained earnings	62,970	61,421

Accumulated other comprehensive income (loss), net	981	(2,201)
Less treasury stock, at cost - 314,397 shares and 314,417 shares at June 30, 2011 and December 31, 2010, respectively	(6,643)	(6,643)
Total stockholders equity	61,100	56,368
Total liabilities and stockholders equity	$ 779,725	$ 763,829

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings

(Unaudited)

(Dollars in thousands, except share and per share data)	**Quarter ended June 30, 2011**	**Quarter ended June 30, 2010**	**Six months ended June 30, 2011**	**Six months ended June 30, 2010**
Interest income:				
Loans, including fees	$ 5,371	$ 5,492	$ 10,658	$ 10,925
Securities	2,613	2,959	5,151	6,178
Federal funds sold and interest bearing bank deposits	14	10	23	17
Total interest income	7,998	8,461	15,832	17,120
Interest expense:				
Deposits	2,092	2,615	4,262	5,255
Short-term borrowings	3	3	6	14
Long-term debt	846	1,155	1,693	2,332
Total interest expense	2,941	3,773	5,961	7,601
Net interest income	5,057	4,688	9,871	9,519
Provision for loan losses	600	750	1,200	2,200
Net interest income after provision for loan losses	4,457	3,938	8,671	7,319
Noninterest income:				
Service charges on deposit accounts	290	334	581	648
Mortgage lending	439	625	879	1,107
Bank-owned life insurance	107	106	214	232
Affordable housing investment losses	(230)	(57)	(230)	(114)
Other	355	353	708	734
Securities gains, net:				
Realized gains, net	445	1,431	450	2,531
Total other-than-temporary impairments	(51)	(20)	(312)	(260)
Non-credit portion of other-than-temporary impairments recognized in other comprehensive income		20	210	210
Total securities gains, net	394	1,431	348	2,481
Total noninterest income	1,355	2,792	2,500	5,088
Noninterest expense:				
Salaries and benefits	2,068	1,939	4,054	3,844
Net occupancy and equipment	328	364	674	748
Professional fees	189	191	360	367
FDIC and other regulatory assessments	199	286	481	562
Other real estate owned, net	718	911	701	972
Prepayment penalty on long-term debt		298		298
Other	861	820	1,743	1,654
Total noninterest expense	4,363	4,809	8,013	8,445

Earnings before income taxes	1,449	1,921	3,158	3,962
Income tax (benefit) expense	(8)	314	152	738
Net earnings	$ 1,457	$ 1,607	$ 3,006	$ 3,224
Net earnings per share:				
Basic and diluted	$ 0.40	$ 0.44	$ 0.83	$ 0.88
Weighted average shares outstanding:				
Basic and diluted	3,642,738	3,642,877	3,642,733	3,642,996

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders Equity and Comprehensive Income

(Unaudited)

(Dollars in thousands, except share data)	**Common Stock** Shares	Amount	**Additional paid-in capital**	**Retained earnings**	**Accumulated other comprehensive income (loss)**	**Treasury stock**	**Total**
Balance, December 31, 2009	3,957,135	$ 39	$ 3,751	$ 58,917	$ 111	$(6,635)	$ 56,183
Comprehensive income:							
Net earnings				3,224			3,224
Other comprehensive loss due to change in other-than-temporary impairment losses related to factors other than credit on available-for- sale, net					(133)		(133)
Other comprehensive income due to change in all other unrealized gains (losses) on securities available-for- sale, net					1,196		1,196
Total comprehensive income				3,224	1,063		4,287
Cash dividends paid ($0.39 per share)				(1,421)			(1,421)
Stock repurchases (484 shares)						(8)	(8)
Sale of treasury stock (60 shares)			1				1
Balance, June 30, 2010	3,957,135	$ 39	$ 3,752	$ 60,720	$ 1,174	$ (6,643)	$ 59,042
Balance, December 31, 2010	3,957,135	$ 39	$ 3,752	$ 61,421	$ (2,201)	$ (6,643)	$ 56,368
Comprehensive income:							
Net earnings				3,006			3,006
Other comprehensive loss due to change in other-than-temporary impairment losses related to factors other than credit on available-for- sale, net					(133)		(133)
Other comprehensive income due to change in all other unrealized gains (losses) on securities available-for- sale, net					3,315		3,315
Total comprehensive income				3,006	3,182		6,188
Cash dividends paid ($0.40 per share)				(1,457)			(1,457)
Sale of treasury stock (20 shares)			1				1
Balance, June 30, 2011	3,957,135	$ 39	$ 3,753	$ 62,970	$ 981	$ (6,643)	$ 61,100

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)	Six months ended June 30, 2011	2010
Cash flows from operating activities:		
Net earnings	$ 3,006	$ 3,224
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	1,200	2,200
Depreciation and amortization	309	273
Premium amortization and discount accretion, net	1,074	916
Net gain on securities	(348)	(2,481)
Net gain on sale of loans held for sale	(683)	(927)
Net loss on other real estate owned	741	857
Loss on prepayment of long-term debt		298
Loans originated for sale	(22,317)	(38,702)
Proceeds from sale of loans	24,851	40,130
Increase in cash surrender value of bank owned life insurance	(214)	(232)
Net increase in other assets	(1,706)	(1,087)
Net (decrease) increase in accrued expenses and other liabilities	(1,298)	355
Net cash provided by operating activities	4,615	4,824
Cash flows from investing activities:		
Proceeds from sales of securities available-for-sale	97,407	120,083
Proceeds from maturities of securities available-for-sale	44,834	71,029
Purchase of securities available-for-sale	(119,147)	(186,208)
Net increase in loans	(3,268)	(3,113)
Net purchases of premises and equipment	(295)	(75)
Decrease in FHLB stock	423	
Proceeds from sale of other real estate owned	581	571
Net cash provided by investing activities	20,535	2,287
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	9,228	10,012
Net increase in interest-bearing deposits	11,614	16,334
Net decrease in federal funds purchased and securities sold under agreements to repurchase	(371)	(13,809)
Repayments or retirement of long-term debt	(8,009)	(5,307)
Proceeds from sale of treasury stock	1	1
Stock repurchases		(8)
Dividends paid	(1,457)	(1,421)
Net cash provided by financing activities	11,006	5,802
Net change in cash and cash equivalents	36,156	12,913
Cash and cash equivalents at beginning of period	21,424	12,395

Cash and cash equivalents at end of period	$ 57,580	$ 25,308

Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 6,108	$ 7,770
Income taxes	332	843
Supplemental disclosure of non-cash transactions:		
Real estate acquired through foreclosure	2,558	477

See accompanying notes to condensed consolidated financial statements

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AUBURN NATIONAL BANCORPORATION, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Auburn National Bancorporation, Inc. (the Company) provides a full range of banking services to individual and corporate customers in Lee County, Alabama and surrounding counties through its wholly owned subsidiary, AuburnBank (the Bank). The Company does not have any segments other than banking that are considered material.

Basis of Presentation and Use of Estimates

The unaudited condensed consolidated financial statements in this report have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include, in the opinion of management, all adjustments necessary to present a fair statement of the financial position and the results of operations for all periods presented. All such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results of operations that the Company and its subsidiaries may achieve for future interim periods or the entire year. For further information, refer to the consolidated financial statements and footnotes included in the Company s annual report on Form 10-K for the year ended December 31, 2010.

Reclassifications

Certain amounts reported in prior periods have been reclassified to conform to the current-period presentation. These reclassifications had no effect on the Company s previously reported net earnings or total stockholders equity.

Subsequent Events

The Company has evaluated the effects of events or transactions through the date of this filing that have occurred subsequent to June 30, 2011. The Company does not believe there are any material subsequent events that would require further recognition or disclosure.

Accounting Developments

No new guidance was adopted by the Company during the second quarter of 2011. In the first quarter of 2011 the Company adopted new guidance related to the following Codification topic:

Accounting Standards Update (ASU) 2010-06, Improving Disclosures about Fair Value Measurements.
Information about this pronouncement is described in more detail below.

ASU 2010-06, *Improving Disclosures about Fair Value Measurements,* amends the disclosure requirements for fair value measurements. Companies are required to disclose significant transfers in and out of Levels 1 and 2 of the fair value hierarchy. The ASU also clarifies that fair value measurement disclosures should be presented for each asset and liability class, which is generally a subset of a line item in the statement of financial position. In the rollforward of Level 3 activity, companies must present information on purchases, sales, issuances, and settlements on a gross basis rather than on a net basis. Companies should also provide information about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring instruments classified as either Level 2 or Level 3. In the first quarter of 2011, the Company adopted the requirement for gross presentation in the Level 3 rollforward with prospective application. The remaining provisions were effective for the Company in the first quarter of 2010. Adoption of the ASU did not have a significant impact on the consolidated financial statements of the Company since it amends only the disclosure requirements for fair value measurements.

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NOTE 2: BASIC AND DILUTED EARNINGS PER SHARE

Basic net earnings per share is computed by dividing net earnings by the weighted average common shares outstanding for the quarter and six months ended June 30, 2011 and 2010, respectively. Diluted net earnings per share reflect the potential dilution that could occur if the Company s potential common stock was issued. At June 30, 2011 and 2010, respectively, the Company had no options issued or outstanding, and therefore, no dilutive effect to consider for the diluted earnings per share calculation.

A reconciliation of the numerator and denominator of the basic and diluted earnings per share computation for the quarter and six months ended June 30, 2011 and 2010 is presented below.

	Quarter ended June 30,		Six months ended June 30,	
(Dollars in thousands, except share and per share data)	**2011**	**2010**	**2011**	**2010**
Basic and diluted:				
Net earnings	$ 1,457	$ 1,607	$ 3,006	$ 3,224
Weighted average common shares outstanding	3,642,738	3,642,877	3,642,733	3,642,996
Earnings per share	$ 0.40	$ 0.44	$ 0.83	$ 0.88

NOTE 3: COMPREHENSIVE INCOME

Comprehensive income is defined as the change in equity from all transactions other than those with shareholders, and it includes net earnings and other comprehensive income (loss). Comprehensive income for the quarter and six months ended June 30, 2011 and 2010 is presented below.

	Quarter ended June 30,		Six months ended June 30,	
(In thousands)	**2011**	**2010**	**2011**	**2010**
Comprehensive income:				
Net earnings	$ 1,457	$ 1,607	$ 3,006	$ 3,224
Other comprehensive income (loss):				
Due to change in other-than-temporary impairment losses related to factors other than credit on securities available-for-sale, net of tax		(13)	(133)	(133)
Due to change in all other unrealized gains on securities available-for-sale, net of tax	2,571	387	3,315	1,196
Total comprehensive income	$ 4,028	$ 1,981	$ 6,188	$ 4,287

NOTE 4: VARIABLE INTEREST ENTITIES

The Company is involved in various entities that are considered to be variable interest entities (VIEs), as defined by authoritative accounting literature. Generally, a VIE is a corporation, partnership, trust or other legal structure that does not have equity investors with substantive or proportional voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities.

At June 30, 2011, the Company did not have any consolidated VIEs to disclose but did have certain nonconsolidated VIEs, discussed below.

Trust Preferred Securities

The Company owns the common stock of a subsidiary business trust, Auburn National Bancorporation Capital Trust I, which issued mandatorily redeemable preferred capital securities (trust preferred securities) in the aggregate of approximately $7.0 million at the time of issuance. This trust meets the definition of a VIE of which the Company is not the primary beneficiary; the trust s only assets are junior subordinated debentures issued by the Company, which were acquired by the trust using the proceeds from the issuance of the trust preferred securities and common stock. The junior subordinated debentures of approximately $7.2 million are included in long-term debt and the Company s equity interest in

the business trust is included in other assets. Interest expense on the junior subordinated debentures is reported in interest expense on long-term debt. For regulatory reporting and capital adequacy purposes, the Federal Reserve Board has indicated that such trust preferred securities will continue to constitute Tier 1 Capital until further notice.

Affordable Housing Investments

Periodically, the Company may invest in various limited partnerships that sponsor affordable housing projects in its primary markets and surrounding areas as a means of supporting local communities. These investments are designed to generate a return primarily through the realization of federal tax credits. These projects are funded through a combination of debt and equity and the partnerships meet the definition of a VIE. While the Company s investment as a limited partner in a single entity may at times exceed 50% of the outstanding equity interests, the Company does not consolidate the partnerships due to the nature of the management activities of the general partner and the performance guaranties provided by the project sponsors. The Company typically provides financing during the construction and development of the properties; however, permanent financing is generally obtained from independent parties upon completion of a project.

At June 30, 2011 and December 31, 2010, the Company had limited partnership investments of $5.6 million and $3.4 million, respectively, related to these projects, which are included in other assets on the Condensed Consolidated Balance Sheets. At June 30, 2011 and December 31, 2010, the Company had unfunded commitments related to affordable housing investments of $0.5 million and $1.9 million, respectively, included in accrued expenses and other liabilities on the Condensed Consolidated Balance Sheets.

Additionally, the Company had outstanding loan commitments with certain of the partnerships totaling $4.1 million and $11.4 million at June 30, 2011 and December 31, 2010, respectively. The funded portion of these loans was approximately $3.0 and $8.9 million at June 30, 2011 and December 31, 2010, respectively. The funded portions of these loans are included in loans, net of unearned income on the Condensed Consolidated Balance Sheets.

The following table summarizes VIEs that are not consolidated by the Company as of June 30, 2011.

(Dollars in thousands)	**Maximum Loss Exposure**	**Liability Recognized**	**Classification**
Type:			
Affordable housing investments (a)	$ 5,647	458	Other assets
Trust preferred issuances	N/A	7,217	Long-term debt

(a) Maximum loss exposure represents the Company s current investment of $5.6 million included in other assets. The current investment of $5.6 million includes $0.5 million of unfunded commitments related to affordable housing investments included in accrued expenses and other liabilities.

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NOTE 5: SECURITIES

At June 30, 2011 and December 31, 2010, respectively, all securities within the scope of FASB ASC 320, *Investments Debt and Equity Securities* were classified as available-for-sale. The fair value and amortized cost for securities available-for-sale by contractual maturity at June 30, 2011 and December 31, 2010, respectively, are presented below.

	June 30, 2011							
(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Amortized Cost
Available-for-sale:								
Agency obligations (a)	$		23,899	26,860	50,759	29	424	$ 51,154
Agency RMBS (a)			14,255	146,103	160,358	1,254	532	159,636
State and political subdivisions	20	932	15,389	66,734	83,075	1,737	353	81,691
Trust preferred securities:								
Pooled				20	20		210	230
Individual issuer				2,231	2,231	186	134	2,179
Total available-for-sale	$ 20	932	53,543	241,948	296,443	3,206	1,653	$ 294,890

(a) Includes securities issued by U.S. government agencies or government sponsored entities.

	December 31, 2010							
(Dollars in thousands)	1 year or less	1 to 5 years	5 to 10 years	After 10 years	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Amortized Cost
Available-for-sale:								
Agency obligations (a)	$		37,821	52,650	90,471	95	1,017	$ 91,393
Agency RMBS (a)			9,976	133,168	143,144	1,566	1,441	143,019
State and political subdivisions	21	856	13,547	62,342	76,766	472	2,801	79,095
Trust preferred securities:								
Pooled				20	20		210	230
Individual issuer				2,129	2,129		153	2,282
Corporate debt		2,690			2,690			2,690
Total available-for-sale	$ 21	3,546	61,344	250,309	315,220	2,133	5,622	$ 318,709

(a) Includes securities issued by U.S. government agencies or government sponsored entities.

Securities with aggregate fair values of $186.5 million and $171.1 million at June 30, 2011 and December 31, 2010, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, Federal Home Loan Bank (FHLB) advances, and for other purposes required or permitted by law.

Included in other assets on the Condensed Consolidated Balance Sheets are cost-method investments. The carrying amounts of cost-method investments were $5.4 and $5.8 million at June 30, 2011 and December 31, 2010, respectively. Cost-method investments primarily include non-marketable equity investments, such as FHLB of Atlanta stock and Federal Reserve Bank (FRB) stock.

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Gross Unrealized Losses and Fair Value

The fair values and gross unrealized losses on securities at June 30, 2011 and December 31, 2010, respectively, segregated by those securities that have been in an unrealized loss position for less than twelve months and twelve months or more are presented below.

	Less than 12 Months		12 Months or Longer		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2011:						
Agency obligations	$ 27,704	424			27,704	$ 424
Agency RMBS	65,363	532			65,363	532
State and political subdivisions	10,604	193	3,459	160	14,063	353
Trust preferred securities:						
Pooled			20	210	20	210
Individual issuer			866	134	866	134
Total	$ 103,671	1,149	4,345	504	108,016	$ 1,653
December 31, 2010:						
Agency obligations	$ 45,351	1,017			45,351	$ 1,017
Agency RMBS	89,840	1,441			89,840	1,441
State and political subdivisions	49,176	2,323	3,207	478	52,383	2,801
Trust preferred securities:						
Pooled			20	210	20	210
Individual issuer			847	153	847	153
Total	$ 184,367	4,781	4,074	841	188,441	$ 5,622

The applicable date for determining when securities are in an unrealized loss position is June 30, 2011. As such, it is possible that a security in an unrealized loss position at June 30, 2011 had a market value that exceeded its amortized cost on other days during the past twelve-month period.

For the securities in the previous table, the Company does not have the intent to sell and has determined it is not more likely than not that the Company will be required to sell the security before recovery of the amortized cost basis, which may be maturity. The Company has assessed each security for credit impairment. For debt securities, the Company evaluates, where necessary, whether credit impairment exists by comparing the present value of the expected cash flows to the securities amortized cost basis. For cost-method investments, the Company evaluates whether an event or change in circumstances has occurred during the reporting period that may have a significant adverse effect on the fair value of the investment.

In determining whether a loss is temporary, the Company considers all relevant information including:

- the length of time and the extent to which the fair value has been less than the amortized cost basis;

- adverse conditions specifically related to the security, an industry, or a geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement);

- the historical and implied volatility of the fair value of the security;

the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future;

failure of the issuer of the security to make scheduled interest or principal payments;

any changes to the rating of the security by a rating agency;

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and recoveries or additional declines in fair value subsequent to the balance sheet date.
To the extent the Company estimates future expected cash flows, the Company considered all available information in developing those expected cash flows. For asset-backed securities such as pooled trust preferred securities, such information generally included:

remaining payment terms of the security (including as applicable, terms that require underlying obligor payments to increase in the future);

current delinquencies and nonperforming assets of underlying collateral;

expected future default rates; and

subordination levels or other credit enhancements.

Agency obligations

The unrealized losses associated with agency obligations are primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities are issued by U.S. government agencies or government-sponsored entities and do not have any credit losses given the explicit or implicit government guarantee.

Agency residential mortgage-backed securities (RMBS)

The unrealized losses associated with Agency RMBS are primarily driven by changes in interest rates and not due to the credit quality of the securities. These securities are issued by U.S. government agencies or government-sponsored entities and do not have any credit losses given the explicit or implicit government guarantee.

Securities of U.S. states and political subdivisions

The unrealized losses associated with securities of U.S. states and political subdivisions are primarily driven by changes in interest rates and are not due to the credit quality of the securities. These securities will continue to be monitored as part of the Company s quarterly impairment analysis, but are expected to perform even if the rating agencies reduce the credit rating of the bond insurers. As a result, the Company expects to recover the entire amortized cost basis of these securities.

Pooled trust preferred securities

The unrealized losses associated with pooled trust preferred securities are primarily driven by higher projected collateral losses and wider credit spreads. Pooled trust preferred securities primarily consist of securities issued by community banks and thrifts. The Company assesses impairment for these securities using a cash flow model. The key assumptions include default probabilities of the underlying collateral and recoveries on collateral defaults. Based upon the Company s assessment of the expected credit losses for these securities, and given the performance of the underlying collateral compared to the Company s credit enhancement, the Company expects to recover the remaining amortized cost basis of these securities.

Individual issuer trust preferred securities

The unrealized losses associated with individual issuer trust preferred securities are primarily related to securities backed by individual issuer community banks. For individual issuers, management evaluates the financial performance of the issuer on a quarterly basis to determine if it is probable that the issuer can make all contractual principal and interest payments. Based upon its evaluation, the Company expects to recover the remaining amortized cost basis of these securities.

Cost-method investments

At June 30, 2011, cost-method investments with an aggregate cost of $5.4 million were not evaluated for impairment because the Company did not identify any events or changes in circumstances that may have a significant adverse effect on the fair value of these cost-method investments.

The carrying values of the Company s investment securities could decline in the future if the underlying performance of the collateral for pooled trust preferred securities, the financial condition of individual issuers of trust preferred securities, or the credit quality of other securities deteriorate and the Company determines it is probable that it will not recover the entire amortized cost basis for the security. As a result, there is a risk that significant other-than-temporary impairment charges may occur in the future.

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The following tables show the applicable credit ratings, fair values, gross unrealized losses, and life-to-date impairment charges for pooled and individual issuer trust preferred securities at June 30, 2011 and December 31, 2010, respectively, segregated by those securities that have been in an unrealized loss position for less than twelve months and twelve months or more.

Trust Preferred Securities as of June 30, 2011

	Credit Rating			Unrealized Losses			
(Dollars in thousands)	**Moody s**	**Fitch**	**Fair Value**	**Less than 12 months**	**12 months or Longer**	**Total**	**Life-to-date Impairment Charges**
Pooled:							
ALESCO Preferred Funding XVII Ltd (a)	C	CC					