FIRST CITIZENS BANCSHARES INC /DE/
Form 10-Q
May 10, 2012
Table of Contents

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

FORM 10-Q

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2012
or

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 001-16715

First Citizens BancShares, Inc.
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 56-1528994<br>(I.R.S. Employer<br>Identification Number) |
| 4300 Six Forks Road, Raleigh, North Carolina<br>(Address of principle executive offices) | 27609<br>(Zip code) |

(919) 716-7000
(Registrant's telephone number, including area code)

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 twelve 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 ninety days. Yes x No ¨

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or 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 definition of 'accelerated filer' and 'large accelerated filer' in Rule 12b-2 of the Exchange Act:

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Smaller reporting company | ¨ |

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

Class A Common Stock—$1 Par Value—8,644,307 shares
Class B Common Stock—$1 Par Value—1,626,937 shares
(Number of shares outstanding, by class, as of May 10, 2012)

Table of Contents

INDEX


| | | Page(s) |
|---|---|---|
| PART I. | FINANCIAL INFORMATION | |
| Item 1. | Financial Statements (Unaudited) | |
| | Consolidated Balance Sheets at March 31, 2012, December 31, 2011 and March 31, 2011 | 3 |
| | Consolidated Statements of Income for the three-month periods ended March 31, 2012 and March 31, 2011 | 4 |
| | Consolidated Statements of Comprehensive Income for the three-month periods ended March 31, 2012 and March 31, 2011 | 5 |
| | Consolidated Statements of Changes in Shareholders' Equity for the three-month periods ended March 31, 2012 and March 31, 2011 | 6 |
| | Consolidated Statements of Cash Flows for the three-month periods ended March 31, 2012 and March 31, 2011 | 7 |
| | Notes to Consolidated Financial Statements | 8 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 36 |
| Item 3. | Quantitative and Qualitative Disclosures about Market Risk | 60 |
| Item 4. | Controls and Procedures | 60 |
| PART II. | OTHER INFORMATION | |
| Item 1A. | Risk Factors | 61 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 66 |
| Item 6. | Exhibits | 67 |

Table of Contents

Part 1

Item 1. Financial Statements (Unaudited)

First Citizens BancShares, Inc. and Subsidiaries
Consolidated Balance Sheets

| | March 31* 2012 | December 31# 2011 | March 31* 2011 |
|---|---|---|---|
| | (thousands, except share data) | | |
| Assets | | | |
| Cash and due from banks | $552,663 | $590,801 | $406,252 |
| Overnight investments | 752,334 | 434,975 | 585,286 |
| Investment securities available for sale | 4,457,739 | 4,056,423 | 4,202,016 |
| Investment securities held to maturity | 1,688 | 1,822 | 2,341 |
| Loans held for sale | 73,457 | 92,539 | 48,222 |
| Loans and leases: | | | |
| Covered under loss share agreements | 2,183,869 | 2,362,152 | 2,658,134 |
| Not covered under loss share agreements | 11,489,529 | 11,581,637 | 11,392,351 |
| Less allowance for loan and lease losses | 272,500 | 270,144 | 232,597 |
| Net loans and leases | 13,400,898 | 13,673,645 | 13,817,888 |
| Premises and equipment | 864,466 | 854,476 | 839,463 |
| Other real estate owned: | | | |
| Covered under loss share agreements | 142,418 | 148,599 | 137,479 |
| Not covered under loss share agreements | 48,092 | 50,399 | 49,584 |
| Income earned not collected | 52,406 | 42,216 | 98,501 |
| Receivable from FDIC for loss share agreements | 410,351 | 539,511 | 624,322 |
| Goodwill | 102,625 | 102,625 | 102,625 |
| Other intangible assets | 6,076 | 7,032 | 9,265 |
| Other assets | 278,415 | 286,430 | 244,251 |
| Total assets | $21,143,628 | $20,881,493 | $21,167,495 |
| Liabilities | | | |
| Deposits: | | | |
| Noninterest-bearing | $4,572,300 | $4,331,706 | $4,164,449 |
| Interest-bearing | 13,187,192 | 13,245,568 | 13,647,287 |
| Total deposits | 17,759,492 | 17,577,274 | 17,811,736 |
| Short-term borrowings | 677,993 | 615,222 | 666,417 |
| Long-term obligations | 649,818 | 687,599 | 801,081 |
| Other liabilities | 164,202 | 140,270 | 100,047 |
| Total liabilities | 19,251,505 | 19,020,365 | 19,379,281 |
| Shareholders’ Equity | | | |
| Common stock: | | | |
| Class A - $1 par value (11,000,000 shares authorized; 8,644,307 shares issued and outstanding at March 31, 2012 and December 31, 2011; 8,756,778 shares issued and outstanding at March 31, 2011) | 8,644 | 8,644 | 8,757 |
| Class B - $1 par value (2,000,000 shares authorized; 1,631,424 shares issued and outstanding at March 31, 2012; 1,639,812 shares issued and outstanding at December 31, 2011; 1,677,675 shares issued and outstanding at March 31, 2011) | 1,631 | 1,640 | 1,678 |

| | | | |
|---|---|---|---|
| Surplus | 143,766 | 143,766 | 143,766 |
| Retained earnings | 1,804,498 | 1,773,652 | 1,673,920 |
| Accumulated other comprehensive loss | (66,416) | (66,574) | (39,907) |
| Total shareholders’ equity | 1,892,123 | 1,861,128 | 1,788,214 |
| Total liabilities and shareholders’ equity | $21,143,628 | $20,881,493 | $21,167,495 |

* Unaudited
# Derived from 2011 Annual Report on Form 10-K.
See accompanying Notes to Consolidated Financial Statements.

3

Table of Contents

First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Income

| | Three Months Ended March 31 | |
|---|---|---|
| | 2012 | 2011 |
| | (thousands, except share and per share data, unaudited) | |
| Interest income | | |
| Loans and leases | $238,137 | $231,453 |
| Investment securities: | | |
| U. S. Treasury | 739 | 3,210 |
| Government agency | 4,332 | 5,047 |
| Residential mortgage-backed securities | 1,889 | 2,653 |
| Corporate bonds | 1,199 | 2,176 |
| State, county and municipal | 12 | 13 |
| Other | 131 | 259 |
| Total investment securities interest and dividend income | 8,302 | 13,358 |
| Overnight investments | 313 | 389 |
| Total interest income | 246,752 | 245,200 |
| Interest expense | | |
| Deposits | 16,472 | 29,820 |
| Short-term borrowings | 1,391 | 1,697 |
| Long-term obligations | 7,937 | 9,696 |
| Total interest expense | 25,800 | 41,213 |
| Net interest income | 220,952 | 203,987 |
| Provision for loan and lease losses | 30,715 | 44,419 |
| Net interest income after provision for loan and lease losses | 190,237 | 159,568 |
| Noninterest income | | |
| Gains on acquisitions | — | 63,474 |
| Cardholder and merchant services | 22,450 | 26,780 |
| Service charges on deposit accounts | 14,846 | 15,790 |
| Wealth management services | 13,755 | 13,288 |
| Fees from processing services | 8,562 | 7,246 |
| Securities gains (losses) | (45) | (449) |
| Other service charges and fees | 3,441 | 5,957 |
| Mortgage income | 4,611 | 2,315 |
| Insurance commissions | 2,756 | 2,534 |
| ATM income | 1,455 | 1,590 |
| Adjustments for FDIC receivable for loss share agreements | (26,796) | (10,379) |
| Other | 1,908 | 1,434 |
| Total noninterest income | 46,943 | 129,580 |
| Noninterest expense | | |
| Salaries and wages | 75,684 | 75,804 |
| Employee benefits | 20,249 | 19,649 |
| Occupancy expense | 18,607 | 18,313 |
| Equipment expense | 18,166 | 17,391 |
| FDIC insurance expense | 3,057 | 8,225 |
| Foreclosure-related expenses | 4,621 | 5,488 |
| Other | 42,947 | 45,158 |

| | | |
|---|---|---|
| Total noninterest expense | 183,331 | 190,028 |
| Income before income taxes | 53,849 | 99,120 |
| Income taxes | 18,354 | 37,360 |
| Net income | $35,495 | $61,760 |
| Average shares outstanding | 10,283,842 | 10,434,453 |
| Net income per share | $3.45 | $5.92 |

See accompanying Notes to Consolidated Financial Statements.

4

Table of Contents

Consolidated Statements of Comprehensive Income
First Citizens BancShares, Inc. and Subsidiaries

| | Three Months Ended March 31 | |
|---|---|---|
| | 2012 | 2011 |
| | (thousands, unaudited) | |
| Net income | $35,495 | $61,760 |
| | | |
| Other comprehensive income (loss) | | |
| Unrealized gains on securities: | | |
| Change in unrealized securities gains arising during period | (2,898) | (9,139) |
| Deferred tax benefit (expense) | 1,123 | 3,447 |
| Reclassification adjustment for losses (gains) included in income before income taxes | — | 449 |
| Deferred tax expense (benefit) | — | (177) |
| Total change in unrealized gains on securities, net of tax | (1,775) | (5,420) |
| | | |
| Change in fair value of cash flow hedges: | | |
| Change in unrecognized loss on cash flow hedges | 1,138 | 3,175 |
| Deferred tax benefit (expense) | (450) | (1,254) |
| Reclassification adjustment for gains (losses) included in income before income taxes | (749) | (1,458) |
| Deferred tax benefit (expense) | 296 | 576 |
| Total change in unrecognized loss on cash flow hedges, net of tax | 235 | 1,039 |
| | | |
| Change in pension obligation: | | |
| Change in pension obligation | 2,790 | 1,648 |
| Deferred tax benefit (expense) | (1,092) | (645) |
| Total change in pension obligation, net of tax | 1,698 | 1,003 |
| | | |
| Other comprehensive income (loss) | 158 | (3,378) |
| | | |
| Total comprehensive income | $35,653 | $58,382 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

Consolidated Statements of Changes in Shareholders’ Equity
First Citizens BancShares, Inc. and Subsidiaries

| | Class A Common Stock | Class B Common Stock | Surplus | Retained Earnings | Accumulated Other Comprehensive Income (loss) | Total Shareholders’ Equity |
|---|---|---|---|---|---|---|
| | (thousands, except share data, unaudited) | | | | | |
| Balance at December 31, 2010 | $8,757 | $ 1,678 | $143,766 | $1,615,290 | $ (36,529) | $1,732,962 |
| Comprehensive income: | | | | | | |
| Net income | — | — | — | 61,760 | — | 61,760 |
| Other comprehensive loss, net of tax | — | — | — | — | (3,378) | (3,378) |
| Total comprehensive income | | | | | | 58,382 |
| Cash dividends ($0.30 per share) | — | — | — | (3,130) | — | (3,130) |
| Balance at March 31, 2011 | $8,757 | $ 1,678 | $143,766 | $1,673,920 | $ (39,907) | $1,788,214 |
| Balance at December 31, 2011 | $8,644 | $ 1,640 | $143,766 | $1,773,652 | $ (66,574) | $1,861,128 |
| Comprehensive income: | | | | | | |
| Net income | — | — | — | 35,495 | — | 35,495 |
| Other comprehensive income, net of tax | — | — | — | — | 158 | 158 |
| Total comprehensive income | | | | | | 35,653 |
| Repurchase of 8,388 shares of Class B common stock | — | (9) | — | (1,564) | — | (1,573) |
| Cash dividends ($0.30 per share) | — | — | — | (3,085) | — | (3,085) |
| Balance at March 31, 2012 | $8,644 | $ 1,631 | $143,766 | $1,804,498 | $ (66,416) | $1,892,123 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

| | Three months ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (thousands, unaudited) | |
| OPERATING ACTIVITIES | | |
| Net income | $35,495 | $61,760 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Provision for loan and lease losses | 30,715 | 44,419 |
| Deferred tax (benefit) expense | (5,692) | 1,155 |
| Change in current taxes payable | 22,857 | 30,455 |
| Depreciation | 16,620 | 16,114 |
| Change in accrued interest payable | (2,233) | (9,074) |
| Change in income earned not collected | (10,190) | (9,582) |
| Gains on acquisitions | — | (63,474) |
| Securities losses | 45 | 449 |
| Origination of loans held for sale | (135,897) | (87,719) |
| Proceeds from sale of loans | 158,391 | 130,641 |
| Gain on sale of loans | (3,412) | (2,211) |
| Loss on sale of other real estate | 1,495 | 2,074 |
| Net amortization (accretion) of premiums and discounts | (60,822) | (34,455) |
| FDIC receivable for loss share agreements | 130,722 | 128,845 |
| Net change in other assets | 23,564 | 143,341 |
| Net change in other liabilities | 6,487 | (14,193) |
| Net cash provided by operating activities | 208,145 | 338,545 |
| INVESTING ACTIVITIES | | |
| Net change in loans outstanding | 277,719 | 119,185 |
| Purchases of investment securities available for sale | (1,681,584) | (141,592) |
| Proceeds from maturities of investment securities held to maturity | 134 | 191 |
| Proceeds from maturities of investment securities available for sale | 1,275,014 | 522,893 |
| Proceeds from sales of investment securities available for sale | — | 191,697 |
| Net change in overnight investments | (317,359) | (186,896) |
| Proceeds from sale of other real estate | 23,853 | 18,067 |
| Additions to premises and equipment | (26,610) | (12,832) |
| Net cash received from acquisitions | — | 961,862 |
| Net cash provided (used) by investing activities | (448,833) | 1,472,575 |
| FINANCING ACTIVITIES | | |
| Net change in time deposits | (306,338) | (367,974) |
| Net change in demand and other interest-bearing deposits | 488,556 | (1,060,414) |
| Net change in short-term borrowings | 62,771 | (217,033) |
| Repayment of long-term obligations | (37,781) | (216,495) |
| Repurchase of common stock | (1,573) | — |
| Cash dividends paid | (3,085) | (3,130) |
| Net cash provided (used) by financing activities | 202,550 | (1,865,046) |
| Change in cash and due from banks | (38,138) | (53,926) |
| Cash and due from banks at beginning of period | 590,801 | 460,178 |
| Cash and due from banks at end of period | $552,663 | $406,252 |
| CASH PAYMENTS FOR: | | |

| | | |
|---|---|---|
| Interest | $28,033 | $50,287 |
| Income taxes | 84 | 9,100 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Change in unrealized securities gains (losses) | $(2,898) | $(9,339) |
| Change in fair value of cash flow hedge | 389 | 1,717 |
| Change in pension obligation | 2,790 | 1,648 |
| Transfers of loans to other real estate | 26,840 | 46,929 |
| Acquisitions: | | |
| Assets acquired | — | 2,225,370 |
| Liabilities assumed | — | 2,161,896 |
| Net assets acquired | — | 63,474 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

First Citizens BancShares, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
Note A
Accounting Policies and Basis of Presentation
The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP) for interim financial information. Accordingly, they do not include all of the information and notes required by US GAAP for complete financial statements.
In the opinion of management, the consolidated financial statements contain all material adjustments necessary to present fairly the financial position of First Citizens BancShares, Inc. and Subsidiaries (BancShares) as of and for each of the periods presented, and all such adjustments are of a normal recurring nature. The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of income and expenses during the period. Actual results could differ from those estimates. Management has evaluated subsequent events through the filing date of the Quarterly Report on Form 10-Q.
These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in BancShares’ 2011 Form 10-K. Certain amounts for prior periods have been reclassified to conform with statement presentations for 2012. The reclassifications have no effect on shareholders’ equity or net income as previously reported. Fair values are subject to refinement for up to one year after the closing date of the transaction as additional information regarding closing date fair values becomes available. There were no adjustments to previously reported acquisition gains during the first quarter of 2012.
Recently Adopted Accounting Policies and Other Regulatory Issues

In May 2011, the FASB issued Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 creates a uniform framework for applying fair value measurement principles for companies around the world. It eliminates differences between GAAP and International Financial Reporting Standards issued by the International Accounting Standards Board. New disclosures required by the guidance include: quantitative information about the significant unobservable inputs used for Level 3 measurements; a qualitative discussion about the sensitivity of recurring Level 3 measurements to changes in the unobservable inputs disclosed, including the interrelationship between inputs; and a description of the company’s valuation processes. The updates in ASU 2011-04 are effective for interim and annual periods beginning after December 15, 2011, and all amendments are to be applied prospectively with any changes in measurements recognized in income in the period of adoption. The provisions of this update have affected BancShares' financial statement disclosures, but had no impact on BancShares' financial condition, results of operations or liquidity.

In June, 2011, the FASB issued Comprehensive Income: Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 allows financial statement issuers to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, in December, 2011, the FASB issued Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12) which deferred the portion of ASU 2011-05 that relates to the presentation of reclassification adjustments. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity, which is the presentation method previously utilized by BancShares. The updates in ASU 2011-05 and ASU 2011-12 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and have been applied retrospectively. The provisions of these updates have affected BancShares' financial statement format, but had no impact on BancShares' financial condition, results of operations or liquidity.

In September, 2011, the FASB issued Intangibles - Goodwill and Other Intangible Assets: Testing Goodwill for Impairment (ASU 2011-08), which allows an entity the option to first assess the qualitative factors to determine whether the existence of events or circumstances leads to a determination that is it more likely than not that the fair value of a reporting unit is less than its carrying amount. Under ASU 2011-08, if, after that assessment is made, an entity determines that it is more likely than not that the carrying value of goodwill is not impaired, then the two-step impairment test is not required. However, if the entity concludes otherwise, the two-step impairment test would be required. The provisions of ASU 2011-08 are

Table of Contents

effective for interim and annual periods beginning after December 15, 2011, although early adoption was allowed. Adoption of ASU 2011-08 has had no material impact on BancShares' financial condition, results of operations or liquidity.

Note B
Investments
The aggregate values of investment securities at March 31, 2012, December 31, 2011, and March 31, 2011 along with unrealized gains and losses determined on an individual security basis are as follows:

| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | | |
|---|---|---|---|---|---|---|
| Investment securities available for sale | | | | | | |
| March 31, 2012 | | | 0.17% | | | |
| Savings and clubs | 116,141 | 73 | 0.25% | 119,239 | 66 | 0.22% |
| Money market | 70,814 | 223 | 1.26% | 43,674 | 147 | 1.35% |
| Certificates of deposit | 316,975 | 1,177 | 1.49% | 325,613 | 1,790 | 2.20% |
| Mortgagors deposits | 3,173 | 13 | 1.64% | 2,891 | 11 | 1.52% |
| Total deposits | 549,199 | 1,517 | 1.10% | 545,589 | 2,037 | 1.49% |
| Borrowed money | 124,542 | 1,041 | 3.34% | 120,276 | 986 | 3.28% |
| Total interest-bearing liabilities | 673,741 | 2,558 | 1.52% | 665,865 | 3,023 | 1.82% |
| Non-interest-bearing liabilities: | | | | | | |
| Demand | 60,322 | | | 58,406 | | |
| Other liabilities | 8,601 | | | 7,904 | | |
| Total liabilities | 742,664 | | | 732,175 | | |
| Stockholders equity | 71,622 | | | 63,790 | | |
| Total liabilities & stockholders equity | $ 814,286 | | | $ 795,965 | | |
| Net interest income | | $ 7,061 | | | $ 6,890 | |
| Average interest rate spread | | | 3.78% | | | 3.52% |
| Net interest margin | | | 3.89% | | | 3.71% |

(1) Includes non-accrual loans

(2) Includes FHLB-NY stock

Table of Contents

**Interest Income**

Interest income decreased to $9.62 million for the quarter ended June 30, 2010 compared to $9.91 million for the prior year period. The decrease in interest income was primarily the result of a decrease in the loans portfolio interest income of $0.15 million, with a reduction in the mortgage-backed securities portfolio interest income of $0.16, offset in part by a $0.01 million increase in interest income on investment securities. The decrease in interest income reflects a decline in the yield on interest-earning assets of 4 basis points to 5.30%, compared to 5.34% for the prior year period. The yield on loans decreased 2 basis points to 5.44% as the average loan balance decreased $9.77 million. The yield on mortgage-backed securities declined 50 basis points, as the average balance decreased of $7.35 million. The decline in yield on interest-earning assets is a result of the low interest rate environment and overall market conditions.

**Interest Expense**

Interest expense decreased $0.46 million, or 15.35%, to $2.56 million for the quarter ended June 30, 2010 compared to $3.0 million for the prior year period. The decrease in interest expense resulted primarily from a 30 basis point decrease in the average cost of interest-bearing liabilities to 1.52% for the quarter ended June 30, 2010 compared to an average cost of 1.82% for the prior year period as higher cost institutional deposits were replaced by lower cost core deposits and transactional accounts. This improvement was partially offset by growth in the average balance of interest-bearing liabilities of $7.88 million, or 1.18%, to $673.7 million at June 30, 2010, compared to $665.9 million for the prior year period.

**Provision for Loan Losses and Asset Quality**

The Bank maintains an allowance for loan and lease losses ( ALLL ) that management believes is sufficient to absorb inherent losses in its loan portfolio. The adequacy of the ALLL is determined by management s continuing review of the Bank s loan portfolio, which includes identification and review of individual factors that may affect a borrower s ability to repay. Management reviews overall portfolio quality through an analysis of delinquency and non-performing loan data, estimates of the value of underlying collateral and current charge-offs. A review of regulatory examinations, an assessment of current and expected economic conditions and changes in the size and composition of the loan portfolio are all taken into consideration. The ALLL reflects management s evaluation of the loans presenting identified loss potential as well as the risk inherent in various components of the portfolio. As such, an increase in the size of the portfolio or any of its components could necessitate an increase in the ALLL even though there may not be a decline in credit quality or an increase in potential problem loans.

The Bank s provision for loan loss methodology is consistent with the Interagency Policy Statement on the Allowance for Loan and Lease Losses (the Interagency Policy Statement ) released by the Federal Financial Regulatory Agencies on December 13, 2006. For additional information regarding the Bank s ALLL policy, refer to Note 2 of Notes to Consolidated Financial Statements, Summary of Significant Accounting Policies included in the Holding Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2010.

**Table of Contents**

The following table summarizes the activity in the ALLL for the three month period ended June 30, 2010 and fiscal year-end March 31, 2010 (dollars in thousands):

| | Three Months Ended June 30, 2010 | Fiscal Year-End March 31, 2010 |
|---|---|---|
| Beginning Balance | $ 12,000 | $ 7,049 |
| Less charge-offs: | | |
| One-to-four family | (539) | (580) |
| Construction | (1,154) | |
| Non-residential | (134) | (1,648) |
| Business | (871) | (646) |
| Consumer and other | | (84) |
| Total Charge-Offs: | (2,698) | (2,958) |
| Add Recoveries: | | |
| One-to-four family | | 12 |
| Non-residential | | |
| Business | 4 | 6 |
| Consumer and other | 5 | 46 |
| Total Recoveries: | 9 | 64 |
| Provision for Loan Losses | 6,241 | 7,845 |
| Ending Balance | $ 15,552 | $ 12,000 |
| Ratios: | | |
| Net charge-offs to average loans outstanding | 2.18% | 0.44% |
| Allowance to total loans | 2.40% | 1.79% |
| Allowance to non-performing loans | 18.02% | 25.23% |

The Bank recorded a $6.2 million provision for loan losses in the quarter ended June 30, 2010 compared to $0.7 million for the prior year period. The increased provision is in response to the Company s current levels of delinquencies and non-performing loans and the uncertainty caused by the uneven economic recovery in the real estate market and the New York City economy. At June 30, 2010, non-performing loans totaled $86.3 million, or 10.96% of total assets compared to $47.6 million or 5.91% of total assets at March 31, 2010. Total delinquencies increased quarter-over-quarter by 66% to $115.1 million or 14.6% of total assets. The ALLL was $15.6 million at June 30, 2010, which represents a ratio of the ALLL to non-performing loans of 17.65% compared to 25.23% at March 31, 2010. The ratio of the ALLL to total loans was 2.41% at June 30, 2010 up from 1.79% at March 31, 2010.

Table of Contents

**Non-performing Assets.**

Non-performing assets consist of non-accrual loans and property acquired in settlement of loans, including foreclosure. When a borrower fails to make a payment on a loan, the Bank and/or its loan servicers takes prompt steps to have the delinquency cured and the loan restored to current status. This includes a series of actions such as phone calls, letters, customer visits and, if necessary, legal action. In the event the loan has a guarantee, the Bank may seek to recover on the guarantee, including, where applicable, from the Small Business Administration ( SBA ). Loans that remain delinquent are reviewed for reserve provisions and charge-off. The Bank s collection efforts continue after the loan is charged off, except when a determination is made that collection efforts have been exhausted or are not productive.

The Bank may from time to time agree to modify the contractual terms of a borrower s loan. In cases where such modifications represent a concession to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ( TDR ). Loans modified in a troubled debt restructuring are placed on non-accrual status until the Bank determines that future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate a period of performance according to the restructured terms for a minimum of six months. At June 30, 2010, loans classified as a troubled debt restructuring totaled $18 million.

At June 30, 2010, non-performing assets totaled $86.3 million, or 10.74%, of total assets compared to $47.6 million or 5.91% of total assets at March 31, 2010. The increase in non-performing loans is primarily attributed to an increase in non-performing construction loans. The Bank continues its proactive approach to working with borrowers to resolve early stage delinquencies; however given the continued distressed economic climate we have seen an increase in the 30-89 day category of $5.70 million to $28.8 million or 4.45% of loans receivable at June 30, 2010 compared to $23.1 million or 3.45% at March 31, 2010. Uncertainty still remains with respect to the timing of possible sustained economic recovery which may affect the ability of borrowers to continue to stay current with their loans.

**Table of Contents**

The following table sets forth information with respect to the Bank s non-performing assets for the past five quarter end periods (dollars in thousands):

| | June 2010 | March 2010 | December 2009 | September 2009 | June 2009 |
|---|---|---|---|---|---|
| Loans accounted for on a non-accrual basis (1): | | | | | |
| Gross loans receivable: | | | | | |
| One- to four-family | $ 14,320 | $ 7,682 | $ 5,009 | $ 3,297 | $ 6,598 |
| Multifamily | 16,923 | 10,334 | 6,406 | 5,988 | 3,978 |
| Non-residential | 13,249 | 6,315 | 3,831 | 4,933 | 7,963 |
| Construction | 34,792 | 17,413 | 12,719 | 9,808 | 3,750 |
| Business | 7,031 | 5,799 | 5,138 | 2,760 | 2,801 |
| Consumer | 15 | 28 | 35 | 31 | 3 |
| Total non-accrual loans | 86,331 | 47,571 | 33,138 | 26,817 | 25,093 |
| Other non-performing assets (2): | | | | | |
| Real estate owned | 1 | 66 | 28 | 67 | 162 |
| Total other non-performing assets | 1 | 66 | 28 | 67 | 162 |
| Total non-performing assets (3) | $ 86,332 | $ 47,637 | $ 33,166 | $ 26,884 | $ 25,255 |
| Accruing loans contractually past due > 90 days (4) | 478 | 1,411 | 305 | 987 | 1,388 |
| Non-performing loans to total loans | 13.34% | 7.10% | 4.86% | 4.17% | 4.02% |
| Non-performing assets to total assets | 10.74% | 5.91% | 4.12% | 3.45% | 3.29% |

(1) Non-accrual status denotes any loan where the delinquency exceeds 90 days past due and in the opinion of management the collection of additional interest is doubtful. Payments received on a non-accrual loan are either

applied to the outstanding principal balance or recorded as interest income, depending on assessment of the ability to collect on the loan.

(2) Other non-performing assets generally represent property acquired by the Bank in settlement of loans (i.e., through foreclosure, repossession or as an in-substance foreclosure). These assets are recorded at the lower of their fair value or the cost to acquire.

(3) Troubled debt restructured loans performing in accordance with their modified terms for less than six months and those not performing to their modified terms are considered non-accrual and are included in the non-accrual category in the table above.

TDR loans that have performed in accordance with their modified terms for a period of at least six months are generally considered performing loans and are not presented in the table above.

(4) Loans 90 days or more past due and still accruing, which were not included in the non-performing category, are presented in the above table. Loans past due 90 days or more and still accruing represent mostly 1-4 family loans where the loan servicer is contractually abligated to make payments.

**Subprime Loans**

In the past, the Bank originated a limited amount of subprime loans; however, such lending has been discontinued. At June 30, 2010, the Bank had $8.7 million in subprime loans, or 1.3%, of its total loan portfolio of which $4.6 million are non-performing loans.

**Non-Interest Income**

Non-interest income increased $0.71 million, or 61.6%, to $1.86 million for the quarter ended June 30, 2010 compared to $1.2 million for the prior year period. The increase was mostly due to a $0.76 million of fees recognized during the quarter ended June 2010 related to several New Market Tax Credit transactions.

**Non-Interest Expense**

Non-interest expense for the quarter ended June 31, 2010 increased $0.4 million or 4.79%, to $7.5 million compared to $7.1 million for the prior year period. This increase in non-interest expense is primarily due to collection costs related to delinquencies and non performing loans as well as consulting expenses.

**Income Tax Benefit**

The income tax benefit was $2.3 million for the quarter ended June 30, 2010 compared to an income tax benefit of $0.40 million for the prior year period. The tax benefit for the quarter ended June 30, 2010 reflects income tax expense of $0.3 million offset by tax benefits from New Market Tax Credit (NMTC) totaling $0.6 million. The Company expects to receive additional NMTC tax benefits of approximately $7.2 million through the period ending March 31, 2014. The Company s ability to utilize the deferred tax asset generated by NMTC income tax benefits over the next four years, as well as other deferred tax assets, depends on its ability to meet the NMTC compliance requirements and its ability to generate sufficient taxable income from operations or from potential tax strategies to generate taxable income in the future. The Company has $16.7 million of deferred tax assets as of June 30, 2010. (See above PART I, ITEM 2. Deferred Taxes and below PART II, ITEM 1A. Risk Factors).

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

Quantitative and qualitative disclosure about market risk is presented at March 31, 2010 in Item 7A of the Company s 2010 Form 10-K and is incorporated herein by reference. The Company believes that there has been no material change in the Company s market risk at June 30, 2010 compared to March 31, 2010.

**ITEM 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. As of June 30, 2010, the Company s management, including the Company s Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Accounting Officer), has evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this report.

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act 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 required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting

There have not been any changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

There have been no material changes with regard to legal proceedings since the filing of the 2010 Form 10-K.

**ITEM 1A. Risk Factors**

The following risk factors represent material updates and additions to the risk factors previously disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2010 ( Form 10-K ). The risk factors below should be read in conjunction with the risk factors and other information disclosed in our Form 10-K. The risks described below and in our Form 10-K are not the only risks facing the Company. Additional risks not presently known to the Company, or that we currently deem immaterial, may also adversely affect the Company s business, financial condition or results of operations.

An investment in our securities is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below, in addition to the risk factors previously disclosed in The Companys Annual Report on Form 10-K for the year ended March, 31 2010.

The Company s ability to utilize the deferred tax asset generated by New Markets Tax Credit income tax benefits as well as other deferred tax assets depends on its ability to meet the NMTC compliance requirements and its ability to generate sufficient taxable income from operations to generate taxable income in the future. Since the Bank has not generated sufficient taxable income to utilize tax credits as they were earned, a deferred tax asset has been recorded in the Company s financial statements.

The future recognition of Carver s deferred tax asset is highly dependent upon Carver s ability to generate sufficient taxable income. A valuation allowance is required to be maintained for any deferred tax assets that we estimate are more likely than not to be unrealizable, based on available evidence at the time the estimate is made. In assessing Carver s need for a valuation allowance, we rely upon estimates of future taxable income. Although we use the best available information to estimate future taxable income, underlying estimates and assumptions can change over time as a result of unanticipated events or circumstances influencing our projections. Valuation allowances related to deferred tax assets can be affected by changes to tax laws, statutory tax rates, and future taxable income levels. In the event that we were to determine that we would not be able to realize all or a portion of our net deferred tax assets in the future, we would reduce such amounts through a charge to income tax expense in the period in which that determination was made. Conversely, if we were to determine that we would be able to realize our deferred tax assets in the future in excess of the net carrying amounts, we would decrease the recorded valuation allowance through a decrease in income tax expense in the period in which that determination was made. No assurances can be made that the Company will be able to generate sufficient taxable income in the future to realize the deferred tax asset.

On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act ). The Dodd-Frank Act implements significant changes in the financial regulatory landscape and will impact all financial institutions. This impact may materially affect our business activities, financial position and profitability by, among other things. increasing our regulatory compliance burden and associated costs, placing restrictions on certain products and services, and limiting our future capital raising strategies.

Among the Dodd-Frank Act s significant regulatory changes, it creates a new financial consumer protection agency, known as the Bureau of Consumer Financial Protection (the Bureau ), that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer protection. The Bureau has exclusive authority to issue regulations, orders and guidance to administer and implement the objectives of federal consumer protection laws. The Dodd-Frank Act also eliminates our primary regulator, the Office of Thrift Supervision and designates the Comptroller of the Currency to become our primary regulator. Moreover, the Dodd-Frank Act permits States to adopt stricter consumer protection laws and authorizes State attorney generals to enforce consumer protection rules issued by the Bureau. The Dodd-Frank Act also may affect the preemption of State laws as they affect subsidiaries and agents of federally chartered banks, changes the scope of federal deposit insurance coverage, and increases the FDIC assessment payable by the Bank. We expect the Bureau and these other changes will significantly increase our regulatory compliance burden and costs and may restrict the financial products and services we offer to our customers.

The Dodd-Frank Act also imposes more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred issuances from counting as Tier I capital. These restrictions will limit our future capital strategies. Under the Dodd-Frank Act, our outstanding trust preferred securities will continue to count as Tier I capital but we will be unable to issue replacement or additional trust preferred securities which would count as Tier I capital. Because many of the Dodd-Frank Act s provisions require subsequent regulatory rulemaking, we are uncertain as to the impact that some of the provisions will have on the Company and cannot provide assurance that the Dodd-Frank Act will not adversely affect our financial condition and results of operations for other reasons.

**Any future FDIC special assessments or increases in insurance premiums will adversely impact the Company s earnings.**

**ITEM 2. Issuer Purchases of Equity Securities**

None.

**ITEM 3. Defaults Upon Senior Securities**

Not applicable.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

Not applicable.

**ITEM 5. Other Information**

Not applicable.

**ITEM 6. Exhibits**

The following exhibits are submitted with this report:

| | |
|---|---|
| Exhibit 11. | Computation of Earnings Per Share. |
| Exhibit 31.1 | Certification of Chief Executive Officer. |
| Exhibit 31.2 | Certification of Chief Accounting Officer. |
| Exhibit 32.1 | Certification of Chief Executive Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. |
| Exhibit 32.2 | Certification of Chief Accounting Officer furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350. |

**Table of Contents**

**SIGNATURES**

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

| | |
|---|---|
| | CARVER BANCORP, INC. |
| Date: August 16, 2010 | /s/ Deborah C. Wright<br>Deborah C. Wright<br>Chairman and Chief Executive Officer<br>(Principal Executive Officer) |
| Date: August 16, 2010 | /s/ Chris A. McFadden<br>Chris A. McFadden<br>Executive Vice President & Chief Financial Officer<br>(Principal Accounting Officer) |

41