INTERNATIONAL BANCSHARES CORP
Form 10-Q
August 06, 2012

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 June 30, 2012

OR

o **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 000-09439

INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

Texas	**74-2157138**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1200 San Bernardo Avenue, Laredo, Texas 78042-1359

(Address of principal executive offices)
(Zip Code)

(956) 722-7611

(Registrant s telephone number, including area code)

None

(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 o

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o 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	**Shares Issued and Outstanding**
Common Stock, $1.00 par value	67,229,006 shares outstanding at August 1, 2012

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	June 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$ 219,907	$ 261,885
Investment securities:		
Held-to-maturity (Market value of $2,425 on June 30, 2012 and $2,450 on December 31, 2011)	2,425	2,450
Available-for-sale (Amortized cost of $5,077,867 on June 30, 2012 and $5,082,095 on December 31, 2011)	5,208,603	5,213,915
Total investment securities	5,211,028	5,216,365
Loans	4,878,322	5,053,475
Less allowance for probable loan losses	(70,378)	(84,192)
Net loans	4,807,944	4,969,283
Bank premises and equipment, net	454,433	453,050
Accrued interest receivable	31,290	32,002
Other investments	337,411	351,209
Identified intangible assets, net	10,001	12,190
Goodwill, net	282,532	282,532
Other assets	201,450	161,133
Total assets	$ 11,555,996	$ 11,739,649

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition, continued (Unaudited)

(Dollars in Thousands)

	June 30, 2012	December 31, 2011
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Demand non-interest bearing	$ 2,035,263	$ 1,927,018
Savings and interest bearing demand	2,704,865	2,707,693
Time	3,419,495	3,311,381
Total deposits	8,159,623	7,946,092
Securities sold under repurchase agreements	1,329,998	1,348,629
Other borrowed funds	142,095	494,161
Junior subordinated deferrable interest debentures	190,726	190,726
Other liabilities	97,373	159,876
Total liabilities	9,919,815	10,139,484
Commitments, Contingent Liabilities and Other Tax Matters (Note 10)		
Shareholders equity:		
Series A Cumulative perpetual preferred shares, $.01 par value, $1,000 per share liquidation value. Authorized 25,000,000 shares; issued 216,000 shares on June 30, 2012, net of discount of $4,154,and issued 216,000 shares on December 31, 2011, net of discount of $5,452	211,846	210,548
Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 95,722,817,shares on June 30, 2012 and 95,719,652 shares on December 31, 2011	95,723	95,720
Surplus	163,050	162,767
Retained earnings	1,339,053	1,302,964
Accumulated other comprehensive income (including $(7,498) and $(6,889) of comprehensive loss related to other-than-temporary impairment for non-credit related issues)	84,273	84,959
	1,893,945	1,856,958
Less cost of shares in treasury, 28,494,286 shares on June 30, 2012 and 28,441,714 December 31, 2011	(257,764)	(256,793)
Total shareholders equity	1,636,181	1,600,165
Total liabilities and shareholders equity	$ 11,555,996	$ 11,739,649

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Interest income:				
Loans, including fees	$ 67,413	$ 74,574	$ 135,736	$ 149,254
Investment securities:				
Taxable	23,228	29,208	47,740	59,463
Tax-exempt	2,849	2,386	5,710	4,514
Other interest income	193	1,676	279	1,751
Total interest income	93,683	107,844	189,465	214,982
Interest expense:				
Savings deposits	1,479	2,232	3,102	4,494
Time deposits	6,255	8,145	12,740	16,915
Securities sold under repurchase agreements	10,267	10,613	20,569	21,199
Other borrowings	138	445	346	1,095
Junior subordinated interest deferrable debentures	1,901	2,998	3,948	6,035
Total interest expense	20,040	24,433	40,705	49,738
Net interest income	73,643	83,411	148,760	165,244
Provision (credit) for probable loan losses	6,107	(1,917)	11,392	2,163
Net interest income after provision (credit) for probable loan losses	67,536	85,328	137,368	163,081
Non-interest income:				
Service charges on deposit accounts	23,100	23,918	45,853	48,700
Other service charges, commissions and fees				
Banking	9,424	14,412	19,488	27,438
Non-banking	1,682	1,177	2,933	2,669
Gain on investment securities transactions, net	1,420	1,445	2,592	2,861
Other investments, net	2,647	4,220	7,781	9,576
Other income	2,546	2,692	5,349	4,986
Total non-interest income	40,819	47,864	83,996	96,230

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Non-interest expense:				
Employee compensation and benefits	$ 30,210	$ 32,620	$ 59,611	$ 64,655
Occupancy	8,107	9,015	16,841	17,616
Depreciation of bank premises and equipment	6,790	7,931	13,717	16,258
Professional fees	4,171	3,689	7,541	7,575
Deposit insurance assessments	1,490	2,592	3,057	5,049
Net expense, other real estate owned	1,385	8,150	2,566	9,264
Amortization of identified intangible assets	1,163	1,323	2,300	2,626
Advertising	1,970	1,840	3,797	3,627
Impairment charges (Total other-than-temporary impairment losses, $(301), net of $(523), $(254), net of $(420), $1,349, net of $941, and $1,055, net of $640, included in other comprehensive income)	222	166	408	415
Other	16,583	16,616	30,396	32,322
Total non-interest expense	72,091	83,942	140,234	159,407
Income before income taxes	36,264	49,250	81,130	99,904
Provision for income taxes	11,714	16,626	24,893	33,759
Net income	24,550	32,624	56,237	66,145
Preferred stock dividends	3,355	3,315	6,698	6,620
Net income available to common shareholders	$ 21,195	$ 29,309	$ 49,539	$ 59,525
Basic earnings per common share:				
Weighted average number of shares outstanding:	67,244,005	67,628,223	67,257,456	67,664,567
Net income	$ .32	$ .43	$ .74	$ .88
Fully diluted earnings per common share:				
Weighted average number of shares outstanding:	67,323,912	67,689,784	67,339,550	67,734,494
Net income	$ .31	$ .43	$ .74	$ .88

See accompanying notes to consolidated financial statements.

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net income	$ 24,550	$ 32,624	$ 56,237	$ 66,145
Other comprehensive income, net of tax				
Net unrealized holding gains on securities available for sale arising during period (tax effects of $4,354, $29,866, $395 and $31,877)	8,086	55,465	734	59,201
Reclassification adjustment for gains on securities available for sale included in net income (tax effects of $(497), $(505), $(907) and $(1,001))	(923)	(940)	(1,685)	(1,860)
Reclassification adjustment for impairment charges on available for sale securities included in net income (tax effects of $78, $58, $143 and $145)	144	108	265	270
	7,307	54,633	(686)	57,611
Comprehensive income	$ 31,857	$ 87,257	$ 55,551	$ 123,756

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Operating activities:		
Net income	$ 56,237	$ 66,145
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for probable loan losses	11,392	2,163
Specific reserve, other real estate owned	741	7,710
Accretion of time deposit discounts		(7)
Depreciation of bank premises and equipment	13,717	16,258
Gain on sale of bank premises and equipment	(319)	(332)
Gain on sale of other real estate owned	(395)	(254)
Accretion of investment securities discounts	(1,521)	(870)
Amortization of investment securities premiums	13,339	10,223
Investment securities transactions, net	(2,592)	(2,861)
Impairment charges on available-for-sale investment securities	408	415
Amortization of junior subordinated debenture discounts		9
Amortization of identified intangible assets	2,300	2,626
Stock based compensation expense	253	195
Earnings from affiliates and other investments	(7,348)	(8,980)
Deferred tax expense (benefit)	2,869	(2,283)
Decrease in accrued interest receivable	712	1,691
Net (increase) decrease in other assets	(123)	34,476
Net increase in other liabilities	5,138	2,942
Net cash provided by operating activities	94,808	129,266
Investing activities:		
Proceeds from maturities of held-to-maturity securities	1,100	500
Proceeds from sales and calls of available for sale securities	72,383	774,856
Purchases of available for sale securities	(792,642)	(1,331,496)
Principal collected on mortgage-backed securities	643,667	497,445
Net decrease in loans	94,229	62,252
Purchases of other investments	(1,860)	(2,173)
Distributions received on other investments	23,006	13,556
Purchases of bank premises and equipment	(17,282)	(9,018)
Proceeds from sales of other real estate owned	15,066	7,341
Proceeds from sale of bank premises and equipment	2,501	1,109
Net cash provided by investing activities	40,168	14,372

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Six Months Ended June 30, 2012	2011
Financing activities:		
Net increase in non-interest bearing demand deposits	$ 108,245	$ 107,280
Net (decrease) increase in savings and interest bearing demand deposits	(2,828)	149,421
Net increase (decrease) in time deposits	108,114	(69,367)
Net decrease in securities sold under repurchase agreements	(18,631)	(9,681)
Net decrease in other borrowed funds	(352,066)	(270,879)
Repayment of long-term debt		(5,200)
Purchase of treasury stock	(971)	(2,951)
Proceeds from stock transactions	33	110
Payments of dividends on common stock	(13,450)	(12,863)
Payments of dividends on preferred stock	(5,400)	(5,400)
Net cash used in financing activities	(176,954)	(119,530)
(Decrease) increase in cash and cash equivalents	(41,978)	24,108
Cash and cash equivalents at beginning of period	261,885	197,814
Cash and cash equivalents at end of period	$ 219,907	$ 221,922
Supplemental cash flow information:		
Interest paid	42,268	52,494
Income taxes paid	14,719	42,773
Non-cash investing and financing activities:		
Accrued dividends, preferred shares	1,350	1,350
Net transfer from loans to other real estate owned	57,605	42,383
Purchases of available-for-sale securities not yet settled	2,427	
Accrued partial redemption of trust preferred securities, IB Capital Trust I		5,200

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 - Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (Corporation) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo (IBC), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, IBC Capital Corporation and Premier Tierra Holdings, Inc. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2011 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

The Company operates as one segment. The operating information used by the Company s chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville.

The Company has evaluated all events or transactions that occurred through the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

Note 2 Fair Value Measurements

ASC Topic 820, Fair Value Measurements and Disclosures (ASC 820) defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; it also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2 Inputs Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 Inputs Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy is set forth below.

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of June 30, 2012 by level within the fair value measurement hierarchy:

	Fair Value Measurements at Reporting Date Using (in thousands)			
	Assets/Liabilities Measured at Fair Value June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured on a recurring basis:				
Assets:				
Available for sale securities				
Residential mortgage-backed securities	$ 4,953,594	$	$ 4,917,718	$ 35,876
States and political subdivisions	233,899		233,899	
Other	21,110	21,110		
Total	$ 5,208,603	$ 21,110	$ 5,151,617	$ 35,876

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of December 31, 2011 by level within the fair value measurement hierarchy:

	Fair Value Measurements at Reporting Date Using (in thousands)			
	Assets/Liabilities Measured at Fair Value December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured on a recurring basis:				
Assets:				
Available for sale securities				
Residential mortgage-backed securities	$ 4,969,263	$	$ 4,929,658	$ 39,605
States and political subdivisions	224,761		224,761	
Other	19,891	19,891		
Total	$ 5,213,915	$ 19,891	$ 5,154,419	$ 39,605

Investment securities available-for-sale are classified within level 2 and level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within level 1. For investments classified as level 2 in the fair value hierarchy, the Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. Investment securities classified as level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in inactive markets and markets that have experienced significant decreases in volume and level of activity, as evidenced by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company used a discounted cash flow model to determine fair value. Inputs in the model included both historical performance and expected future performance based on information currently available.

Assumptions used in the discounted cash flow model for the quarter and six months ended June 30, 2012, were applied separately to those portions of the bond where the underlying residential mortgage loans had been performing under original contract terms for at least the prior 24 months and those where the underlying residential mortgages had not been meeting the original contractual obligation for the same period. Unobservable inputs included in the model are estimates on future principal prepayment rates, and default and loss severity rates. For that portion of the bond where the underlying residential mortgage had been meeting the original contract terms for at least 24 months, the Company used the following estimates in the model: (i) a voluntary prepayment rate of 7%, (ii) a 1% default rate, (iii) a loss severity rate of 25%, and (iv) a discount rate of 13%. The assumptions used in the model for the rest of the bond included the following estimates: (i) a voluntary prepayment rate of 2%, (ii) a default rate of 9%, (iii) a loss severity rate that starts at 60% for the first year then declines by 5% for the following five years and remains at 25% thereafter, and (iv) a discount rate of 13%. The estimates used in the model to determine fair value are based on observable historical data of the underlying collateral. The model anticipates that the housing market will gradually improve and that the underlying collateral will eventually all perform in accordance with the original contract terms on the bond. Should the number of loans in the underlying collateral that default and go into foreclosure or the severity of the losses in the underlying collateral significantly change, the results of the model would be impacted. The Company will continue to evaluate the actual historical performance of the underlying collateral and will modify the assumptions used in the model as necessary. As actual historical information has become more widely available to investors, the Company determined that this approach to the model was appropriate and therefore, modified the model that had been used in prior periods. The change did not significantly impact the results of the model.

Assumptions used in the model for the year ended December 31, 2011, included estimates on future principal prepayment rates, default and loss severity rates. The Company estimates that future principal prepayment rates will range from 4 5% and used a 13% discount rate. Default rates used in the model were 10 11% for the first year and 7% thereafter, and loss severity rates started at 60% for the first year and are decreased by 10% for the following three years, then remain at 20% thereafter.

The following table presents a reconciliation of activity for such mortgage-backed securities on a net basis (dollars in thousands):

Balance at December 31, 2011	$	39,605
Principal paydowns		(2,380)
Total unrealized losses included in:		
Other comprehensive income		(941)
Impairment realized in earnings		(408)
Balance at June 30, 2012	$	35,876

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

The following table represents assets measured at fair value on a non-recurring basis as of and for the period ended June 30, 2012 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Six months ended June 30, 2012	Fair Value Measurements at Reporting Date Using (in thousands) Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	(Credit) Provision During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 12,709	$	$	$ 12,709	$ (527)
Other real estate owned	13,407			10,924	668

The following table represents assets measured at fair value on a non-recurring basis as of and for the year ended December 31, 2011 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Year ended December 31, 2011	Fair Value Measurements at Reporting Date Using (in thousands) Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Provision During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 81,723	$	$	$ 81,723	$ 15,457
Other real estate owned	34,631			34,631	9,509

The Company s assets measured at fair value on a non-recurring basis are limited to impaired loans and other real estate owned. Impaired loans are classified within level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, Receivables . The fair value of impaired loans is based on the fair value of the collateral, as determined through an external appraisal process, discounted based on internal criteria. Impaired loans are primarily comprised of collateral-dependent commercial loans. Impaired loans are remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for probable loan losses based upon the fair value of the underlying collateral.

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate owned is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal) within level 3 of the fair value hierarchy. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. The fair value is reviewed periodically and subsequent write downs are made accordingly through a charge to operations. Other real estate owned is included in other assets on the consolidated financial statements. For the six months ended June 30, 2012 and the twelve months ended December 31, 2011, the Company recorded $16,775,000 and $1,100,000 in charges to the allowance for probable loan losses in connection with loans transferred to other real estate owned. For the six months ended June 30, 2012 and twelve months ended December 31, 2011, the Company recorded $668,000 and $9,509,000 in write downs in fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for the Company s financial instruments at June 30, 2012 and December 31, 2011 are outlined below.

Cash and Due From Banks and Federal Funds Sold

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Time Deposits with Banks

The carrying amounts of time deposits with banks approximate fair value.

Investment Securities Held-to-Maturity

The carrying amounts of investments held-to-maturity approximate fair value.

Investment Securities

For investment securities, which include U.S. Treasury securities, obligations of other U.S. government agencies, obligations of states and political subdivisions and mortgage pass through and related securities, fair values are from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. See disclosures of fair value of investment securities in Note 6.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate and consumer loans as outlined by regulatory reporting guidelines. Each category is segmented into fixed and variable interest rate terms and by performing and non-performing categories.

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, excluding impaired loans and residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed rate performing loans are within Level 2 of the fair value hierarchy. At June 30, 2012, and December 31, 2011, the carrying amount of fixed rate performing loans was $1,203,071,000 and $1,273,989,000 respectively, and the estimated fair value was $1,137,384,000 and $1,200,837,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of June 30, 2012 and December 31, 2011. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. Time deposits are within Level 2 of the fair value hierarchy. At June 30, 2012 and December 31, 2011, the carrying amount of time deposits was $3,419,495,000 and $3,311,381,000, respectively, and the estimated fair value was $3,430,336,000 and $3,323,680,000, respectively.

Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at June 30, 2012 and December 31, 2011. The fair value of the long-term instruments is based on established market spreads using option adjusted spreads methodology. Long-term repurchase agreements are within level 2 of the fair value hierarchy. At June 30, 2012 and December 31, 2011, the carrying amount of long-term repurchase agreements was $1,000,000,000 and the estimated fair value was $1,166,668,000 and $1,161,849,000, respectively.

Junior Subordinated Deferrable Interest Debentures

The Company currently has fixed and floating rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at June 30, 2012 and December 31, 2011. The fair value of the fixed rate junior subordinated deferrable interest debentures is based on established market spreads to similar debt instruments with similar characteristics to the debentures. The fixed rate junior subordinated deferrable interest debentures are within level 2 of the fair value hierarchy. At June 30, 2012 and December 31, 2011, the carrying amount of fixed rate junior subordinated deferrable interest debentures was $20,619,000 and $87,630,000, respectively, and the estimated fair value was $11,340,000 and $43,403,000, respectively.

Other Borrowed Funds

The company currently has short and long-term borrowings issued from the Federal Home Loan Bank (FHLB). Due to the contractual terms of the short-term borrowings, the carrying amounts approximated fair value at June 30, 2012 and December 31, 2011. The fair value of the long-term borrowings is based on established market spreads for similar types of borrowings. The long-term borrowings are included in Level 2 of the fair value hierarchy. At June 30, 2012 and December 31, 2011, the carrying amount of the long-term FHLB borrowings was $6,595,000, and $6,661,000, respectively, and the estimated fair value was $7,142,000 and $6,998,000, respectively.

Commitments to Extend Credit and Letters of Credit

Commitments to extend credit and fund letters of credit are principally at current interest rates, and, therefore, the carrying amount approximates fair value.

Limitations

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on-and off-statement of condition financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include the bank premises and equipment and core deposit value. In addition, the tax ramifications related to the effect of fair value estimates have not been considered in the above estimates.

Note 3 Loans

A summary of loans, by loan type at June 30, 2012 and December 31, 2011 is as follows:

	June 30, 2012 (Dollars in Thousands)	December 31, 2011
Commercial, financial and agricultural	$ 2,533,270	$ 2,560,102
Real estate mortgage	842,312	895,870
Real estate construction	1,210,491	1,273,389
Consumer	83,199	94,109
Foreign	209,050	230,005
Total loans	$ 4,878,322	$ 5,053,475

Note 4 - Allowance for Probable Loan Losses

The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the bank subsidiaries. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each bank subsidiary is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance for probable loan losses is derived from the following elements: (i) allowances established on specific loans, which are based on a review of the individual characteristics of each loan, including the customer s ability to repay the loan, the underlying collateral values, and the industry in which the customer operates, (ii) allowances based on actual historical loss experience for similar types of loans in the Company s loan portfolio, and (iii) allowances based on general economic conditions, changes in the mix of loans, company resources, border risk and credit quality indicators, among other things. All segments of the loan portfolio continue to be impacted by the prolonged economic downturn. Loans secured by real estate could be impacted negatively by the continued economic environment and resulting decrease in collateral values. Consumer loans may be impacted by continued and prolonged unemployment rates.

The Company s management continually reviews the allowance for loan losses of the bank subsidiaries using the amounts determined from the allowances established on specific loans, the allowance established on quantitative historical loss percentages, and the allowance based on qualitative data to establish an appropriate amount to maintain in the Company s allowance for loan losses. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, the Company s estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses. While the calculation of the allowance for probable loan losses utilizes management s best judgment and all information available, the adequacy of the allowance is dependent on a variety of factors beyond the Company s control, including, among other things, the performance of the entire loan portfolio, the economy, changes in interest rates and the view of regulatory authorities towards loan classifications.

The specific loan loss provision is determined using the following methods. On a weekly basis, loan past due reports are reviewed by the servicing loan officer to determine if a loan has any potential problems and if a loan should be placed on the Company s internal classified report. Additionally, the Company s credit department reviews the majority of the Company s loans regardless of whether they are past due and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, the Company will determine if a loan should be placed on an internal classified report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

A summary of the transactions in the allowance for probable loan losses by loan class is as follows:

Quarter ended June 30, 2012		
Domestic		Foreign
Commercial	Commercial real estate: other construction & land development	