CULLEN FROST BANKERS INC
Form 10-Q
April 27, 2011
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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, 2011

Or

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from _____ to _____

Commission file number: 001-13221

Cullen/Frost Bankers, Inc.

(Exact name of registrant as specified in its charter)

Texas **(State or other jurisdiction of** **incorporation or organization)**	**74-1751768** **(I.R.S. Employer** **Identification No.)**
100 W. Houston Street, San Antonio, Texas **(Address of principal executive offices)**	**78205** **(Zip code)**

(210) 220-4011

(Registrant s telephone number, including area code)

N/A

(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 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 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 x	Accelerated filer ¨
Non-accelerated filer ¨ (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

As of April 21, 2011, there were 61,254,693 shares of the registrant s Common Stock, $.01 par value, outstanding.

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Cullen/Frost Bankers, Inc.

Quarterly Report on Form 10-Q

March 31, 2011

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Part I. Financial Information

Item 1. Financial Statements (Unaudited)

Cullen/Frost Bankers, Inc.

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Interest income:		
Loans, including fees	$ 98,488	$ 102,512
Securities:		
Taxable	31,185	29,075
Tax-exempt	22,733	19,709
Interest-bearing deposits	1,171	855
Federal funds sold and resell agreements	16	10
Total interest income	153,593	152,161
Interest expense:		
Deposits	5,951	8,561
Federal funds purchased and repurchase agreements	131	58
Junior subordinated deferrable interest debentures	1,672	1,773
Other long-term borrowings	4,080	4,185
Total interest expense	11,834	14,577
Net interest income	141,759	137,584
Provision for possible loan losses	9,450	13,571
Net interest income after provision for possible loan losses	132,309	124,013
Non-interest income:		
Trust fees	18,220	16,963
Service charges on deposit accounts	23,368	24,809
Insurance commissions and fees	10,494	11,138
Other charges, commissions and fees	8,759	6,919
Net gain on securities transactions	5	5
Other	11,487	11,559
Total non-interest income	72,333	71,393
Non-interest expense:		
Salaries and wages	62,430	60,275
Employee benefits	15,311	14,521
Net occupancy	11,652	11,135
Furniture and equipment	12,281	11,489
Deposit insurance	4,760	5,443
Intangible amortization	1,120	1,333
Other	32,507	30,398
Total non-interest expense	140,061	134,594

Income before income taxes	64,581	60,812
Income taxes	12,653	12,994
Net income	$ 51,928	$ 47,818
Earnings per common share:		
Basic	$ 0.85	$ 0.79
Diluted	0.85	0.79

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)

	March 31, 2011	December 31, 2010	March 31, 2010
Assets:			
Cash and due from banks	$ 587,655	$ 587,847	$ 493,777
Interest-bearing deposits	2,101,014	2,171,828	2,059,720
Federal funds sold and resell agreements	10,002	61,302	6,240
Total cash and cash equivalents	2,698,671	2,820,977	2,559,737
Securities held to maturity, at amortized cost	341,034	283,629	5,923
Securities available for sale, at estimated fair value	5,662,211	5,157,470	4,713,349
Trading account securities	20,746	15,101	16,611
Loans, net of unearned discounts	8,025,080	8,117,020	8,189,591
Less: Allowance for possible loan losses	(124,321)	(126,316)	(125,369)
Net loans	7,900,759	7,990,704	8,064,222
Premises and equipment, net	313,233	316,909	322,721
Goodwill	527,684	527,684	527,684
Other intangible assets, net	13,215	14,335	18,127
Cash surrender value of life insurance policies	130,910	129,922	126,501
Accrued interest receivable and other assets	333,181	360,361	406,105
Total assets	$ 17,941,644	$ 17,617,092	$ 16,760,980
Liabilities:			
Deposits:			
Non-interest-bearing demand deposits	$ 5,413,002	$ 5,360,436	$ 4,887,224
Interest-bearing deposits	9,296,557	9,118,906	8,846,524
Total deposits	14,709,559	14,479,342	13,733,748
Federal funds purchased and repurchase agreements	553,571	475,673	481,453
Junior subordinated deferrable interest debentures	123,712	123,712	136,084
Other long-term borrowings	250,040	250,045	256,558
Accrued interest payable and other liabilities	207,411	226,640	203,897
Total liabilities	15,844,293	15,555,412	14,811,740
Shareholders Equity:			
Preferred stock, par value $0.01 per share; 10,000,000 shares authorized; none issued			
Junior participating preferred stock, par value $0.01 per share; 250,000 shares authorized; none issued			
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 61,244,157, shares issued at March 31, 2011, 61,108,184 shares issued at December 31, 2010 and 60,443,221 shares issued at March 31, 2010	613	611	605
Additional paid-in capital	668,237	657,335	613,989
Retained earnings	1,273,826	1,249,484	1,170,642
Accumulated other comprehensive income, net of tax	154,818	154,250	164,004
Treasury stock, 2,464 shares at March 31, 2011, at cost	(143)		
Total shareholders equity	2,097,351	2,061,680	1,949,240

Total liabilities and shareholders equity	$ 17,941,644	$ 17,617,092	$ 16,760,980

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Changes in Shareholders Equity

(Dollars in thousands, except per share amounts)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Total shareholders equity at beginning of period	$ 2,061,680	$ 1,894,424
Comprehensive income:		
Net income	51,928	47,818
Other comprehensive income	568	9,799
Total comprehensive income	52,496	57,617
Stock option exercises (114,293 shares in 2011 and 337,575 shares in 2010)	5,769	15,865
Stock compensation expense recognized in earnings	3,737	3,648
Tax benefits related to stock compensation	89	44
Purchase of treasury stock (3,464 shares in 2011 and 3,406 shares in 2010)	(201)	(193)
Treasury stock issued/sold to the 401(k) stock purchase plan (40,019 shares in 2010)		2,069
Common stock issued/sold to the 401(k) stock purchase plan (22,680 shares in 2011 and 30,757 shares in 2010)	1,360	1,688
Cash dividends ($0.45 per share in 2011 and $0.43 per share in 2010)	(27,579)	(25,922)
Total shareholders equity at end of period	$ 2,097,351	$ 1,949,240

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Cash Flows

(Dollars in thousands)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Operating Activities:		
Net income	$ 51,928	$ 47,818
Adjustments to reconcile net income to net cash from operating activities:		
Provision for possible loan losses	9,450	13,571
Deferred tax expense (benefit)	(139)	(393)
Accretion of loan discounts	(2,366)	(2,687)
Securities premium amortization (discount accretion), net	2,368	2,497
Net gain on securities transactions	(5)	(5)
Depreciation and amortization	9,191	8,970
Net loss on sale of loans held for sale and other assets	1,597	1,864
Stock-based compensation	3,737	3,648
Net tax benefit (deficiency) from stock-based compensation	(65)	(215)
Excess tax benefits from stock-based compensation	(154)	(259)
Earnings on life insurance policies	(988)	(1,096)
Net change in:		
Trading account securities	(5,645)	(485)
Student loans held for sale		5,537
Accrued interest receivable and other assets	27,621	10,488
Accrued interest payable and other liabilities	(25,293)	(4,067)
Net cash from operating activities	71,237	85,186
Investing Activities:		
Securities held to maturity:		
Purchases	(57,547)	
Maturities, calls and principal repayments	156	190
Securities available for sale:		
Purchases	(6,195,353)	(7,068,993)
Sales	5,547,541	6,998,743
Maturities, calls and principal repayments	148,979	249,546
Net change in loans	75,427	156,791
Proceeds from sales of premises and equipment	988	577
Purchases of premises and equipment	(3,586)	(4,440)
Proceeds from sales of repossessed properties	3,599	9,961
Net cash from investing activities	(479,796)	342,375
Financing Activities:		
Net change in deposits	230,217	420,438
Net change in short-term borrowings	77,898	(595)
Principal payments on long-term borrowings	(5)	(4)
Proceeds from stock option exercises	5,769	15,865
Excess tax benefits from stock-based compensation	154	259
Purchase of treasury stock	(201)	(193)
Common stock/treasury stock sold to the 401(k) stock purchase plan		849
Cash dividends paid	(27,579)	(25,922)

Net cash from financing activities	286,253	410,697
Net change in cash and cash equivalents	(122,306)	838,258
Cash and equivalents at beginning of period	2,820,977	1,721,479
Cash and equivalents at end of period	$ 2,698,671	$ 2,559,737

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Notes to Consolidated Financial Statements

(Table amounts in thousands, except for share and per share amounts)

Note 1 - Significant Accounting Policies

Nature of Operations. Cullen/Frost Bankers, Inc. (Cullen/Frost) is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout numerous Texas markets. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, investment banking, insurance, brokerage, leasing, asset-based lending, treasury management and item processing.

Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest (collectively referred to as the Corporation). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies the Corporation follows conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.

The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Corporation s financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with the Corporation s consolidated financial statements, and notes thereto, for the year ended December 31, 2010, included in the Corporation s Annual Report on Form 10-K filed with the SEC on February 3, 2011 (the 2010 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for possible loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly subject to change.

Cash Flow Reporting. Additional cash flow information was as follows:

	Three Months Ended March 31,	
	2011	**2010**
Cash paid for interest	$ 16,634	$ 20,418
Cash paid for income tax		997
Significant non-cash transactions:		
Loans foreclosed and transferred to other real estate owned and foreclosed assets	7,434	5,396
Loans to facilitate the sale of other real estate owned		185
Common stock/treasury stock issued to the Corporation s 401(k) stock purchase plan	1,360	2,908

Reclassifications. Certain items in prior financial statements have been reclassified to conform to the current presentation.

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Note 2 - Securities

A summary of the amortized cost and estimated fair value of securities, excluding trading securities, is presented below.

	March 31, 2011				December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held to Maturity								
U. S. Treasury	$ 247,512	$ 11,707	$	$ 259,219	$ 247,421	$ 13,517	$	$ 260,938
Residential mortgage-backed securities	4,249	162		4,411	4,405	136		4,541
States and political subdivisions	88,273	65	1,457	86,881	30,803		1,054	29,749
Other	1,000			1,000	1,000			1,000
Total	$ 341,034	$ 11,934	$ 1,457	$ 351,511	$ 283,629	$ 13,653	$ 1,054	$ 296,228
Available for Sale:								
U. S. Treasury	$ 973,159	$ 10,825	$ 66	$ 983,918	$ 973,033	$ 13,998	$	$ 987,031
Residential mortgage-backed securities	2,465,614	103,092	5,208	2,563,498	1,989,299	103,018	987	2,091,330
States and political subdivisions	2,028,626	60,261	12,908	2,075,979	2,008,618	53,358	21,676	2,040,300
Other	38,816			38,816	38,809			38,809
Total	$ 5,506,215	$ 174,178	$ 18,182	$ 5,662,211	$ 5,009,759	$ 170,374	$ 22,663	$ 5,157,470

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities in the above table. The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law was $2.1 billion and $2.3 billion at March 31, 2011 and December 31, 2010.

As of March 31, 2011, securities, with unrealized losses segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
States and political subdivisions	$ 73,796	$ 1,457	$	$	$ 73,796	$ 1,457
Total	$ 73,796	$ 1,457	$	$	$ 73,796	$ 1,457
Available for Sale						
U.S. Treasury	$ 250,370	$ 66	$	$	$ 250,370	$ 66
Residential mortgage-backed securities	404,232	5,208			404,232	5,208
States and political subdivisions	604,776	12,848	634	60	605,410	12,908
Total	$ 1,259,378	$ 18,122	$ 634	$ 60	$ 1,260,012	$ 18,182

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost.

Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time the Corporation will receive full value for the securities. Furthermore, as of March 31, 2011, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Corporation will not have to sell any such securities before a recovery of cost. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of March 31, 2011, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation s consolidated income statement.

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The amortized cost and estimated fair value of securities, excluding trading securities, at March 31, 2011 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Residential mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$	$	$ 244,597	$ 245,799
Due after one year through five years	1,000	1,000	823,903	837,128
Due after five years through ten years	247,512	259,219	177,391	184,306
Due after ten years	88,273	86,881	1,755,894	1,792,664
Residential mortgage-backed securities	4,249	4,411	2,465,614	2,563,498
Equity securities			38,816	38,816
Total	$ 341,034	$ 351,511	$ 5,506,215	$ 5,662,211

Sales of securities available for sale were as follows:

	Three Months Ended March 31,	
	2011	2010
Proceeds from sales	$ 5,547,541	$ 6,998,743
Gross realized gains	9	7
Gross realized losses	4	2

Trading account securities, at estimated fair value, were as follows:

	March 31, 2011	December 31, 2010
U.S. Treasury	$ 15,705	$ 14,986
States and political subdivisions	5,041	115
Total	$ 20,746	$ 15,101

Net gains and losses on trading account securities were as follows:

	Three Months Ended March 31,	
	2011	2010
Net gain on sales transactions	$ 308	$ 482
Net mark-to-market gains		52
Net gain on trading account securities	$ 308	$ 534

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Note 3 - Loans

Loans were as follows:

	March 31, 2011	Percentage of Total	December 31, 2010	Percentage of Total	March 31, 2010	Percentage of Total
Commercial and industrial:						
Commercial	$ 3,393,769	42.3%	$ 3,479,349	42.9%	$ 3,466,706	42.3%
Leases	194,692	2.4	186,443	2.3	185,540	2.3
Asset-based	134,783	1.7	122,866	1.5	118,342	1.5
Total commercial and industrial	3,723,244	46.4	3,788,658	46.7	3,770,588	46.1
Commercial real estate:						
Commercial mortgages	2,410,760	30.0	2,374,542	29.3	2,333,703	28.5
Construction	574,637	7.2	593,273	7.3	635,146	7.7
Land	227,297	2.8	234,952	2.9	235,536	2.9
Total commercial real estate	3,212,694	40.0	3,202,767	39.5	3,204,385	39.1
Consumer real estate:						
Home equity loans	274,952	3.4	275,806	3.4	279,012	3.4
Home equity lines of credit	187,573	2.3	186,465	2.3	169,393	2.1
1-4 family residential mortgages	53,587	0.7	57,877	0.7	66,368	0.8
Construction	23,504	0.3	23,565	0.3	26,876	0.3
Other	244,752	3.1	254,551	3.1	274,164	3.4
Total consumer real estate	784,368	9.8	798,264	9.8	815,813	10.0
Total real estate	3,997,062	49.8	4,001,031	49.3	4,020,198	49.1
Consumer and other:						
Consumer installment	307,812	3.9	319,384	3.9	336,604	4.1
Student loans held for sale					18,771	0.2
Other	17,310	0.2	28,234	0.4	64,732	0.8
Total consumer and other	325,122	4.1	347,618	4.3	420,107	5.1
Unearned discounts	(20,348)	(0.3)	(20,287)	(0.3)	(21,302)	(0.3)
Total loans	$ 8,025,080	100.0%	$ 8,117,020	100.0%	$ 8,189,591	100.0%

Loan Origination/Risk Management. The Corporation has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower s ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower s management possesses sound ethics and solid business acumen, the Corporation s management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation s commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Corporation s exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Corporation also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At March 31, 2011, approximately 62% of the outstanding principal balance of the Corporation s commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Corporation may originate from time to time, the Corporation generally requires the borrower to have had an existing relationship with the Corporation and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Corporation until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Corporation originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.

The Corporation maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Corporation s policies and procedures.

Concentrations of Credit. Most of the Corporation s lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of the Corporation s loan portfolio consists of commercial and industrial and commercial real estate loans. As of March 31, 2011 there were no concentrations of loans related to any single industry in excess of 10% of total loans.

Student Loans Held for Sale. Prior to the second quarter of 2008, the Corporation originated student loans primarily for sale in the secondary market. These loans were generally sold on a non-recourse basis and were carried at the lower of cost or market on an aggregate basis. During the second quarter of 2008, the Corporation elected to discontinue the origination of student loans for resale, aside from previously outstanding commitments. All remaining student loans were sold during the second quarter of 2010.

Foreign Loans. The Corporation has U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at March 31, 2011 or December 31, 2010.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management s opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received in excess of principal due. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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Non-accrual loans, segregated by class of loans, were as follows:

	March 31, 2011	December 31, 2010	March 31, 2010
Commercial and industrial:			
Energy	$	$	$ 2,564
Other commercial	58,681	60,408	70,948
Commercial real estate:			
Buildings, land and other	53,920	64,213	59,307
Construction	6,888	9,299	7,234
Consumer real estate	3,741	2,758	3,813
Consumer and other	581	462	751
Total	$ 123,811	$ 137,140	$ 144,617

Had non-accrual loans performed in accordance with their original contract terms, the Corporation would have recognized additional interest income, net of tax, of approximately $1.3 million for the three months ended March 31, 2011, compared to $1.0 million for the same period in 2010.

An age analysis of past due loans, segregated by class of loans, as of March 31, 2011 was as follows:

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and industrial:						
Energy	$	$	$	$ 761,570	$ 761,570	$
Other commercial	38,628	38,781	77,409	2,884,265	2,961,674	14,708
Commercial real estate:						
Buildings, land and other	24,935	44,822	69,757	2,568,300	2,638,057	6,226
Construction	7,693	3,185	10,878	563,759	574,637	1,007
Consumer real estate	8,642	5,278	13,920	770,448	784,368	2,357
Consumer and other	2,478	356	2,834	322,288	325,122	201
Unearned discounts				(20,348)	(20,348)	
Total	$ 82,376	$ 92,422	$ 174,798	$ 7,850,282	$ 8,025,080	$ 24,499

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

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Impaired loans are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired. Average recorded investment is reported on a year-to-date basis.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
March 31, 2011						
Commercial and industrial:						
Energy	$	$	$	$	$	$
Other commercial	70,411	27,742	25,245	52,987	13,066	54,215
Commercial real estate:						
Buildings, land and other	62,993	42,021	9,515	51,536	3,626	56,671
Construction	7,124	6,587		6,587		7,944
Consumer real estate	1,786	1,786		1,786		1,152
Consumer and other	102	101		101		51
Total	$ 142,416	$ 78,237	$ 34,760	$ 112,997	$ 16,692	$ 120,033
December 31, 2010						
Commercial and industrial:						
Energy	$	$	$	$	$	$ 1,012
Other commercial	73,518	40,901	14,541	55,442	9,137	61,076
Commercial real estate:						
Buildings, land and other	72,099	50,551	11,254	61,805	4,076	59,179
Construction	9,834	8,553	747	9,300	300	8,132
Consumer real estate	517	517		517		960
Consumer and other						393
Total	$ 155,968	$ 100,522	$ 26,542	$ 127,064	$ 13,513	$ 130,752
March 31, 2010						
Commercial and industrial:						
Energy	$ 2,738	$ 1,500	$ 1,064	$ 2,564	$ 1,064	$ 1,815
Other commercial	76,134	28,726	35,287	64,013	15,512	68,897
Commercial real estate:						
Buildings, land and other	68,002	36,677	20,321	56,998	2,229	54,751
Construction	7,225	5,254	1,680	6,934	539	6,775
Consumer real estate	1,258	1,258		1,258		1,258
Consumer and other	1,282	1,256		1,256		770
Total	$ 156,639	$ 74,671	$ 58,352	$ 133,023	$ 19,344	$ 134,266

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Corporation s loan portfolio, management tracks certain credit quality indicators including trends related to (i) the weighted-average risk grade of commercial loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) non-performing loans (see details above) and (v) the general economic conditions in the State of Texas.

The Corporation utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 14. A description of the general characteristics of the 14 risk grades is as follows:

Grades 1, 2 and 3 - These grades include loans to very high credit quality borrowers of investment or near investment grade. These borrowers are generally publicly traded (grades 1 and 2), have significant capital strength, moderate leverage, stable earnings and growth, and readily available financing alternatives. Smaller entities, regardless of strength, would generally not fit in these grades.

Grades 4 and 5 - These grades include loans to borrowers of solid credit quality with moderate risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality and the stability of the industry or market area.

Grades 6, 7 and 8 - These grades include pass grade loans to borrowers of acceptable credit quality and risk. Such borrowers are differentiated from Grades 4 and 5 in terms of size, secondary sources of repayment or they are of lesser stature in other key credit metrics in that they may be over-leveraged, under capitalized, inconsistent in performance or in an industry or an economic area that is known to have a higher level of risk, volatility, or susceptibility to weaknesses in the economy.

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Grade 9 - This grade includes loans on management s watch list and is intended to be utilized on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near term.

Grade 10 - This grade is for Other Assets Especially Mentioned in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.

Grade 11 - This grade includes Substandard loans, in accordance with regulatory guidelines, for which the accrual of interest has not been stopped. By definition under regulatory guidelines, a Substandard loan has defined weaknesses which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business.

Grade 12 - This grade includes Substandard loans, in accordance with regulatory guidelines, for which the accrual of interest has been stopped. This grade includes loans where interest is more than 120 days past due and not fully secured and loans where a specific valuation allowance may be necessary, but generally does not exceed 30% of the principal balance.

Grade 13 - This grade includes Doubtful loans in accordance with regulatory guidelines. Such loans are placed on non-accrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Additionally, these loans generally have a specific valuation allowance in excess of 30% of the principal balance.

Grade 14 - This grade includes Loss loans in accordance with regulatory guidelines. Such loans are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. Loss is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

The following table presents weighted average risk grades for all loans and the amount of classified loans by class of commercial loan. Classified loans include loans in Risk Grades 11, 12 and 13.

	March 31, 2011		**December 31, 2010**		**March 31, 2010**	
	Weighted Average Risk Grade	**Classified Loans**	**Weighted Average Risk Grade**	**Classified Loans**	**Weighted Average Risk Grade**	**Classified Loans**
Commercial and industrial:						
Energy	5.36	$	5.36	$	5.80	$ 2,800
Other commercial	6.75	171,035	6.75	198,323	6.92	210,133
Commercial real estate:						
Buildings, land and other	7.23	166,799	7.29	190,616	7.30	181,422
Construction	7.53	18,981	7.59	22,946	7.71	38,445
Total		$ 356,815		$ 411,885		$ 432,800

Net (charge-offs)/recoveries, segregated by class of loans, were as follows:

	Three Months Ended March 31,	
	2011	**2010**
Commercial and industrial:		

Energy	$	$
Other commercial	(6,830)	(8,635)
Commercial real estate:		
Buildings, land and other	(3,165)	(3,279)
Construction	(156)	(86)
Consumer real estate	(530)	(363)
Consumer and other	(764)	(1,148)
Total	$ (11,445)	$ (13,511)

In assessing the general economic conditions in the State of Texas, management monitors and tracks the Texas Leading Index (TLI), which is produced by the Federal Reserve Bank of Dallas. The TLI is a single summary statistic that is designed to signal the likelihood of the Texas economy s transition from expansion to recession and vice versa. Management believes this index provides a reliable indication of the direction of overall credit quality. The TLI is a composite of the following eight leading indicators: (i) Texas Value of the Dollar, (ii) U.S. Leading Index, (iii) real oil prices (iv) well permits, (v) initial claims for unemployment insurance, (vi) Texas Stock Index, (vii) Help-Wanted Index and (viii) average weekly hours worked in manufacturing. The TLI totaled 119.4 at February 28, 2011 (most recent date available), 118.2 at December 31, 2010 and 114.9 at March 31, 2010. A higher TLI value implies more favorable economic conditions.

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Allowance for Possible Loan Losses. The allowance for possible loan losses is a reserve established through a provision for possible loan losses charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Corporation s allowance for possible loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation s process for determining the appropriate level of the allowance for possible loan losses is designed to account for credit deterioration as it occurs. The provision for possible loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for possible loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for possible loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss and recovery experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Corporation s control, including, among other things, the performance of the Corporation s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Corporation s allowance for possible loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other risk factors both internal and external to the Corporation.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor s ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for possible loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower s ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower s industry, among other things.

Historical valuation allowances are calculated based on the historical gross loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Corporation calculates historical gross loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical gross loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical gross loss ratio and the total dollar amount of the loans in the pool. The Corporation s pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

General valuation allowances are based on general economic conditions and other risk factors both internal and external to the Corporation. In general, such valuation allowances are determined by evaluating, among other things: (i) the experience, ability and effectiveness of the bank s lending management and staff; (ii) the effectiveness of the Corporation s loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) changes in loan portfolio volume; (v) the composition and concentrations of credit; (vi) the impact of competition on loan structuring and pricing; (vii) the effectiveness of the internal loan review function; (viii) the impact of legislative and governmental influences affecting industry sectors and other environmental risks on portfolio risks; and (ix) the impact of rising interest rates on portfolio risk. Management evaluates the degree of risk that each one of these components has on the quality of the loan portfolio on a quarterly basis. Each component is determined to have either a high, moderate or low degree of risk. The results are then input into a general allocation matrix to determine an appropriate general valuation allowance.

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Certain general valuation allowances are not allocated to specific loan portfolio segments and are reported as unallocated in the allowance for possible loan losses activity tables below. Included in these general valuation allowances are allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy exceptions that exceed specified risk grades. In addition, during the first quarter of 2011, the Corporation further refined its methodology for the determination of general valuation allowances to also (i) provide additional allocations for loans that did not undergo a separate, independent concurrence review during the underwriting process (generally those loans under $1.0 million at origination), (ii) reduce the minimum balance/commitment threshold for which allocations are made for highly leveraged credit relationships that exceed specified risk grades, (iii) lower the maximum risk grade thresholds for highly leveraged credit relationships, and (iv) include a reduction factor for recoveries of prior charge-offs to compensate for the fact that historical loss allocations are based upon gross charge-offs rather than net. These changes to the Corporation s methodology for the determination of general valuation allowances did not significantly impact the provision for possible loan losses recorded during the three months ended March 31, 2011.

Loans identified as losses by management, internal loan review and/or bank examiners are charged-off. Furthermore, consumer loan accounts are charged-off automatically based on regulatory requirements.

The following table details activity in the allowance for possible loan losses by portfolio segment for the three months ended March 31, 2011 and 2010. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
March 31, 2011						
Beginning balance	$ 57,789	$ 28,534	$ 3,223	$ 11,974	$ 24,796	$ 126,316
Provision for possible loan losses	1,841	(662)	792	1,731	5,748	9,450
Charge-offs	(7,597)	(3,877)	(820)	(2,302)		(14,596)
Recoveries	767	556	290	1,538		3,151
Net charge-offs	(6,830)	(3,321)	(530)	(764)		(11,445)
Ending balance	$ 52,800	$ 24,551	$ 3,485	$ 12,941	$ 30,544	$ 124,321
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 31,065	$ 7,640	$	$	$	$ 38,705
Loans collectively evaluated for impairment	21,735	16,911	3,485	12,941	30,544	85,616
Ending balance	$ 52,800	$ 24,551	$ 3,485	$ 12,941	$ 30,544	$ 124,321
March 31, 2010						
Beginning balance	$ 57,394	$ 28,514	$ 2,560	$ 16,929	$ 19,912	$ 125,309
Provision for possible loan losses	14,817	5,110	233	3,908	(10,497)	13,571
Charge-offs	(9,175)	(3,413)	(375)	(2,843)		(15,806)
Recoveries	540	48	12	1,695		2,295
Net charge-offs	(8,635)	(3,365)	(363)	(1,148)		(13,511)
Ending balance	$ 63,576	$ 30,259	$ 2,430	$ 19,689	$ 9,415	$ 125,369
Period-end amount allocated to:						
Loans individually evaluated for impairment	$ 39,375	$ 8,511	$	$	$	$ 47,886
Loans collectively evaluated for impairment	24,201	21,748	2,430	19,689	9,415	77,483
Ending balance	$ 63,576	$ 30,259	$ 2,430	$ 19,689	$ 9,415	$ 125,369

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The Corporation s recorded investment in loans as of March 31, 2011, December 31, 2010 and March 31, 2010 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Corporation s impairment methodology was as follows:

	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unearned Discounts	Total
March 31, 2011						
Loans individually evaluated for impairment	$ 269,900	$ 295,214	$	$	$	$ 565,114
Loans collectively evaluated for impairment	3,453,344	2,917,480	784,368	325,122	(20,348)	7,459,966
Ending balance	$ 3,723,244	$ 3,212,694	$ 784,368	$ 325,122	$ (20,348)	$ 8,025,080
December 31, 2010						
Loans individually evaluated for impairment	$ 314,482	$ 337,578	$	$	$	$ 652,060
Loans collectively evaluated for impairment	3,474,176	2,865,189	798,264	347,618	(20,287)	7,464,960
Ending balance	$ 3,788,658	$ 3,202,767	$ 798,264	$ 347,618	$ (20,287)	$ 8,117,020
March 31, 2010						
Loans individually evaluated for impairment	$ 296,655	$ 361,196	$	$	$	$ 657,851
Loans collectively evaluated for impairment	3,473,933	2,843,189	815,813	420,107	(21,302)	7,531,740
Ending balance	$ 3,770,588	$ 3,204,385	$ 815,813	$ 420,107	$ (21,302)	$ 8,189,591

Note 4 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets were as follows:

	March 31, 2011	December 31, 2010
Goodwill	$ 527,684	$ 527,684
Other intangible assets:		
Core deposits	$ 10,892	$ 11,819
Customer relationship	2,097	2,253
Non-compete agreements	226	263
	$ 13,215	$ 14,335

The estimated aggregate future amortization expense for intangible assets remaining as of March 31, 2011 is as follows:

Remainder of 2011	$ 3,179
2012	3,500
2013	2,729
2014	1,944
2015	1,206
Thereafter	657

$ 13,215

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Note 5 - Deposits

Deposits were as follows:

	March 31, 2011	Percentage of Total	December 31, 2010	Percentage of Total	March 31, 2010	Percentage of Total
Non-interest-bearing demand deposits:						
Commercial and individual	$ 4,903,053	33.3%	$ 4,791,149	33.1%	$ 4,452,690	32.4%
Correspondent banks	290,099	2.0	361,100	2.5	269,705	2.0
Public funds	219,850	1.5	208,187	1.4	164,829	1.2
Total non-interest-bearing demand deposits	5,413,002	36.8	5,360,436	37.0	4,887,224	35.6
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	2,484,668	16.9	2,505,143	17.3	2,244,506	16.4
Money market accounts	5,243,830	35.6	4,949,764	34.2	4,877,836	35.5
Time accounts of $100,000 or more	609,166	4.2	611,836	4.2	609,327	4.4
Time accounts under $100,000	546,167	3.7	571,447	4.0	658,055	4.8
Total private accounts	8,883,831	60.4	8,638,190	59.7	8,389,724	61.1
Public funds:						
Savings and interest checking	183,752	1.3	255,605	1.8	225,543	1.6
Money market accounts	85,745	0.6	84,093	0.6	91,451	0.7
Time accounts of $100,000 or more	139,221	0.9	137,506	0.9	136,500	1.0
Time accounts under $100,000	4,008		3,512		3,306	
Total public funds	412,726	2.8	480,716	3.3	456,800	3.3
Total interest-bearing deposits	9,296,557	63.2	9,118,906	63.0	8,846,524	64.4
Total deposits	$ 14,709,559	100.0%	$ 14,479,342	100.0%	$ 13,733,748	100.0%

The following table presents additional information about the Corporation s deposits:

	March 31, 2011	December 31, 2010	March 31, 2010
Money market deposits obtained through brokers	$ 24,852	$ 24,700	$ 194,133
Deposits from the Certificate of Deposit Account Registry Service (CDARS) deposits	48,005	60,972	112,983
Deposits from foreign sources (primarily Mexico)	759,297	748,255	852,869

Note 6 - Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, the Corporation enters into various transactions, which, in accordance with generally accepted accounting principles are not included in its consolidated balance sheets. The Corporation enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Corporation minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

The Corporation enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Corporation would be entitled to seek recovery from the customer. The Corporation s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

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The Corporation considers the fees collected in connection with the issuance of standby letters of credit to be representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, the Corporation defers fees collected in connection with the issuance of standby letters of credit. The fees are then recognized in income proportionately over the life of the standby letter of credit agreement. The deferred standby letter of credit fees represent the fair value of the Corporation s potential obligations under the standby letter of credit guarantees.

Financial instruments with off-balance-sheet risk were as follows:

	March 31, 2011	December 31, 2010
Commitments to extend credit	$ 4,506,769	$ 4,528,196
Standby letters of credit	252,706	294,116
Deferred standby letter of credit fees	1,540	1,707

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $5.5 million and $5.3 million for the three months ended March 31, 2011 and 2010. There has been no significant change in the future minimum lease payments payable by the Corporation since December 31, 2010. See the 2010 Form 10-K for information regarding these commitments.

Litigation. The Corporation is subject to various claims and legal actions that have arisen in the course of conducting business. Management does not expect the ultimate disposition of these matters to have a material adverse impact on the Corporation s financial statements.

Note 7 - Regulatory Matters

Regulatory Capital Requirements. Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

Quantitative measures established by regulations to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

Cullen/Frost s and Frost Bank s Tier 1 capital consists of shareholders equity excluding unrealized gains and losses on securities available for sale, the accumulated gain or loss on effective cash flow hedging derivatives, the net actuarial gain/loss on the Corporation s defined benefit post-retirement benefit plans, goodwill and other intangible assets. Tier 1 capital for Cullen/Frost also includes $120 million of trust preferred securities issued by an unconsolidated subsidiary trust. Cullen/Frost s and Frost Bank s total capital is comprised of Tier 1 capital for each entity plus a permissible portion of the allowance for possible loan losses. The Corporation s aggregate $100 million of 5.75% fixed-to-floating rate subordinated notes are not included in Tier 1 capital but are included in total capital of Cullen/Frost.

The Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets, allocated by risk weight category, and certain off-balance-sheet items (primarily loan commitments). The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets.

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Actual and required capital ratios for Cullen/Frost and Frost Bank were as follows:

	Actual		Minimum Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
March 31, 2011						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,754,703	16.31%	$ 860,802	8.00%	N/A	N/A
Frost Bank	1,583,241	14.72	860,189	8.00	$ 1,075,237	10.00%
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,530,382	14.22	430,401	4.00	N/A	N/A
Frost Bank	1,458,920	13.57	430,095	4.00	645,142	6.00
Leverage Ratio						
Cullen/Frost	1,530,382	8.99	680,938	4.00	N/A	N/A
Frost Bank	1,458,920	8.58	680,354	4.00	850,443	5.00
December 31, 2010						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,720,691	15.91%	$ 865,081	8.00%	N/A	N/A
Frost Bank	1,558,977	14.43	864,318	8.00	$ 1,080,397	10.00%
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,494,375	13.82	432,540	4.00	N/A	N/A
Frost Bank	1,432,661	13.26	432,159	4.00	648,238	6.00
Leverage Ratio						
Cullen/Frost	1,494,375	8.68	688,880	4.00	N/A	N/A
Frost Bank	1,432,661	8.33	688,196	4.00	860,246	5.00

Cullen/Frost believes that, as of March 31, 2011, its bank subsidiary, Frost Bank, was well capitalized based on the ratios presented above.

Cullen/Frost is subject to the regulatory capital requirements administered by the Federal Reserve, while Frost Bank is subject to the regulatory capital requirements administered by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Regulatory authorities can initiate certain mandatory actions if Cullen/Frost or Frost Bank fail to meet the minimum capital requirements, which could have a direct material effect on the Corporation s financial statements. Management believes, as of March 31, 2011, that Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.

Dividend Restrictions. In the ordinary course of business, Cullen/Frost is dependent upon dividends from Frost Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of Frost Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. Under the foregoing dividend restrictions and while maintaining its well capitalized status, at March 31, 2011, Frost Bank could pay aggregate dividends of up to $228.7 million to Cullen/Frost without prior regulatory approval.

Trust Preferred Securities. In accordance with the applicable accounting standard related to variable interest entities, the accounts of the Corporation s wholly owned subsidiary trust, Cullen/Frost Capital Trust II, have not been included in the Corporation s consolidated financial statements. However, the $120.0 million in trust preferred securities issued by this subsidiary trust have been included in the Tier 1 capital of Cullen/Frost for regulatory capital purposes pursuant to guidance from the Federal Reserve. On July 21, 2010, financial regulatory reform legislation entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law. Certain provisions of the Dodd-Frank Act will require the Corporation to deduct, over three years beginning on January 1, 2013, all trust preferred securities from the Corporation s Tier 1 capital. Nonetheless, excluding trust preferred securities from Tier 1 capital at March 31, 2011 would not affect the Corporation s ability to meet all capital adequacy requirements to which it is subject.

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Note 8 - Derivative Financial Instruments

The fair value of derivative positions outstanding is included in accrued interest receivable and other assets and accrued interest payable and other liabilities in the accompanying consolidated balance sheets and in the net change in each of these financial statement line items in the accompanying consolidated statements of cash flows.

Interest Rate Derivatives. The Corporation utilizes interest rate swaps, caps and floors to mitigate exposure to interest rate risk and to facilitate the needs of its customers. The Corporation s objectives for utilizing these derivative instruments is described below:

The Corporation has entered into certain interest rate swap contracts that are matched to specific fixed-rate commercial loans or leases that the Corporation has entered into with its customers. These contracts have been designated as hedging instruments to hedge the risk of changes in the fair value of the underlying commercial loan/lease due to changes in interest rates. The related contracts are structured so that the notional amounts reduce over time to generally match the expected amortization of the underlying loan/lease.

During 2007, the Corporation entered into three interest rate swap contracts on variable-rate loans with a total notional amount of $1.2 billion. The interest rate swap contracts were designated as hedging instruments in cash flow hedges with the objective of protecting the overall cash flows from the Corporation s monthly interest receipts on a rolling portfolio of $1.2 billion of variable-rate loans outstanding throughout the 84-month period beginning in October 2007 and ending in October 2014 from the risk of variability of those cash flows such that the yield on the underlying loans would remain constant. As further discussed below, during November 2009, the Corporation terminated portions of the hedges and settled portions of the interest rate swap contracts during November 2009 and terminated the remaining portions of the hedges and settled the remaining portions interest rate swap contracts during November 2010. Under the initial hedge relationship, the desired constant yield was 7.559% in the case of the first contract (underlying loan pool totaling $650.0 million carrying an interest rate equal to Prime), 8.059% in the case of the second contract (underlying loan pool totaling $230.0 million carrying an interest rate equal to Prime plus a margin of 50 basis points) and 8.559% in the case of the third contract (underlying loan pool totaling $320.0 million carrying an interest rate equal to Prime plus a margin of 100 basis points). Under the swaps, the Corporation received a fixed interest rate of 7.559% and paid a variable interest rate equal to the daily Federal Reserve Statistical Release H-15 Prime Rate (Prime), with monthly settlements.

As stated above, during November 2009, the Corporation settled portions of two of the interest rate swap contracts having a total notional amount of $400.0 million and concurrently terminated the hedges related to the interest cash flows on a rolling portfolio of $400.0 million of variable rate loans. The terminated hedges had underlying loan pools totaling $300.0 million carrying an interest rate equal to Prime and $100.0 million carrying an interest rate equal to Prime plus a margin of 50 basis points. In November 2010, the Corporation settled the remaining interest rate swap contracts having a total notional amount of $800.0 million and concurrently terminated the hedges related to the interest cash flows on a rolling portfolio of $800.0 million of variable rate loans. The terminated hedges had underlying loan pools totaling $350.0 million carrying an interest rate equal to Prime, $130.0 million carrying an interest rate equal to Prime plus a margin of 50 basis points and $320.0 million carrying an interest rate equal to Prime plus a margin of 100 basis points. The deferred accumulated after-tax gain applicable to the settled interest rate contracts included in accumulated other comprehensive income totaled $86.7 million at March 31, 2011. The deferred gain will be reclassified into earnings during future periods when the formerly hedged transactions impact future earnings.

In October 2008, the Corporation entered into an interest rate swap contract on junior subordinated deferrable interest debentures with a total notional amount of $120.0 million. The interest rate swap contract was designated as a hedging instrument in a cash flow hedge with the objective of protecting the quarterly interest payments on the Corporation s $120.0 million of junior subordinated deferrable interest debentures issued to Cullen/Frost Capital Trust II throughout the five-year period beginning in December 2008 and ending in December 2013 from the risk of variability of those payments resulting from changes in the three-month LIBOR interest rate. Under the swap, the Corporation will pay a fixed interest rate of 5.47% and receive a variable interest rate of three-month LIBOR plus a margin of 1.55% on a total notional amount of $120.0 million, with quarterly settlements.

The Corporation has entered into certain interest rate swap, cap and floor contracts that are not designated as hedging instruments. These derivative contracts relate to transactions in which the Corporation enters into an interest rate swap, cap and/or floor with a customer while at the same time entering into an offsetting interest rate swap, cap and/or floor with another financial institution. In connection with each swap transaction, the Corporation agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, the Corporation agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the Corporation s customer to effectively convert a variable rate loan to a fixed rate. Because the Corporation acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact the Corporation s results of operations.

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The notional amounts and estimated fair values of interest rate derivative contracts outstanding at March 31, 2011 and December 31, 2010 are presented in the following table. The Corporation obtains dealer quotations to value its interest rate derivative contracts designated as hedges of cash flows, while the fair values of other interest rate derivative contracts are estimated utilizing internal valuation models with observable market data inputs.

	March 31, 2011		December 31, 2010	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate derivatives designated as hedges of fair value:				
Commercial loan/lease interest rate swaps	$ 96,796	$ (7,090)	$ 104,088	$ (8,350)
Interest rate derivatives designated as hedges of cash flows:				
Interest rate swap on junior subordinated deferrable interest debentures	120,000	(8,742)	120,000	(9,895)
Non-hedging interest rate derivatives:				
Commercial loan/lease interest rate swaps	604,859	38,231	593,792	44,335
Commercial loan/lease interest rate swaps	604,859	(38,523)	593,792	(44,666)
Commercial loan/lease interest rate caps	20,000	398	20,000	388
Commercial loan/lease interest rate caps	20,000	(398)	20,000	(388)

The weighted-average rates paid and received for interest rate swaps outstanding at March 31, 2011 were as follows:

	Weighted-Average	
	Interest Rate Paid	Interest Rate Received
Interest rate swaps:		
Fair value hedge commercial loan/lease interest rate swaps	4.51%	0.25%
Cash flow hedge interest rate swaps on junior subordinated deferrable interest debentures	5.47	1.86
Non-hedging interest rate swaps	1.92	5.16
Non-hedging interest rate swaps	5.16	1.92

The weighted-average strike rate for outstanding interest rate caps was 3.10% at March 31, 2011.

Commodity Derivatives. The Corporation enters into commodity swaps and option contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a commodity swap or option contract with a customer, the Corporation simultaneously enters into an offsetting contract with a third party to mitigate the exposure to fluctuations in commodity prices.

The notional amounts and estimated fair values of commodity derivative positions outstanding are presented in the following table. The Corporation obtains dealer quotations to value its commodity derivative positions.

		March 31, 2011		December 31, 2010	
	Notional Units	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Non-hedging commodity swaps:					
Oil	Barrels	531	$ 6,345	321	$ 2,502
Oil	Barrels	531	(6,228)	321	(2,428)
Natural gas	MMBTUs	5,365	673	510	195
Natural gas	MMBTUs	5,365	(522)	510	(174)
Non-hedging commodity options:					
Oil	Barrels	2,451	18,359	1,288	7,706

Oil	Barrels	2,451	(18,359)	1,288	(7,706)
Natural gas	MMBTUs	3,360	2,825	3,820	3,774
Natural gas	MMBTUs	3,360	(2,825)	3,820	(3,774)

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Foreign Currency Derivatives. The Corporation enters into foreign currency forward contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a foreign currency denominated transaction with a customer, the Corporation simultaneously enters into an offsetting contract with a third party to negate the exposure to fluctuations in foreign currency exchange rates. The Corporation also utilizes foreign currency forward contracts that are not designated as hedging instruments to mitigate the economic effect of fluctuations in foreign currency exchange rates on certain short-term, non-U.S. dollar denominated loans. The notional amounts and fair values of open foreign currency forward contracts were not significant at March 31, 2011 and December 31, 2010.

Gains, Losses and Derivative Cash Flows. For fair value hedges, the changes in the fair value of both the derivative hedging instrument and the hedged item are included in other non-interest income or other non-interest expense. The extent that such changes in fair value do not offset represents hedge ineffectiveness. Net cash flows from interest rate swaps on commercial loans/leases designated as hedging instruments in effective hedges of fair value are included in interest income on loans. For cash flow hedges, the effective portion of the gain or loss due to changes in the fair value of the derivative hedging instrument is included in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is included in other non-interest income or other non-interest expense. Net cash flows from interest rate swaps on variable-rate loans designated as hedging instruments in effective hedges of cash flows and the reclassification from other comprehensive income of deferred gains associated with the termination of those hedges are included in interest income on loans. Net cash flows from the interest rate swap on junior subordinated deferrable interest debentures designated as a hedging instrument in an effective hedge of cash flows are included in interest expense on junior subordinated deferrable interest debentures. For non-hedging derivative instruments, gains and losses due to changes in fair value and all cash flows are included in other non-interest income and other non-interest expense.

Amounts included in the consolidated statements of income related to interest rate derivatives designated as hedges of fair value were as follows:

	Three Months Ended March 31, 2011	2010
Commercial loan/lease interest rate swaps:		
Amount of gain (loss) included in interest income on loans	$ (1,005)	$ (1,416)
Amount of (gain) loss included in other non-interest expense	(9)	6

Amounts included in the consolidated statements of income and in other comprehensive income for the period related to interest rate derivatives designated as hedges of cash flows were as follows:

	Three Months Ended March 31, 2011	2010
Interest rate swaps/caps/floors on variable-rate loans:		
Amount reclassified from accumulated other comprehensive income to interest income on loans	$ 9,345	$ 10,937
Amount of gain (loss) recognized in other comprehensive income		15,772
Interest rate swaps on junior subordinated deferrable interest debentures:		
Amount reclassified from accumulated other comprehensive income to interest expense on junior subordinated deferrable interest debentures	1,086	1,111
Amount of gain (loss) recognized in other comprehensive income	65	(2,477)

No ineffectiveness related to interest rate derivatives designated as hedges of cash flows was recognized in the consolidated statements of income during the reported periods. The accumulated net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive income totaled $81.3 million at March 31, 2011 and $86.6 million at December 31, 2010. The Corporation currently expects approximately $16.1 million of the net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive income at March 31, 2011 will be reclassified into earnings during the remainder of 2011. This amount represents management s best estimate given current expectations about market interest rates and volumes related to loan pools underlying the terminated cash flow hedges. Because actual market interest rates and volumes related to loan pools underlying the terminated cash flow hedges may differ from management s expectations, there can be no assurance as to the ultimate amount that will be reclassified into earnings during 2011.

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As stated above, the Corporation enters into non-hedge related derivative positions primarily to accommodate the business needs of its customers. Upon the origination of a derivative contract with a customer, the Corporation simultaneously enters into an offsetting derivative contract with a third party. The Corporation recognizes immediate income based upon the difference in the bid/ask spread of the underlying transactions with its customers and the third party. Because the Corporation acts only as an intermediary for its customer, subsequent changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact the Corporation s results of operations.

Amounts included in the consolidated statements of income related to non-hedging interest rate and commodity derivative instruments are presented in the table below. Amounts included in the consolidated statements of income related to foreign currency derivatives during the reported periods were not significant.

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Non-hedging interest rate derivatives:		
Other non-interest income	$ 274	$ 702
Other non-interest expense	(39)	19
Non-hedging commodity derivatives:		
Other non-interest income	383	20

Counterparty Credit Risk. Derivative contracts involve the risk of dealing with both bank customers and institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have an investment grade credit rating and be approved by the Corporation s Asset/Liability Management Committee. The Corporation s credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty, while the Corporation s credit exposure on commodity swaps/options is limited to the net favorable value of all swaps/options by each counterparty. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. There are no credit-risk-related contingent features associated with any of the Corporation s derivative contracts. Certain derivative contracts with upstream financial institution counterparties may be terminated with respect to a party in the transaction, if such party does not have at least a minimum level rating assigned to either its senior unsecured long-term debt or its deposit obligations by certain third-party rating agencies.

The Corporation s credit exposure relating to interest rate swaps and commodity swaps/options with bank customers was approximately $52.1 million at March 31, 2011. This credit exposure is partly mitigated as transactions with customers are generally secured by the collateral, if any, securing the underlying transaction being hedged. The Corporation had no credit exposure, net of collateral pledged, relating to interest rate swaps and commodity swaps/options with upstream financial institution counterparties at March 31, 2011. Collateral levels for upstream financial institution counterparties are monitored and adjusted as necessary.

The aggregate fair value of securities posted as collateral by the Corporation related to derivative contracts totaled $58.3 million at March 31, 2011. At such date, the Corporation also had $8.0 million in cash collateral on deposit with other financial institution counterparties.

Note 9 - Earnings Per Common Share

Earnings per common share is computed using the two-class method. Basic earnings per common share is computed by dividing net earnings allocated to common stock by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include non-vested stock awards/stock units and deferred stock units, though no actual shares of common stock related to non-vested stock units and deferred stock units have been issued. Non-vested stock awards/stock units and deferred stock units are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as holders of the Corporation s common stock. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of stock compensation using the treasury stock method.

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The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share.

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Distributed earnings allocated to common stock	$ 27,470	$ 25,816
Undistributed earnings allocated to common stock	24,252	21,808
Net earnings allocated to common stock	$ 51,722	$ 47,624
Weighted-average shares outstanding for basic earnings per common share	61,018,169	59,972,214
Dilutive effect of stock compensation	316,295	185,269
Weighted-average shares outstanding for diluted earnings per common share	61,334,464	60,157,483

Note 10 - Stock-Based Compensation

A combined summary of activity in the Corporation s active stock plans is presented in the following table.

	Shares Available for Grant	Director Deferred Stock Units Outstanding	Non-Vested Stock Awards/Stock Units Outstanding: Number of Shares	Non-Vested Stock Awards/Stock Units Outstanding: Weighted-Average Grant-Date Fair Value	Stock Options Outstanding: Number of Shares	Stock Options Outstanding: Weighted-Average Exercise Price
Balance, January 1, 2011	2,759,347	16,515	227,550	$ 51.10	4,383,885	$ 52.08
Granted						
Stock options exercised					(114,293)	50.47
Stock awards vested			(13,100)	50.64		
Forfeited	11,750				(11,750)	51.36
Balance, March 31, 2011	2,771,097	16,515	214,450	$ 51.13	4,257,842	$ 52.13

During the three months ended March 31, 2011 and 2010, proceeds from stock option exercises totaled $5.8 million and $15.9 million. During the three months ended March 31, 2011, 113,293 shares issued in connection with stock option exercises were new shares issued from available authorized shares, while 1,000 shares were issued from available treasury stock.

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Stock-based compensation expense was as follows:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Stock options	$ 2,310	$ 2,546
Non-vested stock awards/stock units	1,427	1,102

Total	$ 3,737	$ 3,648

Unrecognized stock-based compensation expense at March 31, 2011 was as follows:

Stock options	$ 20,431
Non-vested stock awards/stock units	3,765
Total	$ 24,196

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Note 11 - Defined Benefit Plans

The components of the combined net periodic cost (benefit) for the Corporation s qualified and non-qualified defined benefit pension plans were as follows:

	Three Months Ended March 31,	
	2011	2010
Expected return on plan assets, net of expenses	$ (2,859)	$ (2,752)
Interest cost on projected benefit obligation	1,973	1,931
Net amortization and deferral	783	728
Net periodic benefit	$ (103)	$ (93)

The Corporation s non-qualified defined benefit pension plan is not funded. No contributions to the qualified defined benefit pension plan were made during the three months ended March 31, 2011. The Corporation does not expect to make any contributions during the remainder of 2011.

Note 12 - Income Taxes

Income tax expense was as follows:

	Three Months Ended March 31,	
	2011	2010
Current income tax expense	$ 12,792	$ 13,387
Deferred income tax benefit	(139)	(393)
Income tax expense as reported	$ 12,653	$ 12,994
Effective tax rate	19.6%	21.4%

Net deferred tax liabilities totaled $65.4 million at March 31, 2011 and $65.2 million at December 31, 2010. No valuation allowance was recorded against deferred tax assets at March 31, 2011 as management believes that it is more likely than not that all of the deferred tax assets will be realized because they were supported by recoverable taxes paid in prior years.

The Corporation files income tax returns in the U.S. federal jurisdiction. The Company is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2007.

Note 13 - Comprehensive Income

Comprehensive income was as follows:

	Three Months Ended March 31,	
	2011	2010
Net income	$ 51,928	$ 47,818
Other comprehensive income:		
Securities available for sale:		

Change in net unrealized gain/loss during the period	8,290	10,883
Reclassification adjustment for gains in net income	(5)	(5)
Change in the net actuarial gain/loss on defined benefit post- retirement benefit plans	783	728
Change in the accumulated gain/loss on effective cash flow hedging derivatives	(8,194)	3,469
	874	15,075
Deferred tax expense	306	5,276
Net other comprehensive income	568	9,799
Comprehensive income	$ 52,496	$ 57,617

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Note 14 - Operating Segments

The Corporation is managed under a matrix organizational structure whereby significant lines of business, including Banking and the Financial Management Group (FMG), overlap a regional reporting structure. The regions are primarily based upon geographic location and include Austin, Corpus Christi, Dallas, Fort Worth, Houston, Rio Grande Valley, San Antonio and Statewide. The Corporation is primarily managed based on the line of business structure. In that regard, all regions have the same lines of business, which have the same product and service offerings, have similar types and classes of customers and utilize similar service delivery methods. Pricing guidelines for products and services are the same across all regions. The regional reporting structure is primarily a means to scale the lines of business to provide a local, community focus for customer relations and business development.

The Corporation has two primary operating segments, Banking and FMG, that are delineated by the products and services that each segment offers. The Banking operating segment includes both commercial and consumer banking services, Frost Insurance Agency and Frost Securities, Inc. Commercial banking services are provided to corporations and other business clients and include a wide array of lending and cash management products. Consumer banking services include direct lending and depository services. Frost Insurance Agency provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty products, as well as group health and life insurance products. Frost Securities, Inc. provides advisory and private equity services to middle market companies. The FMG operating segment includes fee-based services within private trust, retirement services, and financial management services, including personal wealth management and brokerage services. The third operating segment, Non-Banks, is for the most part the parent holding company, as well as certain other insignificant non-bank subsidiaries of the parent that, for the most part, have little or no activity. The parent company s principal activities include the direct and indirect ownership of the Corporation s banking and non-banking subsidiaries and the issuance of debt and equity. Its principal source of revenue is dividends from its subsidiaries.

The accounting policies of each reportable segment are the same as those of the Corporation except for the following items, which impact the Banking and FMG segments: (i) expenses for consolidated back-office operations and general overhead-type expenses such as executive administration, accounting and internal audit are allocated to operating segments based on estimated uses of those services, (ii) income tax expense for the individual segments is calculated essentially at the statutory rate, and (iii) the parent company records the tax expense or benefit necessary to reconcile to the consolidated total.

The Corporation uses a match-funded transfer pricing process to assess operating segment performance. The process helps the Corporation to (i) identify the cost or opportunity value of funds within each business segment, (ii) measure the profitability of a particular business segment by relating appropriate costs to revenues, (iii) evaluate each business segment in a manner consistent with its economic impact on consolidated earnings, and (iv) enhance asset and liability pricing decisions.

Summarized operating results by segment were as follows:

	Banking	FMG	Non-Banks	Consolidated
Revenues from (expenses to) external customers:				
Three months ended:				
March 31, 2011	$ 192,265	$ 24,434	$ (2,607)	$ 214,092
March 31, 2010	189,464	22,410	(2,897)	208,977
Net income (loss):				
Three months ended:				
March 31, 2011	$ 51,853	$ 1,670	$ (1,595)	$ 51,928
March 31, 2010	48,763	1,303	(2,248)	47,818

Note 15 - Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Corporation utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation s creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation s valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation s valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. A more detailed description of the valuation methodologies used for assets and liabilities measured at fair value is set forth in the 2010 Form 10-K. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Corporation s monthly and/or quarterly valuation process.

Financial Assets and Financial Liabilities: The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2011 and December 31, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
March 31, 2011				
Securities available for sale:				
U.S. Treasury	$ 983,918	$	$	$ 983,918
Residential mortgage-backed securities		2,563,498		2,563,498
States and political subdivisions		2,075,979		2,075,979
Other		38,816		38,816
Trading account securities:				