INTERNATIONAL BANCSHARES CORP
Form 10-Q
November 10, 2014

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 September 30, 2014

OR

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

For the transition period from to

Commission file number 000-09439

INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

Texas	**74-2157138**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1200 San Bernardo Avenue, Laredo, Texas 78042-1359

(Address of principal executive offices)

(Zip Code)

(956) 722-7611

(Registrant s telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

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

Class	**Shares Issued and Outstanding**
Common Stock, $1.00 par value	66,595,786 shares outstanding at November 4, 2014

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	September 30, 2014	December 31, 2013
Assets		
Cash and cash equivalents	$ 303,570	$ 274,785
Investment securities:		
Held-to-maturity (Market value of $2,400 on September 30, 2014 and $2,400 on December 31, 2013)	2,400	2,400
Available-for-sale (Amortized cost of $4,803,160 on September 30, 2014 and $5,372,594 on December 31, 2013)	4,803,290	5,304,579
Total investment securities	4,805,690	5,306,979
Loans	5,660,578	5,199,235
Less allowance for probable loan losses	(71,727)	(70,161)
Net loans	5,588,851	5,129,074
Bank premises and equipment, net	524,384	504,842
Accrued interest receivable	28,573	30,654
Other investments	402,672	388,563
Identified intangible assets, net	940	3,186
Goodwill	282,532	282,532
Other assets	141,975	158,862
Total assets	$ 12,079,187	$ 12,079,477

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition, continued (Unaudited)

(Dollars in Thousands)

	September 30, 2014	December 31, 2013
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Demand non-interest bearing	$ 2,894,294	$ 2,666,510
Savings and interest bearing demand	2,997,540	2,925,612
Time	2,522,239	2,651,303
Total deposits	8,414,073	8,243,425
Securities sold under repurchase agreements	869,411	957,381
Other borrowed funds	987,181	1,223,950
Junior subordinated deferrable interest debentures	180,416	190,726
Other liabilities	90,496	39,587
Total liabilities	10,541,577	10,655,069
Shareholders equity:		
Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 95,773,984 shares on September 30, 2014 and 95,743,592 shares on December 31, 2013	95,774	95,744
Surplus	165,088	163,947
Retained earnings	1,546,841	1,467,000
Accumulated other comprehensive income (loss) (including $(5,217) and $(5,646) of comprehensive loss related to other- than-temporary impairment for non-credit related issues)	133	(43,774)
	1,807,836	1,682,917
Less cost of shares in treasury, 29,029,808 shares on September 30, 2014 and 28,537,180 December 31, 2013	(270,226)	(258,509)
Total shareholders equity	1,537,610	1,424,408
Total liabilities and shareholders equity	$ 12,079,187	$ 12,079,477

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Interest income:				
Loans, including fees	$ 71,026	$ 66,482	$ 208,934	$ 194,633
Investment securities:				
Taxable	24,149	21,821	76,873	60,941
Tax-exempt	2,744	3,318	8,995	9,439
Other interest income	39	29	133	71
Total interest income	97,958	91,650	294,935	265,084
Interest expense:				
Savings deposits	898	885	2,684	2,852
Time deposits	2,976	3,644	9,115	12,067
Securities sold under repurchase agreements	6,150	7,162	18,474	22,042
Other borrowings	488	454	1,608	1,033
Junior subordinated interest deferrable debentures	1,063	862	3,201	3,191
Total interest expense	11,575	13,007	35,082	41,185
Net interest income	86,383	78,643	259,853	223,899
Provision for probable loan losses	2,816	5,800	8,539	17,561
Net interest income after provision for probable loan losses	83,567	72,843	251,314	206,338
Non-interest income:				
Service charges on deposit accounts	22,514	25,026	67,026	72,363
Other service charges, commissions and fees				
Banking	10,880	11,327	33,791	31,362
Non-banking	2,083	2,092	5,143	4,668
Investment securities transactions, net	(6,446)		1,283	9,601
Other investments, net	5,641	3,871	17,008	19,503
Other income	1,811	2,165	11,873	6,941
Total non-interest income	36,483	44,481	136,124	144,438

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Non-interest expense:				
Employee compensation and benefits	$ 32,326	$ 30,627	$ 92,560	$ 91,602
Occupancy	7,865	7,604	22,729	22,596
Depreciation of bank premises and equipment	5,937	6,433	18,083	19,677
Professional fees	3,416	3,669	10,343	11,344
Deposit insurance assessments	1,515	1,683	4,512	5,061
Net expense, other real estate owned	(55)	1,360	1,704	4,724
Amortization of identified intangible assets	117	1,156	2,246	3,451
Advertising	1,928	1,795	5,713	5,664
Early termination fee securities sold under repurchase agreements			11,000	12,303
Impairment charges (Total other-than-temporary impairment losses, $(8), net of $(281), $(13), net of $(560), $(115), net of $(667), and $(27), net of $(1,273), included in other comprehensive income)	273	573	552	1,300
Other	16,835	15,327	47,043	47,080
Total non-interest expense	70,157	70,227	216,485	224,802
Income before income taxes	49,893	47,097	170,953	125,974
Provision for income taxes	16,660	15,271	56,356	38,566
Net income	$ 33,233	$ 31,826	$ 114,597	$ 87,408
Basic earnings per common share:				
Weighted average number of shares outstanding:	66,860,997	67,197,847	66,971,555	67,192,112
Net income	$ .50	$ .47	$ 1.71	$ 1.30
Fully diluted earnings per common share:				
Weighted average number of shares outstanding:	67,016,937	67,333,442	67,119,213	67,301,863
Net income	$ .50	$ .47	$ 1.71	$ 1.30

See accompanying notes to consolidated financial statements.

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Net income	$ 33,233	$ 31,826	$ 114,597	$ 87,408
Other comprehensive income (loss), net of tax				
Net unrealized holding gains (losses) on securities available for sale arising during period (tax effects of $(7,888), $609, $23,898 and $(39,816))	(14,649)	1,132	44,382	(73,943)
Reclassification adjustment for losses (gains) on securities available for sale included in net income (tax effects of $2,256, $0, $(449) and $(3,360))	4,190		(834)	(6,241)
Reclassification adjustment for impairment charges on available for sale securities included in net income (tax effects of $96 , $201, $193 and $455)	177	372	359	845
	(10,282)	1,504	43,907	(79,339)
Comprehensive income	$ 22,951	$ 33,330	$ 158,504	$ 8,069

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Operating activities:		
Net income	$ 114,597	$ 87,408
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for probable loan losses	8,539	17,561
Specific reserve, other real estate owned	371	478
Depreciation of bank premises and equipment	18,083	19,677
Gain on sale of bank premises and equipment	(3,955)	(626)
Gain on sale of other real estate owned	(314)	(201)
Accretion of investment securities discounts	(2,161)	(2,844)
Amortization of investment securities premiums	20,096	35,666
Investment securities transactions, net	(1,283)	(9,601)
Impairment charges on available-for-sale investment securities	552	1,300
Amortization of identified intangible assets	2,246	3,451
Stock based compensation expense	766	322
Earnings from affiliates and other investments	(10,455)	(16,085)
Deferred tax benefit	(2,993)	(2,325)
Decrease in accrued interest receivable	2,081	2,051
Net (increase) decrease in other assets	(4,779)	16,624
Net decrease in other liabilities	8,300	7,535
Net cash provided by operating activities	149,691	160,391
Investing activities:		
Proceeds from sales and calls of available for sale securities	621,588	178,124
Purchases of available for sale securities	(648,910)	(1,274,574)
Principal collected on mortgage-backed securities	582,631	1,025,015
Net increase in loans	(470,723)	(285,453)
Purchases of other investments	(12,930)	(1,637)
Distributions received on other investments	23,311	4,159
Purchases of bank premises and equipment	(42,089)	(30,792)
Proceeds from sales of other real estate owned	10,251	19,303
Proceeds from sale of bank premises and equipment	8,419	653
Net cash (used in) provided by investing activities	71,548	(365,202)

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2014	2013
Financing activities:		
Net increase in non-interest bearing demand deposits	$ 227,784	$ 185,882
Net increase (decrease) in savings and interest bearing demand deposits	71,928	(108,029)
Net decrease in time deposits	(129,064)	(252,260)
Net decrease in securities sold under repurchase agreements	(87,970)	(128,542)
Net (decrease) increase in other borrowed funds	(236,769)	540,466
Purchase of treasury stock	(11,717)	
Repayment of long-term debt	(10,310)	
Proceeds from stock transactions	405	146
Payments of dividends on common stock	(16,741)	(13,438)
Net cash provided by (used in) financing activities	(192,454)	224,225
Increase in cash and cash equivalents	28,785	19,414
Cash and cash equivalents at beginning of period	274,785	283,100
Cash and cash equivalents at end of period	$ 303,570	$ 302,514
Supplemental cash flow information:		
Interest paid	$ 35,764	$ 43,405
Income taxes paid	64,912	45,480
Non-cash investing and financing activities:		
Dividends declared, not yet paid on common stock	18,021	15,456
Net transfer from loans to other real estate owned	(2,406)	(371)

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 - Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (Corporation) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo (IBC), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, IBC Capital Corporation, Premier Tierra Holdings, Inc and IBC Charitable and Community Development Corporation. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2013 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable. Operating results for the nine months ended September 30, 2014 are not necessarily indicative of the results for the year ending December 31, 2014, or any future period.

The Company operates as one segment. The operating information used by the Company s chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville. The Company applies the provision of ASC Topic 280, Segment Reporting, in determining its reportable segments and related disclosures.

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

Note 2 Fair Value Measurements

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

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

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

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

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

The following table represents financial instruments reported on the consolidated balance sheets at their fair value on a recurring basis as of September 30, 2014 by level within the fair value measurement hierarchy:

			Fair Value Measurements at Reporting Date Using (Dollars in Thousands)					
	Assets/Liabilities Measured at Fair Value September 30, 2014		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Measured on a recurring basis:								
Assets:								
Available for sale securities								
Residential mortgage-backed securities	$	4,499,264	$		$	4,474,311	$	24,953
States and political subdivisions		275,120				275,120		
Other		28,906		28,906				
Total	$	4,803,290	$	28,906	$	4,749,431	$	24,953

The following table represents financial instruments reported on the consolidated balance sheets at their fair value on a recurring basis as of December 31, 2013 by level within the fair value measurement hierarchy:

			Fair Value Measurements at Reporting Date Using (Dollars in Thousands)					
	Assets/Liabilities Measured at Fair Value December 31, 2013		Quoted Prices in Active Markets for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Measured on a recurring basis:								
Assets:								
Available for sale securities								
Residential mortgage-backed securities	$	5,027,701	$		$	4,999,849	$	27,852
States and political subdivisions		248,410				248,410		
Other		28,468		28,468				
Total	$	5,304,579	$	28,468	$	5,248,259	$	27,852

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

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Assumptions used in the discounted cash flow model as of September 30, 2014 and December 31, 2013, were applied separately to those portions of the bond where the underlying residential mortgage loans had been performing under original contract terms for at least the prior 24 months and those where the underlying residential mortgages had not been meeting the original contractual obligation for the same period. Unobservable inputs included in the model are estimates on future principal prepayment rates, and default and loss severity rates. For that portion of the bond where the underlying residential mortgage had been meeting the original contract terms for at least 24 months, the Company used the following estimates in the model: (i) a voluntary prepayment rate of 7%, (ii) a 1% default rate, (iii) a loss severity rate of 25%, and (iv) a discount rate of 13%. The assumptions used in the model for the rest of the bond included the following estimates: (i) a voluntary prepayment rate of 2 %, (ii) a default rate of 4.5%, (iii) a loss severity rate that started at 60% for the first year (2012) then declines by 5% for the following five years (2013, 2014, 2015, 2016 and 2017) and remains at 25% thereafter (2018 and beyond), and (iv) a discount rate of 13%. The estimates used in the model to determine fair value are based on observable historical data of the underlying collateral. The model anticipates that the housing market will gradually improve and that the underlying collateral will eventually all perform in accordance with the original contract terms on the bond. Should the number of loans in the underlying collateral that default and go into foreclosure or the severity of the losses in the underlying collateral significantly change, the results of the model would be impacted. The Company will continue to evaluate the actual historical performance of the underlying collateral and will modify the assumptions used in the model as necessary.

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

Balance at December 31, 2013	$	27,852
Principal pay downs		(3,014)
Total unrealized gains (losses) included in:		
Other comprehensive income		667
Impairment realized in earnings		(552)
Balance at September 30, 2014	$	24,953

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

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended September 30, 2014 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (Dollars in Thousands)			
	Assets/Liabilities Measured at Fair Value September 30, 2014	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Net Provision During Nine Month Period**
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 29,993	$	$	$ 29,993	$ 5,743
Other real estate owned	13,931			13,931	371

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The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the year ended December 31, 2013 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (Dollars in Thousands)			
	Assets/Liabilities Measured at Fair Value December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision During Twelve Month Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 28,391	$	$	$ 28,391	$ 13,229
Other real estate owned	16,329			16,329	1,204

The Company s assets measured at fair value on a non-recurring basis are limited to impaired loans and other real estate owned. Impaired loans are classified within level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, Receivables . Impaired loans are primarily comprised of collateral-dependent commercial loans. Understanding that as the primary sources of loan repayments decline, the secondary repayment source comes into play and correctly evaluating the fair value of that secondary source, the collateral, becomes even more important. Re-measurement of the impaired loan to fair value is done through a specific valuation allowance included in the allowance for probable loan losses. The fair value of impaired loans is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for the Company s appraisal and appraisal review process is based on regulatory guidelines and strives to comply with all regulatory appraisal laws, regulations and the Uniform Standards of Professional Appraisal Practice. All appraisals and evaluations are as is (the property s highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of September 30, 2014, the Company had $67,602,000 of impaired commercial collateral dependent loans, of which $21,015,000 had an appraisal or evaluation performed within the immediately preceding twelve months. As of December 31, 2013, the Company had $64,585,000 of impaired commercial collateral dependent loans, of which $50,346,000 had an appraisal or evaluation performed within the immediately preceding twelve months.

The determination to either seek an appraisal or to perform an evaluation begins in weekly credit quality meetings, where the committee analyzes the existing collateral values of the impaired loans and where obsolete appraisals are identified. In order to determine whether the Company would obtain a new appraisal or perform an internal evaluation to determine the fair value of the collateral, the credit committee reviews the existing appraisal to determine if the collateral value is reasonable in view of the current use of the collateral and the economic environment related to the collateral. If the analysis of the existing appraisal does not find that the collateral value is reasonable under the current circumstances, the Company would obtain a new appraisal on the collateral or perform an internal evaluation of the collateral. The ultimate decision to get a new appraisal rests with the independent credit administration group. A new appraisal is not required if an internal evaluation, as performed by in-house experts, is able to appropriately update the original appraisal assumptions to reflect current market conditions and provide an estimate of the collateral s market value for impairment analysis. The internal evaluations must be in writing and contain sufficient information detailing the analysis, assumptions and conclusions and they must support performing an evaluation in lieu of ordering a new appraisal.

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate owned is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal) within level 3 of the fair value hierarchy. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. The fair value is reviewed periodically and subsequent write downs are made accordingly through a charge to operations. Other real estate owned is included in other assets on the consolidated financial statements. For the nine months ended September 30, 2014 and the twelve months ended December 31, 2013, respectively the Company recorded $328,000 and $402,000 in charges to the allowance for probable loan losses in connection with loans transferred to other real estate owned. For the nine months ended September 30, 2014 and twelve months ended December 31, 2013, respectively, the Company recorded $371,000 and $1,204,000 in adjustments to fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for the Company s financial instruments at September 30, 2014 and December 31, 2013 are outlined below.

Cash and Cash Equivalents

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

Time Deposits with Banks

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

Investment Securities Held-to-Maturity

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

Investment Securities

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

Loans

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

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed rate performing loans are within Level 3 of the fair value hierarchy. At September 30, 2014, and December 31, 2013, the carrying amount of fixed rate performing loans was $1,307,205,000 and $1,243,252,000 respectively, and the estimated fair value was $1,238,356,000 and $1,196,916,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of September 30, 2014 and December 31, 2013. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. Time deposits are within Level 3 of the fair value hierarchy. At September 30, 2014 and December 31, 2013, the carrying amount of time deposits was $2,522,239,000 and $2,651,303,000, respectively, and the estimated fair value was $2,521,059,000 and $2,649,452,000, respectively.

Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at September 30, 2014 and December 31, 2013. The fair value of the long-term instruments is based on established market spreads using option adjusted spread methodology. Long-term repurchase agreements are within level 3 of the fair value hierarchy. At September 30, 2014 and December 31, 2013, respectively, the carrying amount of long-term repurchase agreements was $610,000,000 and $710,000,000 and the estimated fair value was $663,833,000 and $792,215,500, respectively.

Junior Subordinated Deferrable Interest Debentures

The Company currently has floating rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at September 30, 2014 and December 31, 2013.

Other Borrowed Funds

The Company currently has short and long-term borrowings issued from the Federal Home Loan Bank (FHLB). Due to the contractual terms of the short-term borrowings, the carrying amounts approximated fair value at September 30, 2014 and December 31, 2013. The fair value of the long-term borrowings is based on established market spreads for similar types of borrowings. The long-term borrowings are included in Level 2 of the fair value hierarchy. At September 30, 2014 and December 31, 2013, the carrying amount of the long-term FHLB borrowings was $6,281,000 and $8,950,000 respectively, and the estimated fair value was $6,665,000 and $8,950,000, respectively.

Commitments to Extend Credit and Letters of Credit

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

Limitations

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

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

Note 3 Loans

A summary of loans, by loan type at September 30, 2014 and December 31, 2013 is as follows:

	September 30, 2014	December 31, 2013
	(Dollars in Thousands)	
Commercial, financial and agricultural	$ 3,105,682	$ 2,894,779
Real estate mortgage	887,734	847,692
Real estate construction	1,413,912	1,208,508
Consumer	61,993	66,414
Foreign	191,257	181,842
Total loans	$ 5,660,578	$ 5,199,235

Note 4 - Allowance for Probable Loan Losses

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

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

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

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

	Quarter Ended September 30, 2014								
	Domestic							Foreign	
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at June 30,	$ 28,006	$ 13,006	$ 19,538	$ 786	$ 3,721	$ 4,736	$ 706	$ 1,038	$ 71,537
Losses charge to allowance	(2,920)	(43)	(38)		(131)	(242)	(146)		(3,520)
	740	14	42		11	40	47		894

Recoveries credited to allowance									
Net (losses) gains charged to allowance	(2,180)	(29)	4		(120)	(202)	(99)		(2,626)
Provision (credit) charged to operations	2,454	852	(701)	(41)	27	164	79	(18)	2,816
Balance at September 30,	$ 28,280	$ 13,829	$ 18,841	$ 745	$ 3,628	$ 4,698	$ 686	$ 1,020	$ 71,727

	Quarter Ended September 30, 2013								
	Domestic							Foreign	
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at June 30,	$ 20,676	$ 11,624	$ 22,383	$ 623	$ 3,855	$ 4,047	$ 797	$ 1,046	$ 65,051
Losses charge to allowance	(3,540)	(2)			(22)	(149)	(130)	(2)	(3,845)
Recoveries credited to allowance	658	10	9		45	80	21		823
Net (losses) gains charged to allowance	(2,882)	8	9		23	(69)	(109)	(2)	(3,022)
Provision (credit) charged to operations	3,370	(10)	1,549	112	186	404	124	65	5,800
Balance at September 30,	$ 21,164	$ 11,622	$ 23,941	$ 735	$ 4,064	$ 4,382	$ 812	$ 1,109	$ 67,829

	Nine Months Ended September 30, 2014								
	Domestic							Foreign	
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31,	$ 22,433	$ 12,541	$ 24,467	$ 776	$ 3,812	$ 4,249	$ 750	$ 1,133	$ 70,161
Losses charge to allowance	(7,780)	(442)	(208)		(261)	(395)	(555)	(50)	(9,691)
Recoveries credited to allowance	2,156	66	100		16	140	194	46	2,718
Net losses charged to allowance	(5,624)	(376)	(108)		(245)	(255)	(361)	(4)	(6,973)
Provision (credit) charged to operations	11,471	1,664	(5,518)	(31)	61	704	297	(109)	8,539
Balance at September 30,	$ 28,280	$ 13,829	$ 18,841	$ 745	$ 3,628	$ 4,698	$ 686	$ 1,020	$ 71,727

	Nine Months Ended September 30, 2013								
	Domestic							Foreign	
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31,	$ 11,632	$ 12,720	$ 21,880	$ 694	$ 4,390	$ 4,448	$ 1,289	$ 1,140	$ 58,193
Losses charge to allowance	(8,866)	(250)	(61)		(221)	(544)	(446)	(22)	(10,410)
Recoveries credited to allowance	1,909	36	150		54	204	127	5	2,485
Net (losses) gains charged to allowance	(6,957)	(214)	89		(167)	(340)	(319)	(17)	(7,925)
Provision (credit) charged to operations	16,489	(884)	1,972	41	(159)	274	(158)	(14)	17,561
Balance at September 30,	$ 21,164	$ 11,622	$ 23,941	$ 735	$ 4,064	$ 4,382	$ 812	$ 1,109	$ 67,829

The allowance for probable loan losses is a reserve established through a provision for probable loan losses charged to expense, which represents management s best estimate of probable loan losses when evaluating loans (i) individually or (ii) collectively.

The table below provides additional information on the balance of loans individually or collectively evaluated for impairment and their related allowance, by loan class as of September 30, 2014 and December 31, 2013:

	September 30, 2014			
	Loans individually evaluated for impairment		Loans collectively evaluated for impairment	
	(Dollars in Thousands)			
	Recorded Investment	Allowance	Recorded Investment	Allowance
Domestic				
Commercial	$ 40,195	$ 16,302	$ 1,219,188	$ 11,978
Commercial real estate: other construction & land development	11,535	2,022	1,402,377	11,807
Commercial real estate: farmland & commercial	15,771	2,984	1,729,809	15,857
Commercial real estate: multifamily	251		100,468	745
Residential: first lien	5,457		412,101	3,628
Residential: junior lien	2,933		467,243	4,698
Consumer	1,408		60,585	686
Foreign	417		190,840	1,020
Total	$ 77,967	$ 21,308	$ 5,582,611	$ 50,419

	December 31, 2013			
	Loans individually evaluated for impairment		Loans collectively evaluated for impairment	
	(Dollars in Thousands)			
	Recorded Investment	Allowance	Recorded Investment	Allowance
Domestic				
Commercial	$ 34,183	$ 12,234	$ 1,008,459	$ 10,199
Commercial real estate: other construction & land development	13,976	852	1,194,532	11,689
Commercial real estate: farmland & commercial	16,038	2,916	1,734,001	21,551
Commercial real estate: multifamily	295		101,803	776
Residential: first lien	6,153		432,309	3,812
Residential: junior lien	3,206		406,024	4,249
Consumer	1,606		64,808	750
Foreign	436		181,406	1,133
Total	$ 75,893	$ 16,002	$ 5,123,342	$ 54,159

The table below provides additional information on loans accounted for on a non-accrual basis by loan class at September 30, 2014 and December 31, 2013:

	September 30, 2014	December 31, 2013
	(Dollars in Thousands)	
Domestic		
Commercial	$ 40,140	$ 34,110
Commercial real estate: other construction & land development	9,281	11,726
Commercial real estate: farmland & commercial	13,508	13,775
Commercial real estate: multifamily	251	295
Residential: first lien	516	1,266
Residential: junior lien	1,549	1,576
Consumer	39	75
Total non-accrual loans	$ 65,284	$ 62,823

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on (1) the present value of expected future cash flows discounted at the loan s effective interest rate; (2) the loan s observable market price; or (3) the fair value of the collateral if the loan is collateral dependent. Substantially all of the Company s impaired loans are measured at the fair value of the collateral. In limited cases the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

The following tables detail key information regarding the Company s impaired loans by loan class at September 30, 2014 and December 31, 2013:

	September 30, 2014						
				Quarter to Date		Year to Date	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)						
Loans with Related Allowance							
Domestic							
Commercial	$ 17,659	$ 17,685	$ 16,302	$ 17,677	$	$ 17,550	$
Commercial real estate: other construction & land development	7,344	7,386	2,022	7,329		7,326	
Commercial real estate: farmland & commercial	7,427	7,789	2,984	7,519	23	6,839	69
Total impaired loans with related allowance	$ 32,430	$ 32,860	$ 21,308	$ 32,525	$ 23	$ 31,715	$ 69

	September 30, 2014					
			Quarter to Date		Year to Date	
	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)					
Loans with No Related Allowance						
Domestic						
Commercial	$ 22,536	$ 22,606	$ 21,265	$ 1	$ 19,557	$ 3
Commercial real estate: other construction & land development	4,191	4,262	4,192	19	5,121	56
Commercial real estate: farmland & commercial	8,344	9,664	8,418		8,643	
Commercial real estate: multifamily	251	251	256		270	
Residential: first lien	5,457	5,507	5,648	64	6,028	191
Residential: junior lien	2,933	2,954	2,992	22	3,080	69
Consumer	1,408	1,410	1,408	1	1,407	3
Foreign	417	417	420	5	426	14
Total impaired loans with no related allowance	$ 45,537	$ 47,071	$ 44,599	$ 112	$ 44,532	$ 336

	December 31, 2013				
				Year to Date	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)				
Loans with Related Allowance					
Domestic					
Commercial	$ 17,178	$ 17,177	$ 12,234	$ 18,019	$ 38
Commercial real estate: other construction & land development	6,818	6,825	852	6,058	
Commercial real estate: farmland & commercial	7,259	10,697	2,916	7,167	92
Total impaired loans with related allowance	$ 31,255	$ 34,699	$ 16,002	$ 31,244	$ 130

	December 31, 2013			
			Year to Date	
	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)			
Loans with No Related Allowance				
Domestic				
Commercial	$ 17,005	$ 17,023	$ 16,778	$ 2
Commercial real estate: other construction & land development	7,158	7,187	18,164	74
Commercial real estate: farmland & commercial	8,779	9,949	7,313	
Commercial real estate: multifamily	295	295	322	
Residential: first lien	6,153	6,258	4,860	179
Residential: junior lien	3,206	3,226	2,347	99
Consumer	1,606	1,612	1,380	1
Foreign	436	436	452	19
Total impaired loans with no related allowance	$ 44,638	$ 45,986	$ 51,616	$ 374

The following tables detail key information regarding the Company s average recorded investment in impaired loans and interest recognized on impaired loans by loan class at September 30, 2013:

	September 30, 2013							
	Quarter to Date				Year to Date			
		Average Recorded Investment		Interest Recognized		Average Recorded Investment		Interest Recognized
	(Dollars in Thousands)							
Loans with Related Allowance								
Domestic								
Commercial	$	17,884	$	9	$	17,898	$	29
Commercial real estate: other construction & land development		6,821				5,804		
Commercial real estate: farmland & commercial		7,771		23		7,034		69
Total impaired loans with related allowance	$	32,476	$	32	$	30,736	$	98

	September 30, 2013			
	Quarter to Date		Year to Date	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized