CULLEN FROST BANKERS INC
Form 10-Q
July 23, 2008

United States Securities and Exchange Commission
Washington, D.C. 20549

For a printer-friendly version, click here

Form 10-Q

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

For the quarterly period ended: June 30, 2008

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	74-1751768
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 W. Houston Street, San Antonio, Texas	78205
(Address of principal executive offices)	(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 is a large accelerated filer, an accelerated filer, or 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 July 17, 2008, there were 59,091,315 shares of the registrant's Common Stock, $.01 par value, outstanding.

Cullen/Frost Bankers, Inc.
Quarterly Report on Form 10-Q
June 30, 2008

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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 June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Interest income:				
Loans, including fees	$ 122,755	$ 144,740	$ 253,718	$ 287,501
Securities:				
Taxable	36,803	37,767	74,001	74,596
Tax-exempt	5,448	3,785	10,779	7,092
Interest-bearing deposits	47	106	120	173
Federal funds sold and resell agreements	802	6,623	2,940	16,241
Total interest income	165,855	193,021	341,558	385,603

Interest expense:				
Deposits	25,770	48,370	60,244	97,456
Federal funds purchased and repurchase agreements	2,954	8,251	7,978	16,472
Junior subordinated deferrable interest debentures	1,591	2,499	3,697	6,192
Subordinated notes payable and other borrowings	4,212	4,381	8,431	8,130
Total interest expense	34,527	63,501	80,350	128,250
Net interest income	131,328	129,520	261,208	257,353
Provision for possible loan losses	6,328	2,650	10,333	5,300
Net interest income after provision for possible loan losses	125,000	126,870	250,875	252,053
Non-interest income:				
Trust fees	19,040	17,694	37,322	34,601
Service charges on deposit accounts	21,634	20,147	41,227	38,978
Insurance commissions and fees	7,015	6,545	18,173	17,173
Other charges, commissions and fees	9,496	6,979	16,427	13,837
Net gain (loss) on securities transactions	(56)	-	(104)	-
Other	13,452	12,655	27,764	26,503
Total non-interest income	70,581	64,020	140,809	131,092
Non-interest expense:				
Salaries and wages	54,534	51,203	109,672	102,917
Employee benefits	11,912	11,997	26,025	26,423
Net occupancy	10,091	9,483	19,738	19,117
Furniture and equipment	9,182	8,230	18,132	15,158
Intangible amortization	1,955	2,188	4,001	4,514
Other	32,416	29,541	62,562	66,600
Total non-interest expense	120,090	112,642	240,130	234,729
Income before income taxes	75,491	78,248	151,554	148,416
Income taxes	22,944	24,619	46,227	47,508
Net income	$ 52,547	$ 53,629	$ 105,327	$ 100,908
Earnings per common share:				
Basic	$ 0.89	$ 0.90	$ 1.80	$ 1.70
Diluted	0.89	0.89	1.78	1.67

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)

	June 30, 2008	December 31, 2007	June 30, 2007
Assets:			
Cash and due from banks	$ 876,177	$ 836,539	$ 572,273
Interest-bearing deposits	4,287	5,898	4,329
Federal funds sold and resell agreements	9,000	354,075	661,062
Total cash and cash equivalents	889,464	1,196,512	1,237,664
Securities held to maturity, at amortized cost	7,418	8,125	9,069
Securities available for sale, at estimated fair value	3,220,479	3,407,012	3,159,569
Trading account securities	13,727	11,913	10,816
Loans, net of unearned discounts	8,353,501	7,769,362	7,412,160
Less: Allowance for possible loan losses	(94,520)	(92,339)	(96,071)
Net loans	8,258,981	7,677,023	7,316,089
Premises and equipment, net	238,401	219,615	219,636
Goodwill	526,476	526,851	528,491
Other intangible assets, net	27,955	31,523	33,966
Cash surrender value of life insurance policies	118,760	116,231	113,990
Accrued interest receivable and other assets	369,592	290,209	320,100
	$ 13,671,253	$ 13,485,014	$ 12,949,390
Total assets			

Liabilities:			
Deposits:			
Non-interest-bearing demand deposits	$ 3,804,496	$ 3,597,903	$ 3,512,108
Interest-bearing deposits	6,822,716	6,931,770	6,664,745
Total deposits	10,627,212	10,529,673	10,176,853
Federal funds purchased and repurchase agreements	957,674	933,072	829,164
Subordinated notes payable and other borrowings	259,085	261,146	268,758
Junior subordinated deferrable interest debentures	136,084	139,177	139,177
Accrued interest payable and other liabilities	148,743	144,858	177,465
	12,128,798	12,007,926	11,591,417
Total liabilities			
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; 60,236,862 shares issued at each period end	602	602	602
Additional paid-in capital	585,070	573,799	568,318
Retained earnings	1,032,317	992,138	938,021
Accumulated other comprehensive income (loss), net of tax	(14,956)	(7,382)	(87,455)
Treasury stock, 1,155,547 shares, 1,574,732 shares and 1,163,060 shares, at cost	(60,578)	(82,069)	(61,513)
	1,542,455	1,477,088	1,357,973
Total shareholders' equity			
	$ 13,671,253	$ 13,485,014	$ 12,949,390
Total liabilities and shareholders' equity			

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.

Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands, except per share amounts)

	Six Months Ended June 30,	
	2008	2007
Total shareholders' equity at beginning of period	$ 1,477,088	$ 1,376,883
Cumulative effect of adoption of a new accounting principle on January 1, 2008 (Note 18)	(240)	-
Comprehensive income:		
Net income	105,327	100,908
Other comprehensive income (loss):		
Change in accumulated gain/loss on effective cash flow hedging derivatives of $4,433 in 2008 and $(170) in 2007 net of tax effect of $1,552 in 2008 and $(59) in 2007	2,881	(111)
Change in unrealized gain/loss on securities available for sale of $(16,804) in 2008 and $(51,254) in 2007, net of reclassification adjustment of $104 in 2008 and tax effect of $(5,845) in 2008 and $(17,939) in 2007	(10,855)	(33,315)
Change in funded status of defined benefit post-retirement benefit plans related to the amortization of actuarial losses to net periodic benefit cost of $615 in 2008 and $1,328 in 2007, net of tax effect of $215 in 2008 and $465 in 2007	400	863
Total other comprehensive income (loss)	(7,574)	(32,563)
Total comprehensive income	97,753	68,345
Stock option exercises (823,500 shares in 2008 and 476,509 shares in 2007)	26,835	12,622

Stock compensation expense recognized in earnings	5,055	5,097
Tax benefits related to stock compensation, includes excess tax benefits of $5,817 in 2008 and $4,586 in 2007	6,216	4,653
Purchase of treasury stock (404,315 shares in 2008 and 1,241,851 shares in 2007)	(21,918)	(65,624)
Cash dividends ($0.82 per share in 2008 and $0.74 per share in 2007)	(48,334)	(44,003)
Total shareholders' equity at end of period	$ 1,542,455	$ 1,357,973

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.

Consolidated Statements of Cash Flows

(Dollars in thousands)

	Six Months Ended June 30,	
	2008	2007
Operating Activities:		
Net income	$ 105,327	$ 100,908
Adjustments to reconcile net income to net cash from operating activities:		
Provision for possible loan losses	10,333	5,300
Deferred tax expense (benefit)	948	(21)
Accretion of loan discounts	(6,001)	(7,193)
Securities premium amortization (discount accretion), net	211	(1,524)
Net (gain) loss on securities transactions	104	-
Depreciation and amortization	16,267	14,951
Origination of loans held for sale	(34,628)	(38,435)
Proceeds from sales of loans held for sale	66,039	35,140
Net gain on sale of loans held for sale and other assets	(1,689)	(870)
Stock-based compensation expense	5,055	5,097
Tax benefit from stock-based compensation	399	67
Excess tax benefits from stock-based compensation	(5,817)	(4,586)
Earnings on life insurance policies	(2,529)	(2,248)

Net change in:		
Trading account securities	(1,814)	(1,410)
Accrued interest receivable and other assets	(70,373)	(45,083)
Accrued interest payable and other liabilities	9,948	16,333
Net cash from operating activities	91,780	76,426
Investing Activities:		
Securities held to maturity:		
Maturities, calls and principal repayments	705	1,024
Securities available for sale:		
Purchases	(3,236,256)	(5,032,748)
Sales	856,195	13,840
Maturities, calls and principal repayments	2,549,581	5,140,565
Net change in loans	(622,752)	(34,475)
Net cash paid in acquisitions	(33)	(1,903)
Proceeds from sales of premises and equipment	203	1,396
Purchases of premises and equipment	(28,682)	(13,154)
Proceeds from sales of repossessed properties	2,824	2,511
Net cash from investing activities	(478,215)	77,056
Financing Activities:		
Net change in deposits	97,539	(211,056)
Net change in short-term borrowings	24,602	(35,026)
Proceeds from notes payable	-	98,799
Principal payments on notes payable and other borrowings	(5,154)	(120,701)
Proceeds from stock option exercises	26,835	12,622
Excess tax benefits from stock-based compensation arrangements	5,817	4,586
Purchase of treasury stock	(21,918)	(65,624)
Cash dividends paid	(48,334)	(44,003)
Net cash from financing activities	79,387	(360,403)
Net change in cash and cash equivalents	(307,048)	(206,921)
Cash and equivalents at beginning of period	1,196,512	1,444,585
Cash and equivalents at end of period	$ 889,464	$ 1,237,664
Supplemental disclosures:		
Cash paid for interest	$ 85,115	$ 126,336
Cash paid for income taxes	41,351	39,941

See Notes to Consolidated Financial Statements.

Cullen/Frost Bankers, Inc.
Notes to Consolidated Financial Statements

(Table amounts are stated 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, including commercial and consumer banking, trust and investment management, mutual funds, 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, 2007, included in the Corporation's Annual Report on Form 10-K filed with the SEC on February 1, 2008 (the "2007 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 susceptible to significant change in the near term.

Comprehensive Income. Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of the Corporation's comprehensive income include the after tax effect of changes in the net unrealized gain/loss on securities available for sale, changes in the funded status of defined benefit post-retirement benefit plans and changes in the accumulated gain/loss on effective cash flow hedging instruments. Comprehensive income for the six months ended June 30, 2008 and 2007 is reported in the accompanying consolidated statements of changes in shareholders' equity. The Corporation had a comprehensive loss of $26.8 million for the three months ended June 30, 2008 and comprehensive income of $14.3 million for the three months ended June 30, 2007. Comprehensive income/loss during the three months ended June 30, 2008 and 2007 included net after-tax losses of $46.1 million and $39.6 million, respectively, due to increases in the net unrealized loss on securities available for sale. Comprehensive loss during the three months ended June 30, 2008 also included net after-tax losses of $33.4 million due to changes in the accumulated gain/loss on cash flow hedging derivatives.

Fair Value Measurements. On January 1, 2008, the Corporation adopted Statement of Financial Accounting Standards ("SFAS") No. 157, *"Fair Value Measurements."* SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements (See Note 17 - Fair Value Measurements).

Endorsement Split-Dollar Life Insurance Arrangements. On January 1, 2008, the Corporation changed its accounting policy and recognized a cumulative-effect adjustment to retained earnings totaling $240 thousand related to accounting for certain endorsement split-dollar life insurance arrangements in connection with the adoption of Emerging Issues Task Force ("EITF") Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements." See Note 18 - New Accounting Standards.

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

Note 2 - Mergers and Acquisitions

Prime Benefits, Inc.

On December 1, 2007, the Corporation acquired Prime Benefits, Inc., an independent, Austin-based insurance agency. Prime Benefits, which offered group employee benefits plans, including medical and dental, life, long-term care and disability insurance primarily for businesses, was fully integrated into Frost Insurance Agency. The acquisition was accounted for as a purchase transaction with all cash consideration funded through internal sources. The operating results of Prime Benefits are included with the Corporation's results of operations since the date of acquisition. The purchase of Prime Benefits did not significantly impact the Corporation's financial statements.

Note 3 - Securities Held to Maturity and Securities Available for Sale

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

	June 30, 2008	December 31, 2007

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Held to Maturity:								
U.S. government agencies and corporations	$ 6,418	$ 103	$ 2	$ 6,519	$ 7,125	$ 103	$ 14	$ 7,214
Other	1,000	-	-	1,000	1,000	-	-	1,000
Total	$ 7,418	$ 103	$ 2	$ 7,519	$ 8,125	$ 103	$ 14	$ 8,214
Securities Available for Sale:								
U.S. government agencies and corporations	$ 2,687,808	$ 4,305	$ 36,878	$ 2,655,235	$ 2,865,597	$ 9,756	$ 30,042	$ 2,845,311
States and political subdivisions	532,511	2,337	7,410	527,438	524,745	3,040	3,700	524,085
Other	37,806	-	-	37,806	37,616	-	-	37,616
Total	$ 3,258,125	$ 6,642	$ 44,288	$ 3,220,479	$ 3,427,958	$ 12,796	$ 33,742	$ 3,407,012

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 table above.

Securities with a carrying value totaling $2.1 billion at June 30, 2008 and $2.2 billion at December 31, 2007 were pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law.

Sales of securities available for sale were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Proceeds from sales	$ 257,189	$ 13,329	$ 856,195	$ 13,840

Gross realized gains	730	-	5,834	-
Gross realized losses	786	-	5,938	-

As of June 30, 2008, 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						
U.S. government agencies and corporations	$ 1,611	$ 1	$ 342	$ 1	$ 1,953	$ 2
Total	$ 1,611	$ 1	$ 342	$ 1	$ 1,953	$ 2
Available for Sale						
U.S. government agencies and corporations	$ 2,022,753	$ 25,075	$ 287,156	$ 11,803	$ 2,309,909	$ 36,878
States and political subdivisions	268,623	6,207	27,599	1,203	296,222	7,410
Total	$ 2,291,376	$ 31,282	$ 314,755	$ 13,006	$ 2,606,131	$ 44,288

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. 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 fair value.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Corporation will receive full value for the securities. Furthermore, management also has the ability and intent to hold the securities classified as available for sale for a period of time sufficient for a recovery of cost. The 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 June 30, 2008, 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.

Note 4 - Loans

Loans were as follows:

	June 30, 2008	Percentage of Total	December 31, 2007	Percentage of Total	June 30, 2007	Percentage of Total
Commercial and industrial:						
Commercial	$ 3,714,870	44.4 %	$ 3,472,759	44.7 %	$ 3,258,083	44.0 %
Leases	198,814	2.4	184,140	2.4	181,313	2.4
Asset-based	74,073	0.9	32,963	0.4	30,636	0.4
Total commercial and industrial	3,987,757	47.7	3,689,862	47.5	3,470,032	46.8
Real estate:						
Construction:						
Commercial	671,010	8.0	560,176	7.2	643,182	8.6
Consumer	67,059	0.8	61,595	0.8	87,459	1.2
Land:						
Commercial	398,964	4.8	397,319	5.1	418,951	5.7
Consumer	1,978	-	2,996	-	3,222	0.1
Commercial mortgages	2,117,356	25.3	1,982,786	25.5	1,784,307	24.1
1-4 family residential mortgages	87,862	1.1	98,077	1.3	110,358	1.5
Home equity and other consumer	647,790	7.8	587,721	7.6	527,939	7.1
Total real estate	3,992,019	47.8	3,690,670	47.5	3,575,418	48.3
Consumer:						
Indirect	1,550	-	2,031	-	2,713	-
Student loans held for sale	32,125	0.4	62,861	0.8	52,113	0.7
Other	326,431	3.9	323,320	4.2	309,714	4.2
Other	41,489	0.5	29,891	0.4	30,663	0.4
Unearned discounts	(27,870)	(0.3)	(29,273)	(0.4)	(28,493)	(0.4)
Total loans	$ 8,353,501	100.0 %	$ 7,769,362	100.0 %	$ 7,412,160	100.0 %

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 June 30, 2008, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

Student Loans Held for Sale. Student loans are primarily originated for resale on the secondary market. These loans, which are generally sold on a non-recourse basis, are 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. The Corporation expects to sell the remainder of the student loan portfolio before the end of 2008.

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 June 30, 2008 or December 31, 2007.

Non-Performing/Past Due Loans. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations, which typically occurs when principal or interest payments are more than 90 days past due. Non-accrual loans totaled $40.5 million at June 30, 2008 and $24.4 million at December 31, 2007. Accruing loans past due more than 90 days totaled $11.9 million at June 30, 2008 and $14.3 million at December 31, 2007.

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. 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.

Impaired loans were as follows:

	June 30, 2008	December 31, 2007	June 30, 2007
Balance of impaired loans with no allocated allowance	$ 21,176	$ 14,986	$ 5,564
Balance of impaired loans with an allocated allowance	12,722	2,166	32,477
Total recorded investment in impaired loans	$ 33,898	$ 17,152	$ 38,041
Amount of the allowance allocated to impaired loans	$ 6,309	$ 1,556	$ 7,337

The impaired loans included in the table above were primarily comprised of collateral dependent commercial loans. The average recorded investment in impaired loans was $28.1 million and $24.5 million for the three and six months ended June 30, 2008 and $39.0 million and $40.7 million for the three and six months ended June 30, 2007. No interest income was recognized on these loans subsequent to their classification as impaired.

Note 5 - 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 level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. 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 the performance of the Corporation's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

Activity in the allowance for possible loan losses was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Balance at the beginning of the period	$ 92,498	$96,144	$ 92,339	$ 96,085
Provision for possible loan losses	6,328	2,650	10,333	5,300
Net charge-offs:				
Losses charged to the allowance	(6,539)	(4,138)	(13,205)	(8,138)
Recoveries of loans previously charged off	2,233	1,415	5,053	2,824
Net charge-offs	(4,306)	(2,723)	(8,152)	(5,314)
Balance at the end of the period	$ 94,520	$96,071	$ 94,520	$ 96,071

Note 6 - Goodwill and Other Intangible Assets

Goodwill. Goodwill totaled $526.5 million at June 30, 2008 and $526.9 million at December 31, 2007. The decrease in goodwill was related to recording the final purchase accounting adjustments related to the acquisition of Prime Benefits, Inc. in December 2007 (see Note 2 - Mergers and Acquisitions).

Other Intangible Assets. Other intangible assets totaled $28.0 million at June 30, 2008 including $24.5 million related to core deposits, $2.8 million related to customer relationships and $670 thousand related to non-compete agreements. Other intangible assets totaled $31.5 million at December 31, 2007 including $27.8 million related to core deposits, $2.5 million related to customer relationships and $1.2 million related to non-compete agreements. The change in intangibles related to customer relationship and non-compete agreements were partly due to purchase accounting adjustments related to the acquisition of Prime Benefits, Inc.

Amortization expense related to intangible assets totaled $2.0 million and $4.0 million during the three and six months ended June 30, 2008 and totaled $2.2 million and $4.5 million during the three and six months ended June 30, 2007. The estimated aggregate future amortization expense for intangible assets remaining as of June 30, 2008 is as follows:

Remainder of 2008	$ 3,847
2009	6,269
2010	4,747
2011	3,968
2012	3,242
Thereafter	5,882
	$ 27,955

Note 7 - Deposits

Deposits were as follows:

	June 30, 2008	Percentage of Total	December 31, 2007	Percentage of Total	June 30, 2007	Percentage of Total
Non-interest-bearing demand deposits:						
Commercial and individual	$ 3,390,403	31.9 %	$ 3,171,510	30.1 %	$ 3,245,743	31.9 %
Correspondent banks	351,098	3.3	350,123	3.4	219,515	2.2
Public funds	62,995	0.6	76,270	0.7	46,850	0.4
Total non-interest-bearing demand deposits	3,804,496	35.8	3,597,903	35.2	3,512,108	34.5
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	1,695,565	15.9	1,722,305	16.4	1,334,628	13.1
Money market accounts	3,440,089	32.4	3,404,472	32.3	3,604,372	35.4
	586,944	5.5	618,719	5.9	596,187	5.9

Time accounts under $100,000						
Time accounts of $100,000 or more	717,757	6.8	801,269	7.6	729,172	7.2
Public funds	382,361	3.6	385,005	3.6	400,386	3.9
Total interest-bearing deposits	6,822,716	64.2	6,931,770	65.8	6,664,745	65.5
Total deposits	$ 10,627,212	100.0 %	$ 10,529,673	100.0 %	$ 10,176,853	100.0 %

At June 30, 2008 and December 31, 2007, interest-bearing public funds deposits included $146.7 million and $170.5 million in savings and interest checking accounts, $96.9 million and $107.6 million in money market accounts, $6.5 million and $4.8 million in time accounts under $100 thousand, and $132.3 million and $102.1 million in time accounts of $100 thousand or more.

Deposits from foreign sources, primarily Mexico, totaled $691.0 million at June 30, 2008 and $699.5 million at December 31, 2007.

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Note 8 - 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.

Commitments to Extend Credit. 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. Commitments to extend credit totaled $4.8 billion at both June 30, 2008 and December 31, 2007.

Standby Letters of Credit. 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. Standby letters of credit totaled $296.3 million at June 30, 2008 and $235.9 million at December 31, 2007. The Corporation had an accrued liability totaling $1.6 million at June 30, 2008 and $1.4 million at December 31, 2007 related to potential obligations under these guarantees.

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $4.7 million and $9.3 million for the three and six months ended June 30, 2008 and $4.6 million and $9.0 million for the three and six months ended June 30, 2007. There has been no significant change in the future minimum lease payments payable by the Corporation since December 31, 2007. See the 2007 Form 10-K for information regarding these commitments.

Litigation. The Corporation is subject to various claims and legal actions that have arisen in the normal 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 9 - Borrowed Funds

On January 7, 2008, the Corporation redeemed $3.1 million of floating rate (three-month LIBOR plus a margin of 3.30%) junior subordinated deferrable interest debentures, due January 7, 2033, held of record by Alamo Trust. Concurrently, the $3.0 million of floating rate (three-month LIBOR plus a margin of 3.30%) trust preferred securities issued by Alamo Trust were also redeemed.

On February 15, 2007, the Corporation issued $100 million of 5.75% fixed-to-floating rate subordinated notes due February 15, 2017. The notes bear interest at the rate of 5.75% per annum, payable semi-annually on each February 15 and August 15, commencing on August 15, 2007 until February 15, 2012. From and including February 15, 2012, to but excluding the maturity date or date of earlier redemption, the notes will bear interest at a rate per annum equal to three-month LIBOR for the related interest period plus 0.53%, payable quarterly on each February 15, May 15, August 15 and November 15, commencing May 15, 2012. The notes are subordinated in right of payment to all our senior indebtedness and effectively subordinated to all existing and future debt and all other liabilities of our subsidiaries. The notes cannot be accelerated except in the event of bankruptcy or the occurrence of certain other events of bankruptcy, insolvency or reorganization. The notes mature on February 15, 2017. The Corporation may elect to redeem the notes (subject to regulatory approval), in whole or in part, on any interest payment date on or after February 15, 2012 at a redemption price equal to 100% of the principal amount plus any accrued and unpaid interest.

On February 21, 2007, the Corporation redeemed $103.1 million of 8.42% junior subordinated deferrable interest debentures, Series A due February 1, 2027, held of record by Cullen/Frost Capital Trust I. As a result of the redemption, the Corporation incurred $5.3 million in expense during the first quarter of 2007 related to a prepayment penalty and the write-off of the unamortized debt issuance costs. Concurrently, the $100 million of 8.42% trust preferred securities issued by Cullen/Frost Capital Trust I were also redeemed.

Note 10 - Regulatory Matters and Shareholders' Equity

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 funded status of the Corporation's defined benefit post-retirement benefit plans, goodwill and other intangible assets. Tier 1 capital for Cullen/Frost also includes $132 million of trust preferred securities issued by unconsolidated subsidiary trusts. Cullen/Frost's and Frost Bank's total capital is comprised of Tier 1 capital for each entity plus $90 million of the Corporation's aggregate $150 million of 6.875% subordinated notes payable (of which the permissible portion decreases 20% per year during the final five years of the term of the notes) and a permissible portion of the allowance for possible loan losses. The $100 million of 5.75% fixed-to-floating rate subordinated notes issued during the first quarter of 2007 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.

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
June 30, 2008						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,428,024	12.68 %	$ 901,066	8.00 %	N/A	N/A
Frost Bank	1,346,877	11.96	900,579	8.00	$ 1,125,723	10.00 %
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,143,504	10.15	450,533	4.00	N/A	N/A
Frost Bank	1,162,357	10.33	450,289	4.00	675,434	6.00
Leverage Ratio						

Cullen/Frost	1,143,504	8.69	526,265	4.00	N/A	N/A
Frost Bank	1,162,357	8.84	525,809	4.00	657,261	5.00
December 31, 2007						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,353,125	12.59 %	$ 859,730	8.00 %	N/A	N/A
Frost Bank	1,288,306	12.05	855,265	8.00	$ 1,069,081	10.00 %
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,070,786	9.96	429,865	4.00	N/A	N/A
Frost Bank	1,105,967	10.35	427,632	4.00	641,449	6.00
Leverage Ratio						
Cullen/Frost	1,070,786	8.37	511,636	4.00	N/A	N/A
Frost Bank	1,105,967	8.65	511,164	4.00	638,955	5.00

Frost Bank has been notified by its regulator that, as of its most recent regulatory examination, it is regarded as well capitalized under the regulatory framework for prompt corrective action. Such determination has been made based on Frost Bank's Tier 1, total capital, and leverage ratios. There have been no conditions or events since this notification that management believes would change Frost Bank's categorization as well capitalized under the aforementioned ratios.

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 June 30, 2008, that Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.

Trust Preferred Securities. In accordance with the applicable accounting standard related to variable interest entities, the accounts of the Corporation's wholly owned subsidiary trusts, Cullen/Frost Capital Trust II, and Summit Bancshares Statutory Trust I, have not been included in the Corporation's consolidated financial statements. However, the $132 million in trust preferred securities issued by these subsidiary trusts have been included in the Tier 1 capital of Cullen/Frost for regulatory capital purposes pursuant to guidance from the Federal Reserve Board.

Note 11 - 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 notional amounts and estimated fair values of interest rate derivative positions outstanding at June 30, 2008 and December 31, 2007 are presented in the following table. The Corporation obtains dealer quotations to value its prime-rate loan swaps designated as hedges of cash flows. The Corporation utilizes internal valuation models with observable market data inputs to estimate fair values of customer interest rate swaps, caps and floors.

	June 30, 2008		December 31, 2007	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate derivatives designated as hedges of fair value:				
Interest rate swaps on commercial loans/leases	$ 169,970	$ (5,590)	$ 180,908	$ (5,600)
Interest rate derivatives designated as hedges of cash flows:				
Interest rate swaps on variable-rate loans	1,200,000	37,881	1,200,000	33,857
Non-hedging interest rate derivatives:				
Interest rate swaps on commercial loans/leases	473,264	15,325	328,226	12,928
Interest rate swaps on commercial loans/leases	473,264	(15,325)	328,226	(12,928)
Interest rate caps on commercial loans/leases	4,936	26	-	-
Interest rate caps on commercial loans/leases	4,936	(26)	-	-
Interest rate floors on commercial loans/leases	4,936	32	-	-
Interest rate floors on commercial loans/leases	4,936	(32)	-	-

The weighted-average rates paid and received for interest rate swaps and the weighted-average strike rate for interest rate caps and floors outstanding at June 30, 2008 were as follows:

	Weighted-Average		
	Interest Rate Paid	Interest Rate Received	Strike Rate
Interest rate swaps:			
Fair value hedge commercial loan/lease interest rate swaps	4.85 %	2.51 %	-
Cash flow hedge interest rate swaps on variable-rate loans	5.00	7.56	-
Non-hedging interest rate swaps	5.16	5.16	-
Interest rate caps and floors:			
Interest rate caps on variable-rate loans	-	-	3.50 %
Interest rate floors on variable-rate loans	-	-	3.29

Interest rate 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. In such cases, credit exposure may be reduced by the amount of collateral pledged by the counterparty. The Corporation's credit exposure relating to interest rate swaps with bank customers was approximately $13.4 million at June 30, 2008. 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's credit exposure, net of collateral pledged, relating to interest rate swaps with upstream financial institution counterparties was approximately $9.4 million at June 30, 2008. Collateral levels for upstream financial institution counterparties are monitored and adjusted on a regular basis for changes in interest rate swap values.

For fair value hedges, the changes in the fair value of both the derivative hedging instrument and the hedged item are recorded in current earnings as other income or other expense. The extent that such changes in fair value do not offset represents hedge ineffectiveness. For cash flow hedges, the effective portion of the gain or loss on the derivative hedging instrument is reported 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 recorded in current earnings as other income or other expense. The amount of hedge ineffectiveness reported in earnings was not significant during any of the reported periods. The accumulated net after-tax gain related to derivatives included in accumulated other comprehensive income totaled $24.2 million at June 30, 2008.

Commodity Derivatives. The Corporation enters into commodity swaps and option contracts 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.

		June 30, 2008		December 31, 2007	
	Notional Units	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Commodity swaps:					
Oil	Barrels	267	$ 19,020	355	$ 7,997
Oil	Barrels	267	(18,953)	355	(7,909)
Natural gas	MMBTUs	1,590	6,320	1,510	820
Natural gas	MMBTUs	1,590	(6,273)	1,510	(786)
Commodity options:					
Oil	Barrels	246	7,131	383	3,335
Oil	Barrels	246	(7,131)	383	(3,334)

The Corporation's credit exposure on commodity swaps/options is limited to the net favorable value of all swaps/options by each counterparty. In such cases, credit exposure may be reduced by the amount of collateral pledged by the counterparty. The Corporation's credit exposure relating to commodity swaps/options with bank customers was approximately $32.4 million at June 30, 2008. 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 in excess of collateral pledged relating to commodity swaps/options with upstream financial institution counterparties at June 30, 2008. Collateral levels for upstream financial institution counterparties are monitored and adjusted on a regular basis for changes in commodity swap/option values.

Foreign Currency Derivatives. The Corporation enters into foreign currency forward contracts to accommodate the business needs of its customers. Upon the origination of a foreign currency forward contract 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 notional amounts and fair values of open foreign currency forward contracts were not significant at June 30, 2008 and December 31, 2007.

Note 12 - Earnings Per Common Share

Basic earnings per share is computed by dividing net income by the weighted-average number of shares outstanding during the applicable period. Diluted earnings per share is computed using the weighted-average number of shares determined for the basic computation plus the dilutive effect of stock options and non-vested stock granted using the treasury stock method.

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 June 30,	Six Months Ended June 30,

	2008	2007	2008	2007
Weighted-average shares outstanding for basic earnings per share	58,732,666	59,324,340	58,635,340	59,499,098
Dilutive effect of stock options and non-vested stock awards	482,996	809,980	506,930	863,492
Weighted-average shares outstanding for diluted earnings per share	59,215,662	60,134,320	59,142,270	60,362,590

Note 13 - Stock-Based Compensation

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

		Non-Vested Stock Awards Outstanding		Stock Options Outstanding	
	Shares Available for Grant	Number of Shares	Weighted-Average Grant-Date Fair Value	Number of Shares	Weighted-Average Exercise Price
Balance, January 1, 2008	1,896,150	233,100	$ 50.68	4,526,276	$ 45.44
Granted	(2,000)	-	-	2,000	53.55
Director deferred stock units awarded	(5,450)	-	-	-	-
Stock options exercised	-	-	-	(823,500)	32.59
Stock awards vested	-	(1,500)	42.53	-	-
Forfeited	28,550	-	-	(28,550)	51.68
Canceled	(1,500)	-	-	-	-
Balance, June 30, 2008	1,915,750	231,600	50.73	3,676,226	48.27

During the second quarter of 2008, the Corporation awarded non-employee directors a total of 5,450 deferred stock units. Upon retirement from the Corporation's board of directors, non-employee directors will receive one share of the Corporation's common stock for each deferred stock unit held. The deferred stock units were fully vested upon being awarded and will receive equivalent dividend payments as such dividends are declared on the Corporation's common stock. The Corporation recognized stock-compensation expense totaling $300 thousand related to the award of deferred stock units during the second quarter of 2008. The expense was based upon the market price of the Corporation's stock on the date of the awards.

During the six months ended June 30, 2008 and 2007, proceeds from stock option exercises totaled $26.8 million and $12.6 million. During the six months ended June 30, 2008, all of the shares issued in connection with stock option exercises were issued from available treasury stock.

Stock-based compensation expense totaled $2.7 million and $5.1 million during both the three and six months ended June 30, 2008 and 2007, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Unrecognized stock-based compensation expense related to stock options totaled $15.3 million at June 30, 2008, while unrecognized stock-based compensation expense related to non-vested stock awards was $5.3 million at June 30, 2008.

Note 14 - Defined Benefit Plans

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Expected return on plan assets, net of expenses	$ (2,310)	$ (2,047)	$ (4,620)	$ (4,094)
Interest cost on projected benefit obligation	1,935	1,869	3,871	3,738
Net amortization and deferral	308	664	615	1,328
Net periodic benefit cost	$ (67)	$ 486	$ (134)	$ 972

The Corporation's non-qualified defined benefit pension plan is not funded. Contributions to the qualified defined benefit pension plan totaled $5.2 million through June 30, 2008. The Corporation does not expect to make any additional contributions during the remainder of 2008.

The net periodic benefit cost related to post-retirement healthcare benefits offered by the Corporation to certain former employees was not significant during either of the reported periods.

Note 15 - Income Taxes

Income tax expense was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Current income tax expense	$ 22,171	$ 23,900	$ 45,279	$ 47,529

Deferred income tax expense (benefit)	773	719	948	(21)
Income tax expense as reported	$22,944	$24,619	$ 46,227	$ 47,508
Effective tax rate	30.4 %	31.5 %	30.5 %	32.0 %

Net deferred tax assets totaled $31.2 million at June 30, 2008 and $27.9 million at December 31, 2007. No valuation allowance was recorded against deferred tax assets, as the amounts are recoverable through taxes paid in prior years.

The Corporation adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109," effective January 1, 2007. Interpretation 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Interpretation 48 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. Adoption of Interpretation 48 did not have a significant impact on the Corporation's financial statements.

The Corporation files income tax returns with the U.S. Internal Revenue Service ("IRS"). The Company is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2004. During the third quarter of 2007, the IRS completed an examination of the Corporation's U.S. income tax returns for 2004 and 2005. The adjustments resulting from the examination did not have a significant impact on the Corporation's financial statements.

Note 16 - 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. 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:				
June 30, 2008	$174,143	$ 30,084	$ (2,318)	$ 201,909
June 30, 2007	169,485	27,808	(3,753)	193,540
Six months ended:				
June 30, 2008	$348,790	$ 59,050	$ (5,823)	$ 402,017
June 30, 2007	341,513	54,805	(7,873)	388,445
Net income (loss):				
Three months ended:				
June 30, 2008	$47,702	$ 7,068	$ (2,223)	$ 52,547
June 30, 2007	50,179	6,579	(3,129)	53,629
Six months ended:				

June 30, 2008	$97,138	$ 13,331	$ (5,142)	$ 105,327
June 30, 2007	98,699	12,106	(9,897)	100,908

Note 17 - Fair Value Measurements

Effective January 1, 2008, the Corporation adopted the provisions of SFAS No. 157, "Fair Value Measurements," for financial assets and financial liabilities. In accordance with Financial Accounting Standards Board Staff Position (FSP) No. 157-2, "Effective Date of FASB Statement No. 157," the Corporation will delay application of SFAS 157 for non-financial assets and non-financial liabilities, until January 1, 2009. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements.

SFAS 157 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. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

SFAS 157 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, SFAS 157 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:

w 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.

w 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.

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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.

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. These valuation methodologies were applied to all of the Corporation's financial assets and financial liabilities carried at fair value effective January 1, 2008.

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.

Securities Available for Sale. Securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements 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.

Trading Securities. U.S. Treasury Bills are reported at fair value utilizing Level 1 inputs. Other securities classified as trading are reported at fair value utilizing Level 2 inputs in the same manner as described above for securities available for sale.

Derivatives. Derivatives are reported at fair value utilizing Level 2 inputs. The Corporation obtains dealer quotations to value its prime-rate loan swaps, commodity swaps/options and foreign currency contracts. The Corporation utilizes internal valuation models with observable market data inputs to estimate fair values of customer interest rate swaps, caps and floors. The Corporation also obtains dealer quotations for these derivatives for comparative purposes to assess the reasonableness of the model valuations.

Impaired Loans. Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2008, 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
Securities available for sale	$ -	$ 3,182,673	$ -	$ 3,182,673
Trading account securities	13,622	105	-	13,727
Derivative assets	-	85,735	-	85,735
Derivative liabilities	-	53,330	-	53,330

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments 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). During the six months ended June 30, 2008, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral. Impaired loans with a carrying value of $4.3 million were reduced by specific valuation allowance allocations totaling $1.7 million to a total reported fair value of $2.6 million based on collateral valuations utilizing Level 2 valuation inputs. Impaired loans with a carrying value of $7.8 million were reduced by specific valuation allowance allocations totaling $4.0 million to a total reported fair value of $3.8 million based on collateral valuations utilizing Level 3 valuation inputs.

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Certain non-financial assets and non-financial liabilities measured at fair value on a recurring basis include reporting units measured at fair value in the first step of a goodwill impairment test. Certain non-financial assets measured at fair value on a non-recurring basis include non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, as well as intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. As stated above, SFAS 157 will be applicable to these fair value measurements beginning January 1, 2009.

Effective January 1, 2008, the Corporation adopted the provisions of SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115." SFAS 159 permits the Corporation to choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, thus the Corporation may record identical financial assets and liabilities at fair value or by another measurement basis permitted under generally accepted accounting principles, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments. Adoption of SFAS 159 on January 1, 2008 did not have a significant impact on the Corporation's financial statements.

Note 18 - New Accounting Standards

Statements of Financial Accounting Standards

SFAS No. 141, "Business Combinations (Revised 2007)."

SFAS 141R replaces SFAS 141, "Business Combinations," and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141R, the requirements of SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities," would have to be met by the target in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, "Accounting for Contingencies." SFAS 141R is expected to have a significant impact on the Corporation's accounting for business combinations closing on or after January 1, 2009.

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments."

SFAS 155 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS 155 (i) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (ii) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, (iii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (iv) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (v) amends SFAS 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. Adoption of SFAS 155 on January 1, 2007 did not have a significant impact on the Corporation's financial statements.

SFAS No. 156, "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140."

SFAS 156 amends SFAS 140. "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125," by requiring, in certain situations, an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract. All separately recognized servicing assets and servicing liabilities are required to be initially measured at fair value. Subsequent measurement methods include the amortization method, whereby servicing assets or servicing liabilities are amortized in proportion to and over the period of estimated net servicing income or net servicing loss or the fair value method, whereby servicing assets or servicing liabilities are measured at fair value at each reporting date and changes in fair value are reported in earnings in the period in which they occur. If the amortization method is used, an entity must assess servicing assets or servicing liabilities for impairment or increased obligation based on the fair value at each reporting date. Adoption of SFAS 156 on January 1, 2007 did not have a significant impact on the Corporation's financial statements.

SFAS No. 157, "Fair Value Measurements."

SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements (see Note 17 - Fair Value Measurements).

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115."

SFAS 159 permits entities to choose to measure eligible items at fair value at specified election dates (see Note 17 - Fair Value Measurements).

SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB Statement No. 51."

SFAS 160 amends Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the non-controlling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the non-controlling interest. SFAS 160 is effective for the Corporation on January 1, 2009 and is not expected to have a significant impact on the Corporation's financial statements.

SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133."

SFAS 161 amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," to amend and expand the disclosure requirements of SFAS 133 to provide greater transparency about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedge items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. To meet those objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for the Corporation on January 1, 2009 and is not expected to have a significant impact on the Corporation's financial statements.

SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles."

SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). The hierarchical guidance provided by SFAS 162 did not have a significant impact on the Corporation's financial statements.

Financial Accounting Standards Board Staff Positions

FASB Staff Position (FSP) No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." FSP EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 will be effective on January 1, 2009. All previously reported earnings per share data will be retrospectively adjusted to conform with the provisions of FSP EITF 03-6-1. FSP EITF 03-6-1 is not expected to have a significant impact on the Corporation's financial statements.

Financial Accounting Standards Board Interpretations

FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109." The Corporation adopted Interpretation No. 48 on January 1, 2007. See Note 15 - Income Taxes for additional information.

Emerging Issues Task Force Issues

Emerging Issues Task Force ("EITF") Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements." EITF 06-4 requires the recognition of a liability and related compensation expense for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to post-retirement periods. Under EITF 06-4, life insurance policies purchased for the purpose of providing such benefits do not effectively settle an entity' obligation to the employee. Accordingly, the entity must recognize a liability and related compensation expense during the employee' active service period based on the future cost of insurance to be incurred during the employee' retirement. If the entity has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions." The Corporation adopted EITF 06-4 on January 1, 2008 as a change in accounting principle through a cumulative-effect adjustment to retained earnings totaling $240 thousand.

SEC Staff Accounting Bulletins

SAB No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings."

SAB No. 109 supersedes SAB 105, "Application of Accounting Principles to Loan Commitments," and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The guidance in SAB 109 became effective on January 1, 2008 and did not have a material impact on the Corporation's financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Review
Cullen/Frost Bankers, Inc.

The following discussion should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2007, included in the 2007 Form 10-K. Operating results for the three and six months ended June 30, 2008 are not necessarily indicative of the results for the year ending December 31, 2008 or any future period.

Dollar amounts in tables are stated in thousands, except for per share amounts.

Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified as such. In addition, certain statements may be contained in the Corporation's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Corporation that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of Cullen/Frost or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "continue", "remain", "will", "should", "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- Local, regional, national and international economic conditions and the impact they may have on the Corporation and its customers and the Corporation's assessment of that impact.
- Changes in the level of non-performing assets and charge-offs.
- Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
- The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
- Inflation, interest rate, securities market and monetary fluctuations.
- Political instability.
- Acts of God or of war or terrorism.
- The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

- Changes in consumer spending, borrowings and savings habits.
- Changes in the financial performance and/or condition of the Corporation's borrowers.
- Technological changes.
- Acquisitions and integration of acquired businesses.
- The ability to increase market share and control expenses.
- Changes in the competitive environment among financial holding companies and other financial service providers.
- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Corporation and its subsidiaries must comply.
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.
- Changes in the Corporation's organization, compensation and benefit plans.
- The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews.
- Greater than expected costs or difficulties related to the integration of new products and lines of business.
- The Corporation's success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. The Corporation undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Application of Critical Accounting Policies and Accounting Estimates

The accounting and reporting policies followed by the Corporation conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. 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 amounts reported in the financial statements and accompanying notes. While the Corporation bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The Corporation considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Corporation's financial statements. Accounting policies related to the allowance for possible loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management.

For additional information regarding critical accounting policies, refer to Note 1 - Summary of Significant Accounting Policies in the notes to consolidated financial statements and the sections captioned "Application of Critical Accounting Policies" and "Allowance for Possible Loan Losses" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2007 Form 10-K. There have been no significant changes in the Corporation's application of critical accounting policies related to the allowance for possible loan losses since December 31, 2007.

Overview

A discussion of the Corporation's results of operations is presented below. Certain reclassifications have been made to make prior periods comparable. Taxable-equivalent adjustments are the result of increasing income from tax-free loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 35% federal income tax rate, thus making tax-exempt asset yields comparable to taxable asset yields. All of the Corporation's acquisitions during the reported periods were accounted for as purchase transactions, and as such, their related results of operations are included from the date of acquisition. See Note 2 - Mergers and Acquisitions in the accompanying notes to consolidated financial statements included elsewhere in this report.

Results of Operations

Net income totaled $52.5 million, or $0.89 diluted per share, for the three months ended June 30, 2008 compared to $53.6 million, or $0.89 diluted per share, for the three months ended June 30, 2007 and $52.8 million, or $0.89 diluted per share, for the three months ended March 31, 2008. Net income totaled $105.3 million, or $1.78 diluted per share, for the six months ended June 30, 2008 compared to $100.9 million, or $1.67 diluted per share, for the six months ended June 30, 2007.

Selected income statement data and other selected data for the comparable periods was as follows:

	Three Months Ended			Six Months Ended	
	June 30, 2008	March 31, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Taxable-equivalent net interest income	$ 136,223	$ 134,767	$ 133,095	$ 270,991	$ 264,222
Taxable-equivalent adjustment	4,895	4,887	3,575	9,783	6,869
Net interest income	131,328	129,880	129,520	261,208	257,353
Provision for possible loan losses	6,328	4,005	2,650	10,333	5,300
Net interest income after provision for possible loan losses	125,000	125,875	126,870	250,875	252,053
Non-interest income	70,581	70,228	64,020	140,809	131,092

Non-interest expense	120,090	120,040	112,642	240,130	234,729
Income before income taxes	75,491	76,063	78,248	151,554	148,416
Income taxes	22,944	23,283	24,619	46,227	47,508
Net income	$ 52,547	$ 52,780	$ 53,629	$ 105,327	$ 100,908
Earnings per common share - basic	$ 0.89	$ 0.90	$ 0.90	$ 1.80	$ 1.70
Earnings per common share - diluted	0.89	0.89	0.89	1.78	1.67
Dividends per common share	0.42	0.40	0.40	0.82	0.74
Return on average assets	1.56 %	1.59 %	1.66 %	1.57 %	1.57 %
Return on average equity	13.44	13.89	15.40	13.66	14.60

Net income decreased $1.1 million, or 2.0%, for the three months ended June 30, 2008 and increased $4.4 million, or 4.4%, for six months ended June 30, 2008 compared to the same periods in 2007. The decrease during the three months ended June 30, 2008 was primarily the result of a $7.4 million increase in non-interest expense and a $3.7 million increase in the provision for possible loan losses partly offset by a $6.6 million increase in non-interest income, a $1.8 million increase in net interest income and a $1.7 million decrease in income tax expense. The increase during the six months ended June 30, 2008 was primarily the result of a $9.7 million increase in non-interest income, a $3.9 million increase in net interest income and a $1.3 million decrease in income tax expense partly offset by a $5.4 million increase in non-interest expense and a $5.0 million increase in the provision for possible loan losses.

Net income for the second quarter of 2008 decreased $233 thousand, or 0.4%, from the first quarter of 2008. The decrease was primarily the result of a $2.3 million increase in the provision for possible loan losses partly offset by a $1.4 million increase in net interest income, a $353 thousand increase in non-interest income and a $339 thousand decrease in income tax expense.

Details of the changes in the various components of net income are further discussed below.

Net Interest Income

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Corporation's largest source of revenue, representing 65.0% of total revenue during the first six months of 2008. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Corporation's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, began

2007 at 8.25% and decreased 50 basis points in the third quarter and 50 basis in the fourth quarter to end the year at 7.25%. During the first six months of 2008, the prime interest rate decreased 200 basis points in the first quarter and 25 basis points in the second quarter to end the period at 5.00%. The federal funds rate, which is the cost of immediately available overnight funds, has moved in a similar manner. It began 2007 at 5.25% and decreased 50 basis points in the third quarter and 50 basis points in the fourth quarter to end the year at 4.25%. During the first six months of 2008, the federal funds rate decreased 200 basis points in the first quarter and 25 basis points in the second quarter to end the period at 2.00%.

The Corporation's balance sheet has historically been asset sensitive, meaning that earning assets generally reprice more quickly than interest-bearing liabilities. Therefore, the Corporation's net interest margin was likely to increase in sustained periods of rising interest rates and decrease in sustained periods of declining interest rates. In an effort to make the Corporation's balance sheet less sensitive to changes in interest rates, the Corporation entered into interest rate swaps during the fourth quarter of 2007 that effectively convert $1.2 billion of loans with variable interest rates tied to the prime rate into fixed rate loans for a period of seven years (see Note 17 - Derivative Financial Instruments in the 2007 Form 10-K). As a result, the Corporation's balance sheet is more interest-rate neutral and changes in interest rates are expected to have a less significant impact on the Corporation's net interest margin. The Corporation is primarily funded by core deposits, with non-interest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Corporation's net interest income and net interest margin in a rising interest rate environment. As stated above, during the first six months of 2008, the federal funds rate and the prime interest rate each decreased 225 basis points to 2.00% and 5.00%, respectively. The Corporation currently believes that that the federal funds rate and the prime interest rate will remain stable into the foreseeable future; however, there can be no assurance to that effect as changes in market interest rates are dependent upon a variety of factors that are beyond the Corporation's control. Further analysis of the components of the Corporation's net interest margin is presented below.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or average interest rate change in proportion to the absolute amounts of the change in each. The comparisons between the quarters include an additional change factor that shows the effect of the difference in the number of days in each period, as further discussed below.

	Second Quarter 2008 vs. Second Quarter 2007	Second Quarter 2008 vs. First Quarter 2008	First Six Months 2008 vs. First Six Months 2007
Due to changes in average volumes	$ 4,354	$ 1,171	$ 5,526
Due to changes in average interest rates	(1,226)	285	(246)
Due to difference in the number days in each of the comparable periods	-	-	1,489
Total change	$ 3,128	$ 1,456	$ 6,769

Taxable-equivalent net interest income for the three months ended June 30, 2008 increased $3.1 million, or 2.4%, compared to the same period in 2007. The increase primarily resulted from an increase in the average volume of earning assets partly offset by a decrease in the net interest margin. The average volume of interest-earning assets for the second quarter of 2008 increased $469.0 million compared to the same period in 2007. Over the same time frame, the net interest margin decreased 4 basis points from 4.72% in 2007 to 4.68% in 2008.

Taxable-equivalent net interest income for the six months ended June 30, 2008 increased $6.8 million, or 2.6% compared to the same period in 2007. The increase primarily resulted from an increase in the average volume of interest-earning assets and an increase in the number of days in the first six months of 2008, due to leap year, partly offset by a decrease in the net interest margin. The average volume of interest-earning assets for the first six months of 2008 increased $362.8 million compared to the same period in 2007. Over the same time frame, the net interest margin decreased 2 basis points from 4.69% in 2007 to 4.67% in 2008. Taxable-equivalent net interest income for the first six months of 2008 included 182 days compared to 181 days for the first six months of 2007. The additional day added approximately $1.5 million to taxable-equivalent net interest income during the first six months of 2008. Excluding the impact of the additional day during the first quarter of 2008 results in an effective increase in taxable-equivalent net interest income of approximately $5.3 million during the first six months of 2008 compared to the same period in 2007. This effective increase was the result of the aforementioned increase in the average volume of interest-earning assets partly offset by a decrease in the net interest margin.

The Corporation's net interest margin decreased 2 basis points from 4.69% during the first six months of 2007 to 4.67% during the first six months of 2008, in part due to lower average market interest rates. The effect of lower average market interest rates was substantially mitigated by a disproportionally larger decrease in the average cost of funds, which decreased 129 basis points from 3.26% in 2007 to 1.97% in 2008, compared to the decrease in the average yield on interest-earning assets, which decreased 90 basis points from 6.96% in 2007 to 6.06% in 2008. The decreases in the average cost of funds and the average yield on interest-earning assets were primarily due to a decrease in average market interest rates. The effect of lower average market interest rates on the average yield on interest-earning assets was partly limited by the aforementioned interest rate swaps on variable-rate loans. In addition to lower average market interest rates, the cost of funds was further impacted by an increase in the relative proportion of lower-cost savings and interest checking deposits in 2008 relative to 2007. The negative impact of lower average market interest rates on the average yield on interest-earning assets was partly limited as the Corporation had a larger proportion of average interest-earning assets invested in higher-yielding loans, which increased from 65.8% of total average interest-earning assets during the first six months of 2007 to 69.1% of total average interest-earning assets during the first six months of 2008, and a lower proportion of average interest-earning assets invested in lower-yielding federal funds sold and resell agreements during 2008 relative to 2007.

Taxable-equivalent net interest income for the second quarter of 2008 increased $1.5 million, or 1.1%, from the first quarter of 2008. The increase primarily resulted from an increase in the average volume of interest-earning assets and an increase in the net interest margin. The average volume of interest-earning assets for the second quarter of 2008 increased $111.7 million compared to the first quarter of 2008. The net interest margin increased one basis point from 4.67% in the first quarter of 2008 to 4.68% in the second quarter of 2008, despite a 25 basis point decrease in both the prime rate and the federal funds rate during the second quarter of 2008. The negative impact of lower average market interest rates on the average yield on interest-earning assets was partly limited by the aforementioned interest rate swaps on variable-rate loans as well as the fact that the Corporation had a larger proportion of average interest-earning assets invested in higher-yielding loans, which increased from 68.2% of total average interest-earning assets during the first quarter of 2008 to 69.9% of total average interest-earning assets during the second quarter of

2008, and a lower proportion of average interest-earning assets invested in lower-yielding federal funds sold and resell agreements.

The average volume of loans, the Corporation's primary category of interest-earning assets, increased $622.8 million during the six months ended June 30, 2008 compared to the same period in 2007. The average yield on loans was 6.43% during the first six months of 2008 compared to 7.88% during the same period in 2007. As stated above, the Corporation had a larger proportion of average interest-earning assets invested in loans during 2008 compared to 2007. Such investments have significantly higher yields compared to securities and federal funds sold and resell agreements and, as such, have a positive effect on the net interest margin. The average volume of securities increased $148.5 million during the first six months of 2008 compared to the same period in 2007. The average yield on securities was 5.36% during the first six months of 2008 compared to 5.20% during same period in 2007. The increase in the average yield on securities during 2008 compared to 2007 was partly due to the Corporation having a larger proportion of securities invested in higher-yielding, tax-exempt municipal securities. Average federal funds sold and resell agreements during the first six months of 2008 decreased $409.2 million compared to the same period in 2007. The average yield on federal funds sold and resell agreements was 2.89% during the first six months of 2008 compared to 5.33% during the same period in 2007.

Average deposits increased $230.6 million during the first six months of 2008 compared to the same period in 2007. Average interest-bearing deposits for the first six months of 2008 increased $229.3 million compared to the same period in 2007. The ratio of average interest-bearing deposits to total average deposits was 66.1% during the first six months of 2008 compared to 65.4% during the same period in 2007. The average cost of interest-bearing deposits and total deposits was 1.76% and 1.16% during the first six months of 2008 compared to 2.95% and 1.93% during the first six months of 2007. The decrease in the average cost of interest-bearing deposits was primarily the result of decreases in interest rates offered on deposit products due to decreases in average market interest rates.

The Corporation's net interest spread, which represents the difference between the average rate earned on earning assets and the average rate paid on interest-bearing liabilities, was 4.09% during the first six months of 2008 compared to 3.70% during the first six months of 2007. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

The Corporation's hedging policies permit the use of various derivative financial instruments, including interest rate swaps, swaptions, caps and floors, to manage exposure to changes in interest rates. Details of the Corporation's derivatives and hedging activities are set forth in Note 11 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report. Information regarding the impact of fluctuations in interest rates on the Corporation's derivative financial instruments is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

Provision for Possible Loan Losses

The provision for possible loan losses is determined by management as the amount to be added to the allowance for possible loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for possible loan losses totaled $6.3 million and $10.3 million for the three and six months ended June 30, 2008 compared to $2.7 million and $5.3 million for the three and six months ended June 30, 2007. See the section captioned "Allowance for Possible Loan Losses" elsewhere in this discussion for further analysis of the provision for possible loan losses.

Non-Interest Income

The components of non-interest income were as follows:

	Three Months Ended			Six Months Ended	
	June 30, 2008	March 31, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Trust fees	$ 19,040	$ 18,282	$ 17,694	$ 37,322	$ 34,601
Service charges on deposit accounts	21,634	19,593	20,147	41,227	38,978
Insurance commissions and fees	7,015	11,158	6,545	18,173	17,173
Other charges, commissions and fees	9,496	6,931	6,979	16,427	13,837
Net gain (loss) on securities transactions	(56)	(48)	-	(104)	-
Other	13,452	14,312	12,655	27,764	26,503
Total	$ 70,581	$ 70,228	$ 64,020	$ 140,809	$ 131,092

Total non-interest income for the three and six months ended June 30, 2008 increased $6.6 million, or 10.2%, and $9.7 million, or 7.4%, compared to the same periods in 2007. Total non-interest income for the second quarter of 2008 increased $353 thousand, or 0.5%, compared to the first quarter of 2008. Changes in the components of non-interest income are discussed below.

Trust Fees. Trust fee income for the three and six months ended June 30, 2008 increased $1.3 million, or 7.6%, and $2.7 million, or 7.9%, compared to the same periods in 2007. Investment fees are the most significant component of trust fees, making up approximately 69% and 70% of total trust fees for the first six months of 2008 and 2007, respectively. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees.

The increase in trust fee income during the three months ended June 30, 2008 compared to the same period in 2007 was primarily the result of increases in oil and gas trust management fees (up $601 thousand), securities lending income (up $412 thousand) and investment fees (up $372 thousand). The increase in trust fee income during the six months ended June 30, 2008 compared to the same period in 2007 was primarily the result of increases in investment fees (up $1.3 million), oil and gas trust management fees (up $1.2 million) and securities lending income (up $947 thousand). The increase in oil and gas trust management fees was partly related to new lease bonuses and increased production. The increase in securities lending income was due in part to increased transaction spreads. The increase in investment fees was primarily due to growth in average trust assets and the number of trust accounts. The growth in average trust assets was primarily in managed accounts, which have a higher fee rate than non-managed accounts. The Corporation has been successful with business development activities and customer retention despite the recent market correction in equity valuations. Equity valuations during the first half of 2008 have been lower on average compared to the first half of 2007 while bond valuations are higher as a result of lower market interest rates.

Trust fee income for the second quarter of 2008 increased $758 thousand, or 4.1%, compared to the first quarter of 2008. The increase was primarily the result of increases in tax fees (up $611 thousand), oil and gas fees (up $169 thousand) and investment fees (up $166 thousand). These increases were partially offset by decreases in real estate fees (down $187 thousand).

At June 30, 2008, trust assets, including both managed assets and custody assets, were primarily composed of fixed income securities (40.9% of trust assets), equity securities (37.6% of trust assets) and cash equivalents (14.5% of trust assets). The estimated fair value of trust assets was $23.9 billion (including managed assets of $10.4 billion and custody assets of $13.5 billion) at June 30, 2008, compared to $24.8 billion (including managed assets of $10.5 billion and custody assets of $14.3 billion) at December 31, 2007 and $24.1 billion (including managed assets of $10.0 billion and custody assets of $14.1 billion) at June 30, 2007.

Service Charges on Deposit Accounts. Service charges on deposit accounts for the three and six months ended June 30, 2008 increased $1.5 million, or 7.4%, and $2.2 million, or 5.8%, compared to the same periods in 2007. During the three months ended June 30, 2008 increases in service charges on commercial accounts (up $2.0 million) were partly offset by decreases in service charges on consumer accounts (down $723 thousand). During the six months ended June 30, 2008 increases in service charges on commercial accounts (up $2.4 million) and in overdraft/insufficient funds charges on consumer accounts (up $536 thousand) were partly offset by decreases in service charges on consumer accounts (down $1.4 million). The increase in service charges on commercial accounts was primarily related to increased treasury management fees. The increased treasury management fees resulted primarily from a lower earnings credit rate. The earnings credit rate is the value given to deposits maintained by treasury management customers. Because interest rates are lower compared to the first six months of 2007, deposit balances have become less valuable and are yielding a lower earnings credit rate. As a result, customers are paying for more of their services through fees rather than with earning credits applied to their deposit balances. The increase in overdraft/insufficient funds charges on consumer accounts was partly the result of growth in deposit accounts and an increase in the per-occurrence fee charged during the second quarter of 2007. The decrease in service charges on consumer accounts is partly the result of a shift in the relative mix of deposit products towards lower cost/free accounts, which is partly related to a restructuring of the Corporation's deposit product offerings.

Service charges on deposit accounts for the second quarter of 2008 increased $2.0 million, or 10.4%, compared to the first quarter of 2008. The increase was primarily due to an increase in service charges on commercial accounts (up $1.5 million), primarily from a lower earnings credit rate, and an increase in overdraft/insufficient funds charges on consumer accounts (up $539 thousand), which was partly the result of normal seasonal variation.

Insurance Commissions and Fees. Insurance commissions and fees for the three and six months ended June 30, 2008 increased $470 thousand, or 7.2%, and $1.0 million, or 5.8%, compared to the same periods in 2007. The increases were primarily related to higher commission income (up $417 thousand and $1.1 million for the three and six months ended June 30, 2008).

Insurance commissions and fees include contingent commissions totaling $206 thousand and $3.5 million during the three and six months ended June 30, 2008 and $154 thousand and $3.6 million during the three and six months ended June 30, 2007. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers related to the loss performance of insurance policies previously placed. Such commissions are seasonal in nature and are generally received during the first quarter of each year. These commissions totaled $3.0 million and $3.3 million during the six months ended June 30, 2008 and 2007. Contingent commissions also include amounts received from various benefit plan insurance companies related to the volume of business generated and/or the subsequent retention of such business. These commissions totaled $206 thousand and $491 thousand during the three and six months ended June 30, 2008 and $149 thousand and $274 thousand during the three and six months ended June 30, 2007.

Insurance commissions and fees for the second quarter of 2008 decreased $4.1 million, or 37.1%, compared to the first quarter of 2008. The decrease was primarily due to the seasonal decrease in contingent commissions (down $3.1 million) received from various insurance carriers related to the performance of insurance policies previously placed. Commission income for the second quarter of 2008 decreased $1.0 million compared to the first quarter of 2008 primarily due to normal variation in the timing of renewals and in the market demand for insurance products.

Other Charges, Commissions and Fees. Other charges, commissions and fees for the three and six months ended June 30, 2008 increased $2.5 million, or 36.1%, and $2.6 million, or 18.7%, compared to the same periods in 2007. The increase during the three months ended June 30, 2008 was primarily related to an increase in investment banking fees related to corporate advisory services (up $1.4 million), mutual fund management fees (up $514 thousand) and commission income related to the sale of money market accounts (up $465 thousand). Investment banking fees related to corporate advisory services are transaction-based and can vary significantly from quarter to quarter. The mutual fund management fees represent fee revenue related to Frost Investment Advisors, LLC, a newly formed registered investment advisor subsidiary of the Corporation. The increase in other charges, commissions and fees during the six months ended June 30, 2008 was primarily related to an increase in investment banking fees related to corporate advisory services (up $1.4 million), commission income related to the sale of money market accounts (up $857 thousand) and mutual fund management fees (up $514 thousand) related to Frost Investment Advisors, LLC.

Other charges, commissions and fees for the second quarter of 2008 increased $2.6 million, or 37.0%, compared to the first quarter of 2008. The increase was primarily due to increases in investment banking fees related to corporate advisory services (up $1.3 million) and mutual fund management fees (up $514 thousand) related to Frost Investment Advisors, LLC.

Net Gain/Loss on Securities Transactions. The Corporation sold available-for-sale securities with an amortized cost totaling $856.3 million and $13.8 million during the six months ended June 30, 2008 and 2007. The Corporation realized a net loss of $104 thousand on the 2008 sales. No gains or losses were realized on the 2007 sales. The Corporation sold $599.1 million of securities during the first quarter of 2008 in connection with a restructuring of the Corporation's securities portfolio to help improve net interest income in light of actions taken by the Federal Reserve that resulted in 200 basis point declines in both the federal funds rate and the prime rate. The proceeds from the sales were reinvested in longer-term securities with higher yields. The Corporation sold $257.2 million of securities during the second quarter of 2008,of which approximately $190.0 million were primarily sold for liquidity management purposes as loans grew $584.1 million, or 7.5%, from December 31, 2007.

Other Non-Interest Income. Other non-interest income increased $797 thousand, or 6.3%, for the three months ended June 30, 2008 compared to the same period in 2007. Contributing to the increase were increases in mineral interest income (up $566 thousand), income from check card usage (up $489 thousand), gains on the sale of student loans (up $435 thousand) and income from securities trading and customer derivative activities (up $409 thousand). These increases were partly offset by a decrease in sundry income from various miscellaneous items (down $462 thousand) and earnings on cashier check balances (down $453 thousand). Sundry income from various miscellaneous items generally includes various one-time, non-recurring items. The decrease in earnings on cashier check balances was primarily due to a decrease in fees received on balances maintained with the Corporation's third-party processor as such fees are tied to market interest rates which are comparatively lower in 2008 relative to

2007. During the second quarter of 2008, the Corporation began to maintain cashiers check balances in-house. Accordingly, the third-party fees on cashier check balances will continue to decline. The cashier check balances maintained in-house by the Corporation will provide investable funds from which the Corporation will derive interest income in future periods.

Other non-interest income increased $1.3 million, or 4.8%, for the six months ended June 30, 2008 compared to the same period in 2007. Contributing to the increase were increases in income from check card usage (up $1.1 million), income from securities trading and customer derivative activities (up $596 thousand), gains on the sale of student loans (up $594 thousand) and mineral interest income (up $410 thousand). These increases were partly offset by a decrease in earnings on cashier check balances (down $626 thousand) and in gains on sale of assets (down $602 thousand).

Other non-interest income for the second quarter of 2008 decreased $860 thousand or 6.0%, compared to the first quarter of 2008. Contributing to the decrease were decreases in sundry income from various miscellaneous items (down $1.7 million) and earnings on cashier check balances (down $244 thousand), as well as decreases in various other categories of non-interest income. These decreases were partly offset by increases in mineral interest income (up $665 thousand), income from check card usage (up $315 thousand) and gains on the sale of student loans (up $285 thousand). During the first quarter of 2008, sundry income from various miscellaneous items included $1.9 million related to the partial redemption of shares received from the VISA, Inc. initial public offering resulting from the Corporation's membership interest in VISA USA. A portion of the shares allocated to the Corporation in the initial public offering were withheld to cover the costs and liabilities associated with certain litigation for which the Corporation, based on its prior proportionate membership interest in VISA USA, is obligated to indemnify VISA under its indemnification agreement with VISA USA. The Corporation accrued $548 thousand in connection with its obligations under the indemnification agreement during the fourth quarter of 2007. Since a portion of the shares allocated to the Corporation in the initial public offering were withheld, the Corporation was not required to make any cash payments related to the indemnification agreement. As such, the indemnification accrual related to certain pending litigation was reversed during the first quarter of 2008 and included in the aforementioned $1.9 million of income. Additional accruals may be required in future periods should the Corporation's estimate of its obligations under the indemnification agreement change.

Non-Interest Expense

The components of non-interest expense were as follows:

	Three Months Ended			Six Months Ended	
	June 30, 2008	March 31, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Salaries and wages	$ 54,534	$ 55,138	$ 51,203	$ 109,672	$ 102,917
Employee benefits	11,912	14,113	11,997	26,025	26,423
Net occupancy	10,091	9,647	9,483	19,738	19,117
Furniture and equipment	9,182	8,950	8,230	18,132	15,158
Intangible amortization	1,955	2,046	2,188	4,001	4,514

Other	32,416	30,146	29,541	62,562	66,600
Total	$ 120,090	$ 120,040	$ 112,642	$ 240,130	$ 234,729

Total non-interest expense for the three and six months ended June 30, 2008 increased $7.4 million, or 6.6%, and $5.4 million, or 2.3%, compared to the same periods in 2007. Total non-interest expense for the second quarter of 2008 did not significantly fluctuate compared to the first quarter of 2008. Changes in the components of non-interest expense are discussed below.

Salaries and Wages. Salaries and wages for the three and six months ended June 30, 2008 increased $3.3 million, or 6.5%, and $6.8 million, or 6.6%, compared to the same periods in 2007. The increases were primarily related to normal, annual merit increases and increases in headcount.

Salaries and wages expense for the second quarter of 2008 decreased $604 thousand, or 1.1%, compared to the first quarter of 2008. The decrease was primarily related to an increase in cost deferrals related to increased lending activity.

Employee Benefits. Employee benefits expense for the three months ended June 30, 2008 did not significantly fluctuate when compared to the same period in 2007 as decreases in expenses related to the Corporation's defined benefit retirement and restoration plans (down $532 thousand) and workers compensation insurance expense (down $208 thousand) were mostly offset by increases in expenses related to the Corporation's 401(k) and profit sharing plans (up $495 thousand) and payroll taxes (up $134 thousand). Employee benefits expense for the six months ended June 30, 2008 decreased $398 thousand, or 1.5%, compared to the same periods in 2007. The decrease during the six months ended June 30, 2008 was primarily related to decreases in expenses related to the Corporation's defined benefit retirement and restoration plans (down $1.1 million) and workers compensation insurance expense (down $217 thousand). These decreases were partially offset by increases in expenses related to the Corporation's 401(k) and profit sharing plans (up $483 thousand) and payroll taxes (up $462 thousand).

Employee benefits expense for the second quarter of 2008 decreased $2.2 million, or 15.6%, compared to the first quarter of 2008 primarily due to decreases in payroll taxes (down $1.5 million) and expenses related to the Corporation's 401(k) and profit sharing plan expenses (down $585 thousand). The Corporation generally experiences higher payroll taxes and 401(k) plan contribution matching expense during the first quarter of each year due to the increased payroll related to annual incentive compensation payments.

The Corporation's defined benefit retirement and restoration plans were frozen effective as of December 31, 2001 and were replaced by the profit sharing plan. Management believes these actions reduce the volatility in retirement plan expense. However, the Corporation still has funding obligations related to the defined benefit and restoration plans and could recognize retirement expense related to these plans in future years, which would be dependent on the return earned on plan assets, the level of interest rates and employee turnover.

Net Occupancy. Net occupancy expense for the three and six months ended June 30, 2008 increased $608 thousand, or 6.4%, and $621 million, or 3.2%, compared to the same periods in 2007. The increase during the three months ended June 30, 2008 was primarily related to an increase in lease expense (up $286 thousand), utilities (up $172 thousand) and building maintenance (up $140 thousand). The increase during the six months ended June 30, 2008 was primarily due to an increase in lease expense (up $330 thousand) and utilities (up $259 thousand). Net occupancy expense for the second quarter of 2008 increased $444 thousand, or 4.6%, compared to the first quarter of 2008 primarily due to increases in building maintenance (up $163 thousand), utilities (up $124 thousand) and lease expense (up $115 thousand). The increases in these items were partly related to the additional costs associated with new branch locations.

Furniture and Equipment. Furniture and equipment expense for the three and six months ended June 30, 2008 increased $952 thousand, or 11.6%, and $3.0 million, or 19.6%, compared to the same periods in 2007. The increase during the three months ended June 30, 2008 was primarily related to increases in software amortization expense (up $423 thousand), depreciation expense related to furniture and fixtures (up $325 thousand) and service contracts expense (up $261 thousand). The increase during the six months ended June 30, 2008 was primarily related to increases in software amortization expense (up $884 thousand), depreciation expense related to furniture and fixtures (up $829 thousand), software maintenance expense (up $641 thousand) and service contracts expense (up $509 thousand). The Corporation entered into software maintenance contracts in connection with new operating platforms related to retail delivery during the second quarter of 2007. Furniture and equipment expense for the second quarter of 2008 increased $232 thousand, or 2.6%, compared to the first quarter of 2008 primarily due to increases in software maintenance expense (up $131 thousand) and software amortization expense (up $66 thousand).

Intangible Amortization. Intangible amortization is primarily related to core deposit intangibles and, to a lesser extent, intangibles related to customer relationships and non-compete agreements. Intangible amortization for the three and six months ended June 30, 2008 decreased $233 thousand, or 10.7% and $513 thousand, or 11.4% compared to the same periods in 2007. Intangible amortization for the second quarter of 2008 did not significantly fluctuate when compared to the first quarter of 2008. The decrease in amortization expense is primarily the result of a reduction in the annual amortization rate of certain intangible assets as the Corporation uses an accelerated amortization approach which results in higher amortization rates during the earlier years of the useful lives of intangible assets, as well as the completion of the amortization for certain intangible assets, partly offset by the impact of the additional amortization of intangible assets acquired in connection with the acquisition of Prime Benefits during the fourth quarter of 2007.

Other Non-Interest Expense. Other non-interest expense for the three and six months ended June 30, 2008 increased $2.9 million, or 9.7%, and decreased $4.0 million, or 6.1%, compared to the same periods in 2007. Significant components of the increase during the three months ended June 30, 2008 included professional service expense (up $1.3 million), sundry expense from various miscellaneous items (up $1.0 million) and FDIC insurance expense (up $341 thousand). A portion of the increase in professional services expense was related to Frost Investment Advisors, LLC, a newly formed registered investment advisor subsidiary of the Corporation. Sundry expense from various miscellaneous items during the second quarter of 2008 included $1.1 million related to a settlement, release and license agreement associated with certain patent infringement claims. The additional impact of the agreement on the Corporation's operating results in future periods is not material. The increase in FDIC insurance expense resulted as a portion of 2008 assessments were required to be paid in cash rather than be fully offset by available assessment credits. The Corporation expects quarterly FDIC insurance expense to increase beginning with the third quarter of 2008 as available assessment credits have been mostly utilized for assessments through June 30, 2008. The increases in the aforementioned items were partially offset by decreases in fraud losses (down $426 thousand) and armored motor service (down $338 thousand).

Significant components of the decrease during the six months ended June 30, 2008 included decreases in sundry expense from various miscellaneous items (down $5.7 million), losses on sales and write-downs of foreclosed assets (down $788 thousand), advertising/promotions expenses (down $684 thousand) and armored motor service (down $602 thousand). Sundry expense from various miscellaneous items in 2007 included $5.3 million in expense recognized during the first quarter of 2007 related to a prepayment penalty and the write-off of the unamortized debt issuance costs incurred in connection with the redemption of $103.1 million of 8.42% junior subordinated deferrable interest debentures. Also included in 2007 was $1.4 million in expense related to a contribution for previously unmatched employee contributions to the Corporation's 401(k) plan. As mentioned above, sundry expense from various miscellaneous items for 2008 included $1.1 million related to a settlement of certain patent infringement claims. The decreases in the aforementioned items were partially offset by increases in professional service expense (up $2.0 million), partly related to the aforementioned Frost Investment Advisors, LLC, and travel expense (up $510 thousand).

Total other non-interest expense for the second quarter of 2008 increased $2.3 million, or 7.5%, compared to the first quarter of 2008. Significant components of the increase included sundry expense from various miscellaneous items, (up $1.2 million) including the settlement discussed above, FDIC insurance (up $365 thousand) and travel expense (up $323 thousand).

Results of Segment Operations

The Corporation's operations are managed along two operating segments: Banking and the Financial Management Group (FMG). A description of each business and the methodologies used to measure financial performance is described in Note 16 - Operating Segments in the accompanying notes to consolidated financial statements included elsewhere in this report. Net income (loss) by operating segment is presented below:

	Three Months Ended			Six Months Ended	
	June 30, 2008	March 31, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Banking	$ 47,702	$ 49,436	$ 50,179	$ 97,138	$ 98,699
Financial Management Group	7,068	6,263	6,579	13,331	12,106
Non-Banks	(2,223)	(2,919)	(3,129)	(5,142)	(9,897)
Consolidated net income	$ 52,547	$ 52,780	$ 53,629	$ 105,327	$ 100,908

Banking

Net income for the three and six months ended June 30, 2008 decreased $2.5 million, or 4.9%, and $1.6 million, or 1.6%, compared to the same periods in 2007. The decrease during the three months ended June 30, 2008 was primarily the result of a

$5.6 million increase in non-interest expense and a $3.7 million increase in the provision for possible loan losses partly offset by a $3.7 million increase in non-interest income, a $2.1 million decrease in income tax expense and a $1.0 million increase in net interest income. The decrease during the six months ended June 30, 2008 was primarily the result of a $7.8 million increase in non-interest expense and a $5.0 million increase in the provision for possible loan losses partly offset by a $5.6 million increase in non-interest income, a $3.9 million decrease in income tax expense and a $1.7 million increase in net interest income.

Net interest income for the three and six months ended June 30, 2008 increased $1.0 million, or 0.8%, and $1.7 million, or 0.7%, compared to the same periods in 2007. The increases were for the most part the result of increases in the average volume of earning assets partly offset by decreases the net interest margin. The increase for the six months ended June 30, 2008 was also due in part to a higher number of days during the period relative to 2007 due to leap year. See the analysis of net interest income included in the section captioned "Net Interest Income" included elsewhere in this discussion.

The provision for possible loan losses for the three and six months ended June 30, 2008 totaled $6.3 million and $10.3 million compared to $2.7 million and $5.4 million for the same periods in 2007. See the analysis of the provision for possible loan losses included in the section captioned "Allowance for Possible Loan Losses" included elsewhere in this discussion.

Non-interest income for the three and six months ended June 30, 2008 increased $3.6 million, or 8.8%, and $5.6 million, or 6.5%, compared to the same periods in 2007. The increases were primarily due to increases in service charges on deposit accounts, insurance commissions, other charges, commissions and fees and other non-interest income. See the analysis of these categories of non-interest income included in the section captioned "Non-Interest Income" included elsewhere in this discussion.

Non-interest expense for the three months ended June 30, 2008 increased $5.6 million, or 6.0%, compared to the same period in 2007. The increase was primarily related to increases in salaries and wages, furniture and equipment expense, other non-interest expense and net occupancy partly offset by a decrease in intangible amortization and employee benefits. The increases in salaries and wages were primarily related to normal, annual merit increases, increases in headcount and an increase in bonus/incentive compensation accruals. The increase in furniture and equipment expense was due to increases in depreciation expense related to furniture and fixtures, software amortization expense and service contracts expense. The increase in other non-interest expense was primarily related to increases in professional service expense, sundry expense from various miscellaneous items and FDIC insurance expense. The increase in net occupancy expense was due to an increase in lease expense, utilities and building maintenance.

Non-interest expense for the six months ended June 30, 2008 increased $7.8 million, or 4.1%, compared to the same period in 2007. The increase was primarily related to increases in salaries and wages, furniture and equipment expense and net occupancy partly offset by a decrease in other non-interest expense, employee benefits and intangible amortization. The increases in salaries and wages were primarily related to normal, annual merit increases, increases in headcount and an increase in bonus/incentive compensation accruals. The increase in furniture and equipment expense was primarily related to increases in depreciation expense related to furniture and fixtures, software amortization expense, software maintenance expense and service contracts expense. The increase in net occupancy expense was primarily due to an increase in lease expense and utilities. The decrease in other non-interest expense included decreases in sundry expense from various miscellaneous items, advertising/promotions expenses, losses on sales and write-downs of foreclosed assets and armored motor service. See the analysis of these items included in the section captioned "Non-Interest Expense" included elsewhere in this discussion.

Frost Insurance Agency, which is included in the Banking operating segment, had gross commission revenues of $7.0 million and $18.3 million during the three and six months ended June 30, 2008 and $6.7 million and $17.3 million during the three and six months ended June 30, 2007. Insurance commission revenues increased $364 thousand, or 5.5%, and $1.0 million, or 5.9%, during the three months and six months ended June 30, 2008 compared to the same periods in 2007. See the analysis of insurance commissions and fees included in the section captioned "Non-Interest Income" included elsewhere in this discussion.

Financial Management Group (FMG)

Net income for the three and six months ended June 30, 2008 increased $489 thousand and $1.2 million compared to the same periods in 2007. The increase during the three months ended June 30, 2008 was primarily due to a $2.4 million increase in non-interest income offset by a $1.5 million increase in non-interest expense, a $263 thousand increase in income tax expense and a $115 thousand decrease in net interest income. The increase during the six months ended June 30, 2008 was primarily due to a $3.8 million increase in non-interest income and a $417 thousand increase in net interest income offset by a $2.3 million increase in non-interest expense and a $659 thousand increase in income tax expense.

Net interest income for the three and six months ended June 30, 2008 decreased $115 thousand, or 2.1%, and increased $417 thousand, or 4.0%, from the comparable periods in 2007. The increase in net interest income during the six months ended June 30, 2008 resulted as the average interest rate paid on FMGs repurchase agreements decreased by a disproportionally larger amount than the average funds transfer price received for providing those funds. The funds transfer price received by FMG is adjusted monthly based on the prior 90-day average of the 90-day LIBOR. The effect of the reductions in market interest rates occurring in the first quarter of 2008 did not fully effect the average funds transfer price received by FMG until the second quarter of 2008.

Non-interest income for the three and six months ended June 30, 2008 increased $2.4 million, or 10.7%, and $3.8 million, or 8.6%, from the comparable periods in 2007. The increase during the three months ended June 30, 2008 was primarily due to increases in trust fees (up $1.4 million) and other charges, commissions and fees (up $1.0 million). The increase during the six months ended June 30, 2008 was primarily due to increases in trust fees (up $2.8 million) and other charges, commissions and fees (up $1.7 million) partly offset by other non-interest income (down $633 thousand).

Trust fee income is the most significant income component for FMG. Investment fees are the most significant component of trust fees, making up approximately 69% and 70% of total trust fees for the first six months of 2008 and 2007, respectively. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees. The increases in trust fee income during the three and six months ended June 30, 2008 compared to the same periods in 2007 were primarily the result of increases in oil and gas trust management fees, securities lending income and investment fees. See the analysis of trust fees included in the section captioned "Non-Interest Income" included elsewhere in this discussion.

The increases in other charges, commissions and fees during the three and six months ended June 30, 2008 compared to the same periods in 2007 were primarily due to increases in commission income related to the sale of money market accounts, and annuities as well as an increase in brokerage commissions.

Non-interest expense for the three and six months ended June 30, 2008 increased $1.5 million, or 8.6%, and $2.3 million, or 6.3%, compared to the same periods in 2007. The increase during the three months ended June 30, 2008 was primarily due to increases in other non-interest expense (up $875 thousand) and salaries and wages and employee benefits (up $640 thousand on a combined basis). The increase during the six months ended June 30, 2008 was primarily due to an increase in salaries and wages and employee benefits (up $1.8 million on a combined basis) and other non-interest expense (up $552 thousand). The increase in salaries and wages and employee benefits was primarily the result of normal, annual merit increases and increases in expenses related to payroll taxes and employee benefit plans. The increase in other non-interest expense was primarily due to increases in professional service expense, in part related to Frost Investment Advisors, LLC, a newly formed registered investment advisor subsidiary of the Corporation and component of the FMG operating segment.

Non-Banks

The net loss for the Non-Banks operating segment for the three months ended June 30, 2008 decreased $906 million compared to the same period in 2007. The decrease in the net loss was primarily the result of a decrease in interest expense on certain borrowings. As market interest rates have decreased, the Non-Banks segment has experienced a corresponding decrease in interest cost related to its variable-rate junior subordinated deferrable interest debentures issued in February 2004. Additionally, the $3.1 million of variable-rate junior subordinated deferrable interest debentures acquired in connection with the acquisition of Alamo Corporation of Texas were redeemed in the first quarter of 2008. The net loss for the Non-Banks operating segment for the six months ended June 30, 2008 decreased $4.8 million compared to the same period in 2007. During the first quarter of 2007, the net loss included $5.3 million in expense recognized during the first quarter of 2007 related to a prepayment penalty and the write-off of the unamortized debt issuance costs incurred in connection with the redemption of $103.1 million of 8.42% junior subordinated deferrable interest debentures.

Income Taxes

The Corporation recognized income tax expense of $22.9 million and $46.2 million, for an effective tax rate of 30.4% and 30.5% for the three and six months ended June 30, 2008 compared to $24.6 million and $47.5 million, for an effective tax rate of 31.5% and 32.0% for the three and six months ended June 30, 2007. The effective income tax rates differed from the U.S. statutory rate of 35% during the comparable periods primarily due to the effect of tax-exempt income from loans, securities and life insurance policies. The decrease in the effective tax rate during 2008 was primarily the result of an increase in holdings of tax-exempt municipal securities.

Average Balance Sheet

Average assets totaled $13.5 billion for the six months ended June 30, 2008 representing an increase of $462.9 million, or 3.6%, compared to average assets for the same period in 2007. The increase was primarily reflected in earning assets, which increased $362.8 million, or 3.2%, during the first six months of 2008 compared to the first six months of 2007. The increase was primarily due to a $622.8 million, or 8.4%, increase in average loans. The loan growth was primarily funded by available liquidity as average federal funds sold and resell agreements decreased $409.2 million, or 66.6% during 2008 compared to 2007. Average securities increased $148.5 million, or 4.6%, to $3.4 billion during the first six months of 2008 from $3.2 billion during the first six months of 2007. Total deposits averaged $10.4 billion for the first six months of 2008, increasing $230.6 million, or 2.3%, compared to the same period in 2007. Average interest-bearing accounts increased from 65.4% of average total deposits in 2007 to 66.1% of average total deposits in 2008.

Loans

Loans were as follows as of the dates indicated:

	June 30, 2008	Percent of Total	March 31, 2008	December 31, 2007	June 30, 2007

Commercial and industrial:					
Commercial	$ 3,714,870	44.4 %	$ 3,583,588	$ 3,472,759	$ 3,258,083
Leases	198,814	2.4	189,719	184,140	181,313
Asset-based	74,073	0.9	37,261	32,963	30,636
Total commercial and industrial	3,987,757	47.7	3,810,568	3,689,862	3,470,032
Real estate:					
Construction:					
Commercial	671,010	8.0	635,496	560,176	643,182
Consumer	67,059	0.8	61,101	61,595	87,459
Land:					
Commercial	398,964	4.8	396,759	397,319	418,951
Consumer	1,978	-	2,189	2,996	3,222
Commercial mortgages	2,117,356	25.3	2,001,059	1,982,786	1,784,307
1-4 family residential mortgages	87,862	1.1	96,978	98,077	110,358
Home equity and other consumer	647,790	7.8	607,513	587,721	527,939
Total real estate	3,992,019	47.8	3,801,095	3,690,670	3,575,418
Consumer:					
Indirect	1,550	-	1,805	2,031	2,713
Student loans held for sale	32,125	0.4	75,084	62,861	52,113
Other	326,431	3.9	323,143	323,320	309,714
Other	41,489	0.5	29,927	29,891	30,663
Unearned discount	(27,870)	(0.3)	(28,725)	(29,273)	(28,493)
Total loans	$ 8,353,501	100.0 %	$ 8,012,897	$ 7,769,362	$ 7,412,160

Loans totaled $8.4 billion at June 30, 2008, an increase of $584.1 million, or 7.5%, compared to December 31, 2007. The Corporation stopped originating mortgage and indirect consumer loans during 2000, and as such, these portfolios are excluded when analyzing the growth of the loan portfolio. Student loans are similarly excluded because the Corporation primarily originates these loans for resale. Accordingly, student loans are classified as held for sale. During the second quarter of 2008, the Corporation elected to discontinue the origination of student loans for resale, aside from previously outstanding commitments. The Corporation expects to sell the remainder of the student loan portfolio before the end of 2008. Excluding 1-4 family residential mortgages, the indirect lending portfolio and student loans, loans increased $625.6 million, or 8.2%, from December 31, 2007.

The majority of the Corporation's loan portfolio is comprised of commercial and industrial loans and real estate loans. Commercial and industrial loans made up 47.7% and 47.5% of total loans while real estate loans made up 47.8% and 47.5% of total loans at June 30, 2008 and December 31, 2007, respectively. Real estate loans include both commercial and consumer balances.

Commercial and industrial loans increased $297.9 million, or 8.1%, from December 31, 2007 to June 30, 2008. The Corporation's commercial and industrial loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment.

While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Corporation's loan policy guidelines. The commercial and industrial loan portfolio also includes the commercial lease and asset-based lending portfolios.

Purchased shared national credits ("SNC"s) are participations purchased from upstream financial organizations and tend to be larger in size than the Corporation's originated portfolio. The Corporation's purchased SNC portfolio totaled $387.0 million at June 30, 2008, decreasing $24.9 million, or 6.0%, from $411.9 million at December 31, 2007. At June 30, 2008, 62.0% of outstanding purchased SNCs was related to the energy industry. The remaining purchased SNCs were diversified throughout various other industries, with no other single industry exceeding more than 10% of the total purchased SNC portfolio. Additionally, almost all of the outstanding balance of purchased SNCs was included in the commercial and industrial portfolio, with the remainder included in the commercial real estate category. SNC participations are originated in the normal course of business to meet the needs of the Corporation's customers. As a matter of policy, the Corporation generally only participates in SNCs for companies headquartered in or which have significant operations within the Corporation's market areas. In addition, the Corporation must have direct access to the company's management, an existing banking relationship or the expectation of broadening the relationship with other banking products and services within the following 12 to 24 months. SNCs are reviewed at least quarterly for credit quality and business development successes.

Real estate loans totaled $4.0 billion at June 30, 2008 increasing $301.3 million, or 8.2%, from $3.7 billion at December 31, 2007. Real estate loans include both commercial and consumer balances. Excluding 1-4 family residential mortgage loans, which are discussed below, total real estate loans increased $311.6 million, or 8.7%, from December 31, 2007. Commercial real estate loans totaled $3.2 billion at June 30, 2008 and represented 79.8% of total real estate loans. The majority of this portfolio consists of commercial real estate mortgages, which includes both permanent and intermediate term loans. The Corporation's primary focus for its commercial real estate portfolio has been growth in loans secured by owner-occupied properties. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Consequently, these loans must undergo the analysis and underwriting process of a commercial and industrial loan, as well as that of a real estate loan. At June 30, 2008, approximately 58% of the outstanding principal balance of the Corporation's commercial real estate loans were secured by owner-occupied properties.

The consumer loan portfolio, including all consumer real estate, increased $26.2 million, or 2.3%, from December 31, 2007. Excluding 1-4 family residential mortgages, indirect loans and student loans, total consumer loans increased $67.6 million, or 6.9%, from December 31, 2007.

As the following table illustrates as of the dates indicated, the consumer loan portfolio has five distinct segments, including consumer real estate, consumer non-real estate, student loans held for sale, indirect consumer loans and 1-4 family residential mortgages.

	June 30, 2008	March 31, 2008	December 31, 2007	June 30, 2007
Consumer real estate:				
Construction	$ 67,059	$61,101	$61,595	$87,459
Land	1,978	2,189	2,996	3,222
Home equity loans	303,507	290,845	282,947	253,528

Home equity lines of credit	101,174	93,287	86,873	85,887
Other consumer real estate	243,109	223,381	217,901	188,524
Total consumer real estate	716,827	670,803	652,312	618,620
Consumer non-real estate	326,431	323,143	323,320	309,714
Student loans held for sale	32,125	75,084	62,861	52,113
Indirect	1,550	1,805	2,031	2,713
1-4 family residential mortgages	87,862	96,978	98,077	110,358
Total consumer loans	$ 1,164,795	$ 1,167,813	$ 1,138,601	$ 1,093,518

The consumer non-real estate loan portfolio primarily consists of automobile loans, unsecured revolving credit products, personal loans secured by cash and cash equivalents and other similar types of credit facilities. The Corporation discontinued originating 1-4 family residential mortgage loans and indirect consumer loans in 2000. Additionally, during the second quarter of 2008, the Corporation elected to discontinue the origination of student loans for resale, aside from previously outstanding commitments. The Corporation expects to sell the remainder of the student loan portfolio before the end of 2008.

Non-Performing Assets

Non-performing assets and accruing past due loans are presented in the table below. The Corporation did not have any restructured loans as of the dates presented.

	June 30, 2008	March 31, 2008	December 31, 2007	June 30, 2007
Non-accrual loans:				
Commercial and industrial	$ 20,478	$ 12,516	$ 11,445	$ 14,727
Real estate	18,531	14,465	12,026	29,103
Consumer and other	1,476	1,661	972	1,673
Total non-accrual loans	40,485	28,642	24,443	45,503
Foreclosed assets:				
Real estate	8,544	7,305	4,596	3,630
Other	602	639	810	592
Total foreclosed assets	9,146	7,944	5,406	4,222
Total non-performing assets	$ 49,631	$ 36,586	$ 29,849	$ 49,725

Non-performing assets as a percentage of:				
Total loans and foreclosed assets	0.59 %	0.46 %	0.38 %	0.67 %
Total assets	0.36	0.27	0.22	0.38
Accruing past due loans:				
30 to 89 days past due	$ 56,721	$ 53,936	$ 45,290	$ 60,324
90 or more days past due	11,898	17,563	14,347	12,561
Total accruing past due loans	$ 68,619	$ 71,499	$ 59,637	$ 72,885
Ratio of accruing past due loans to total loans:				
30 to 89 days past due	0.68 %	0.67 %	0.58 %	0.81 %
90 or more days past due	0.14	0.22	0.19	0.17
Total accruing past due loans	0.82 %	0.89 %	0.77 %	0.98 %

Non-performing assets include non-accrual loans and foreclosed assets. Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectibility of the principal and/or interest to be in question, as well as when required by regulatory requirements. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured.

Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for possible loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties.

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. At June 30, 2008 and December 31, 2007, the Corporation had $33.4 million and $30.3 million in loans of this type which are not included in either of the non-accrual or 90 days past due loan categories. At June 30, 2008, potential problem loans consisted of nine credit relationships. Of the total outstanding balance at June 30, 2008, approximately 41.4% related to a customer in the credit collections industry, approximately 36.4% related to six customers in the real estate lot development/single-family residential construction industry, and approximately 16.3% related to a customer in the meat packing industry. Weakness in these companies' operating performance has caused the Corporation to heighten the attention given to these credits.

The after-tax impact (assuming a 35% marginal tax rate) of lost interest from non-performing loans was approximately $321 thousand and $606 thousand for the three and six months ended June 30, 2008, compared to

$689 thousand and $1.4 million for the same periods in 2007.

Allowance for Possible Loan Losses

Activity in the allowance for possible loan losses is presented in the following table.

	Three Months Ended			Six Months Ended	
	June 30, 2008	March 31, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Balance at beginning of period	$ 92,498	$ 92,339	$ 96,144	$ 92,339	$ 96,085
Provision for possible loan losses	6,328	4,005	2,650	10,333	5,300
Charge-offs:					
Commercial and industrial	(2,279)	(3,758)	(2,233)	(6,037)	(3,480)
Real estate	(2,436)	(1,082)	(233)	(3,518)	(1,161)
Consumer and other	(1,824)	(1,826)	(1,672)	(3,650)	(3,497)
Total charge-offs	(6,539)	(6,666)	(4,138)	(13,205)	(8,138)
Recoveries:					
Commercial and industrial	968	1,161	383	2,129	700
Real estate	17	413	40	430	130
Consumer and other	1,248	1,246	992	2,494	1,994
Total recoveries	2,233	2,820	1,415	5,053	2,824
Net charge-offs	(4,306)	(3,846)	(2,723)	(8,152)	(5,314)
Balance at end of period	$ 94,520	$ 92,498	$ 96,071	$ 94,520	$ 96,071
Ratio of allowance for possible loan losses to:					

Total loans	1.13 %	1.15 %	1.30 %	1.13 %	1.30 %
Non-accrual loans	233.47	322.95	211.13	233.47	211.13
Ratio of annualized net charge-offs to average total loans	0.21	0.20	0.15	0.20	0.14

The allowance for possible loan losses is maintained at a level considered appropriate by management, based on estimated probable losses within the existing loan portfolio. The Corporation's allowance for possible loan loss methodology is based on guidance provided in SEC Staff Accounting Bulletin No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues," and includes allowance allocations calculated in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," as amended by SFAS 118, and allowance allocations calculated in accordance with SFAS No. 5, "Accounting for 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 provision for possible loan losses totaled $6.3 million and $10.3 million during the three and six months ended June 30, 2008, compared to $2.7 million and $5.3 million during the three and six months ended June 30, 2007. The provision for possible loan losses increased by $5.0 million, or 95.0%, during the six months ended June 30, 2008 compared to the same period in 2007 in part due to an increase in classified loans and higher levels of net charge-offs, which totaled 0.20% of average loans in 2008 compared to 0.14% of average loans in 2007, as well as growth in loans, which increased $584.1 million, or 7.5% during the first six months of 2008. The ratio of the allowance for possible loan losses to total loans decreased 6 basis points from 1.19% at December 31, 2007 to 1.13% at June 30, 2008. Management believes the level of the allowance for possible loan losses continues to remain adequate. Should any of the factors considered by management in evaluating the adequacy of the allowance for possible loan losses change, the Corporation's estimate of probable loan losses could also change, which could affect the level of future provisions for possible loan losses.

Capital and Liquidity

Capital. At June 30, 2008, shareholders' equity totaled $1.5 billion compared to $1.5 billion at December 31, 2007 and $1.4 billion at June 30, 2007. In addition to net income of $105.3 million, other significant changes in shareholders' equity during the first six months of 2008 included $48.3 million of dividends paid, $21.9 million in treasury stock purchases, $26.8 million in proceeds from stock option exercises and the related tax benefits of $6.2 million and $5.1 million related to stock-based compensation. The accumulated other comprehensive loss component of shareholders' equity totaled $15.0 million at June 30, 2008 compared to an unrealized loss of $7.4 million at December 31, 2007. This fluctuation was primarily related to the after-tax effect of a change in the unrealized gain/loss on securities available for sale offset by a change in the accumulated net gain/loss on effective cash flow hedges during the first six months of 2008. Under regulatory requirements, amounts reported as accumulated other comprehensive income/loss related to the accumulated net gain/loss on effective cash flow hedges, the net unrealized gain or loss on securities available for sale and the funded status of the Corporation's defined benefit post-retirement benefit plans do not increase or reduce regulatory capital and are not included in the calculation of risk-based capital and leverage ratios. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items. See Note 10 - Regulatory Matters and Shareholders' Equity in the accompanying notes to consolidated financial statements included elsewhere in this report.

The Corporation paid quarterly dividends of $0.40 and $0.42 per common share during the first and second quarters of 2008 and quarterly dividends of $0.34 and $0.40 per common share during the first and second quarters of 2007. This equates to a dividend payout ratio of 44.6% and 47.1% during the first and second quarters of 2008 and 43.1% and 44.0% during the first and second quarters of 2007.

From time to time, the Corporation's board of directors has authorized stock repurchase plans. Stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. Under the most recent plan, which was approved on April 26, 2007, the Corporation was authorized to repurchase up to 2.5 million shares of its common stock from time to time over a two-year period in the open market or through private transactions. Under the plan, the Corporation repurchased 2.1 million shares at a total cost of $109.4 million during 2007, while the remaining 404 thousand shares approved for repurchase were repurchased during the first quarter of 2008 at a total cost of $21.9 million. See Part II, Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds, included elsewhere in this report, for details of stock repurchases during the quarter.

Liquidity. Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets, and its access to alternative sources of funds. The Corporation seeks to ensure its funding needs are met by maintaining a level of liquid funds through asset/liability management.

Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale, maturities and cash flow from securities held to maturity, and federal funds sold and resell agreements.

Liability liquidity is provided by access to funding sources which include core deposits and correspondent banks in the Corporation's natural trade area that maintain accounts with and sell federal funds to Frost Bank, as well as federal funds purchased and repurchase agreements from upstream banks and Federal Home Loan Bank advances.

Since Cullen/Frost is a holding company and does not conduct operations, its primary sources of liquidity are dividends upstreamed from Frost Bank and borrowings from outside sources. Banking regulations require the maintenance of certain capital and net income levels that may limit the amount of dividends that may be paid by the Corporation's bank subsidiary. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of the Corporation's bank subsidiary to fall below specified minimum levels. Approval is also needed if dividends declared exceed the net profits for that year combined with the retained net profits for the two preceding years. Under these dividend restrictions, and without adversely affecting its "well capitalized" status, Frost Bank could pay aggregate dividends of approximately $242.4 million to Cullen/Frost, without obtaining affirmative regulatory approvals, at June 30, 2008. At June 30, 2008, Cullen/Frost had liquid assets, including cash and securities purchased under resell agreements, totaling $78.1 million. Cullen/Frost also had outside funding sources available, including a $25.0 million short-term line of credit with another financial institution. The line of credit matures annually and bears interest at a fixed LIBOR-based rate or floats with the prime rate. There were no borrowings outstanding on this line of credit at June 30, 2008.

The liquidity position of the Corporation is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on the Corporation's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on the Corporation.

The Corporation's operating objectives include expansion, diversification within its markets, growth of its fee-based income, and growth internally and through acquisitions of financial institutions, branches and financial services businesses. The Corporation seeks merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. The Corporation regularly evaluates merger and acquisition opportunities and conducts due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur. Acquisitions typically involve the payment of a premium over book and market values, and, therefore, some dilution of the Corporation's tangible book value and net income per common share may occur in connection with any future transaction.

On January 7, 2008, the Corporation redeemed $3.1 million of floating rate (three-month LIBOR plus a margin of 3.30%) junior subordinated deferrable interest debentures, due January 7, 2033, held of record by Alamo Trust. Concurrently, the $3.0 million of floating rate (three-month LIBOR plus a margin of 3.30%) trust preferred securities issued by Alamo Trust were also redeemed. See Note 9 - Borrowed Funds for additional information.

Recently Issued Accounting Pronouncements

See Note 18 - New Accounting Standards in the accompanying notes to consolidated financial statements included elsewhere in this report for details of recently issued accounting pronouncements and their expected impact on the Corporation's financial statements.

Consolidated Average Balance Sheets and Interest Income Analysis - Year-to-Date

(dollars in thousands - taxable-equivalent basis)	June 30, 2008			June 30, 2007		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:						

Interest-bearing deposits	$ 6,640	$ 120	3.63 %	$ 6,012	$ 173	5.81 %
Federal funds sold and resell agreements	204,843	2,940	2.89	614,032	16,241	5.33
Securities:						
Taxable	2,875,164	74,001	5.17	2,903,344	74,596	5.05
Tax-exempt	521,861	16,728	6.45	345,135	11,054	6.41
Total securities	3,397,025	90,729	5.36	3,248,479	85,650	5.20
Loans, net of unearned discounts	8,052,453	257,552	6.43	7,429,683	290,408	7.88
Total Earning Assets and Average Rate Earned	11,660,961	351,341	6.06	11,298,206	392,472	6.96
Cash and due from banks	649,440			618,098		
Allowance for possible loan losses	(92,300)			(96,389)		
Premises and equipment, net	225,569			219,755		
Accrued interest and other assets	1,011,272			952,372		
Total Assets	$ 13,454,942			$ 12,992,042		
Liabilities:						
Non-interest-bearing demand deposits:						
Commercial and individual	$ 3,188,141			$ 3,232,478		
Correspondent banks	284,902			238,918		
Public funds	51,508			51,809		
Total non-interest-bearing demand deposits	3,524,551			3,523,205		
Interest-bearing deposits:						
Private accounts						
Savings and interest checking	1,660,174	1,779	0.22	1,375,088	3,323	0.49
Money market deposit accounts	3,461,793	29,106	1.69	3,446,303	54,892	3.21
Time accounts	1,364,982	25,275	3.72	1,373,511	29,683	4.36
Public funds	393,831	4,084	2.09	456,608	9,558	4.22
Total interest-bearing deposits	6,880,780	60,244	1.76	6,651,510	97,456	2.95
Total deposits	10,405,331			10,174,715		
Federal funds purchased and repurchase agreements	926,357	7,978	1.73	848,531	16,472	3.91
Junior subordinated deferrable interest debentures	136,186	3,697	5.43	168,225	6,192	7.36
Subordinated notes payable and other notes	250,000	8,159	6.53	225,138	7,432	6.60
Federal Home Loan Bank advances	9,558	272	5.72	31,213	698	4.51

Total Interest-Bearing Funds and Average Rate Paid	8,202,881	80,350	1.97	7,924,617	128,250	3.26
Accrued interest and other liabilities	176,982			150,224		
Total Liabilities	11,904,414			11,598,046		
Shareholders' Equity	1,550,528			1,393,996		
Total Liabilities and Shareholders' Equity	$ 13,454,942			$ 12,992,042		
Net interest income		$ 270,991			$ 264,222	
Net interest spread			4.09 %			3.70 %
Net interest income to total average earning assets			4.67 %			4.69 %

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a 35% tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

Consolidated Average Balance Sheets and Interest Income Analysis-By-Quarter

(dollars in thousands - taxable-equivalent basis)	June 30, 2008			March 31, 2008		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:						
Interest-bearing deposits	$ 5,934	$ 47	3.19 %	$ 7,345	$ 73	4.00 %
Federal funds sold and resell agreements	143,625	802	2.25	266,060	2,138	3.23
Securities:						
Taxable	2,849,656	36,803	5.19	2,900,671	37,198	5.15
Tax-exempt	530,209	8,453	6.47	513,512	8,275	6.43
Total securities	3,379,865	45,256	5.39	3,414,183	45,473	5.34
Loans, net of unearned discounts	8,187,370	124,645	6.12	7,917,536	132,906	6.75
Total Earning Assets and Average Rate Earned	11,716,794	170,750	5.86	11,605,124	180,590	6.25
Cash and due from banks	649,457			649,424		
Allowance for possible loan losses	(92,720)			(91,879)		

Premises and equipment	230,336			220,804		
Accrued interest and other assets	1,014,474			998,182		
Total Assets	$ 13,518,341			$ 13,381,655		
Liabilities:						
Non-interest-bearing demand deposits:						
Commercial and individual	$ 3,200,533			$ 3,175,749		
Correspondent banks	280,274			289,530		
Public funds	50,506			52,511		
Total non-interest-bearing demand deposits	3,531,313			3,517,790		
Interest-bearing deposits:						
Private accounts						
Savings and interest checking	1,699,880	750	0.18	1,620,468	1,028	0.26
Money market deposit accounts	3,468,094	12,092	1.40	3,455,492	17,014	1.98
Time accounts	1,334,875	11,297	3.40	1,395,089	13,979	4.03
Public funds	382,219	1,631	1.72	405,444	2,453	2.43
Total interest-bearing deposits	6,885,068	25,770	1.51	6,876,493	34,474	2.02
Total deposits	10,416,381			10,394,283		
Federal funds purchased and repurchase agreements	958,343	2,954	1.24	894,371	5,024	2.26
Junior subordinated deferrable interest debentures	136,084	1,591	4.68	136,288	2,106	6.18
Subordinated notes payable and other notes	250,000	4,079	6.53	250,000	4,080	6.53
Federal Home Loan Bank advances	9,087	133	5.89	10,028	139	5.57
Total Interest-Bearing Funds and Average						
Rate Paid	8,238,582	34,527	1.68	8,167,180	45,823	2.25
Accrued interest and other liabilities	175,940			168,135		
Total Liabilities	11,945,835			11,853,105		
Shareholders' Equity	1,572,506			1,528,550		
Total Liabilities and Shareholders' Equity	$ 13,518,341			$ 13,381,655		
Net interest income		$ 136,223			$ 134,767	
Net interest spread			4.18 %			4.00 %
Net interest income to total average earning assets			4.68 %			4.67 %

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a 35% tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

Consolidated Average Balance Sheets and Interest Income Analysis-By-Quarter

(dollars in thousands - taxable-equivalent basis)	December 31, 2007			September 30, 2007		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:						
Interest-bearing deposits	$ 8,994	$ 124	5.47 %	$ 8,749	$ 99	4.49 %
Federal funds sold and resell agreements	379,484	4,366	4.56	713,418	9,288	5.17
Securities:						
Taxable	2,966,132	38,196	5.11	2,733,002	35,675	5.08
Tax-exempt	506,716	8,154	6.43	449,162	7,312	6.42
Total securities	3,472,848	46,350	5.30	3,182,164	42,987	5.26
Loans, net of unearned discounts	7,560,382	142,039	7.45	7,435,690	146,580	7.82
Total Earning Assets and Average Rate Earned	11,421,708	192,879	6.70	11,340,021	198,954	6.92
Cash and due from banks	665,754			602,798		
Allowance for possible loan losses	(92,157)			(95,992)		
Premises and equipment	219,053			220,926		
Accrued interest and other assets	954,184			957,770		
Total Assets	$ 13,168,542			$ 13,025,523		
Liabilities:						
Non-interest-bearing demand deposits:						
Commercial and individual	$ 3,165,177			$ 3,269,084		
Correspondent banks	268,840			247,372		
Public funds	49,001			50,614		
Total non-interest-bearing demand deposits	3,483,018			3,567,070		
Interest-bearing deposits:						
Private accounts						
Savings and interest checking	1,528,748	1,456	0.38	1,325,966	1,776	0.53

Money market deposit accounts	3,453,993	23,522	2.70	3,630,638	29,072	3.18
Time accounts	1,419,934	15,558	4.35	1,363,571	15,023	4.37
Public funds	362,277	2,804	3.07	364,681	3,570	3.88
Total interest-bearing deposits	6,764,952	43,340	2.54	6,684,856	49,441	2.93
Total deposits	10,247,970			10,251,926		
Federal funds purchased and repurchase agreements	918,599	7,498	3.24	852,338	7,981	3.71
Junior subordinated deferrable interest debentures	139,177	2,543	7.31	139,177	2,548	7.32
Subordinated notes payable and other notes	250,000	4,080	6.53	250,000	4,079	6.53
Federal Home Loan Bank advances	11,183	149	5.28	16,467	201	4.84
Total Interest-Bearing Funds and Average Rate Paid	8,083,911	57,610	2.83	7,942,838	64,250	3.21
Accrued interest and other liabilities	172,202			152,953		
Total Liabilities	11,739,131			11,662,861		
Shareholders' Equity	1,429,411			1,362,662		
Total Liabilities and Shareholders' Equity	$ 13,168,542			$ 13,025,523		
Net interest income		$ 135,269			$ 134,704	
Net interest spread			3.87 %			3.71 %
Net interest income to total average earning assets			4.70 %			4.69 %

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a 35% tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

Consolidated Average Balance Sheets and Interest Income Analysis-By-Quarter

(dollars in thousands - taxable-equivalent basis)	June 30, 2007		
	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:			

Interest-bearing deposits	$ 7,911	$ 106	5.37 %
Federal funds sold and resell agreements	498,193	6,623	5.33
Securities:			
Taxable	2,918,801	37,767	5.09
Tax-exempt	367,684	5,896	6.41
Total securities	3,286,485	43,663	5.24
Loans, net of unearned discounts	7,455,208	146,204	7.87
Total Earning Assets and Average Rate Earned	11,247,797	196,596	6.98
Cash and due from banks	595,943		
Allowance for possible loan losses	(96,613)		
Premises and equipment, net	219,288		
Accrued interest and other assets	956,338		
Total Assets	$ 12,922,753		
Liabilities:			
Non-interest-bearing demand deposits:			
Commercial and individual	$ 3,226,530		
Correspondent banks	230,383		
Public funds	48,271		
Total non-interest-bearing demand deposits	3,505,184		
Interest-bearing deposits:			
Private accounts			
Savings and interest checking	1,365,463	1,896	0.56
Money market deposit accounts	3,449,291	27,305	3.18
Time accounts	1,344,221	14,582	4.35
Public funds	433,652	4,587	4.24
Total interest-bearing deposits	6,592,627	48,370	2.94
Total deposits	10,097,811		
Federal funds purchased and repurchase agreements	859,511	8,251	3.85
Junior subordinated deferrable interest debentures	139,177	2,499	7.18
Subordinated notes payable and other notes	250,000	4,080	6.53
Federal Home Loan Bank advances	26,299	301	4.59
Total Interest-Bearing Funds and Average			

Rate Paid	7,867,614	63,501	3.24
Accrued interest and other liabilities	153,522		
Total Liabilities	11,526,320		
Shareholders' Equity	1,396,433		
Total Liabilities and Shareholders' Equity	$ 12,922,753		
Net interest income		$ 133,095	
Net interest spread			3.74 %
Net interest income to total average earning assets			4.72 %

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a 35% tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The disclosures set forth in this item are qualified by the section captioned "Forward-Looking Statements and Factors that Could Affect Future Results" included in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

Refer to the discussion of market risks included in Item 7A. Quantitative and Qualitative Disclosures About Market Risks in the 2007 Form 10-K. There has been no significant change in the types of market risks faced by the Corporation since December 31, 2007.

The Corporation utilizes an earnings simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model was used to measure the impact on net interest income relative to a base case scenario of rates increasing 100 and 200 basis points or decreasing 100 and 200 basis points over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. The impact of interest rate derivatives, such as interest rate swaps, caps and floors, is also included in the model. Other interest rate-related risks such as prepayment, basis and option risk are also considered.

As of June 30, 2008, the model simulations projected that 100 and 200 basis point increases in interest rates would not result in any significant variance in net interest income relative to the base case over the next 12 months, while a decrease in interest rates of 100 basis points would result in a negative variance in net interest income of 0.7% relative to the base case over the next 12 months. The likelihood of a 200 basis point decrease in interest rates as of June 30, 2008 was considered to be remote given current interest rate levels. As of June 30, 2007, the model simulations projected that 100 and 200 basis point increases in interest rates would result in positive variances in net interest income of 1.1% and 1.9%, respectively, relative to the base case over the next 12 months, while decreases in interest rates of 100 and 200 basis points would result in negative variances in net interest income of 1.8% and

4.1%, respectively, relative to the base case over the next 12 months.

During the fourth quarter of 2007, the Corporation entered into three interest rate swap contracts 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 on October 25, 2007 and ending on October 25, 2014 from the risk of variability of those cash flows such that the yield on the underlying loans would remain constant at 7.559% to 8.559%, depending upon the applicable swap contract. In conjunction with entering into the interest rate swap contracts, the Corporation terminated its three interest rate floor contracts, which had a total notional amount of $1.3 billion. These actions were partly responsible for the decrease in the Corporation's sensitivity to changes in interest rates during the first six months of 2008 compared to the same period in 2007. See Note 17 - Derivative Financial Instruments in the 2007 Form 10-K. The impact of a projected increase in interest rates was further limited as of June 30, 2008 as the Corporation increased its net average federal funds purchased position and repurchase agreements to fund loan growth during the first six months of 2008. The Corporation's securities portfolio and approximately half of it's loan portfolio will not reprice as readily with interest rate changes due to their fixed rates or the effect of the aforementioned hedge. The benefit of an increase in interest rates derived from an upward repricing of the remaining variable rate loans is mostly offset by the effect of an assumed upward repricing of the Corporation's funding sources.

As of June 30, 2008, the effect of a 200 basis point increase in interest rates on the Corporation's derivative holdings would result in a 2.1% negative variance in net interest income. The effect of a 200 basis point decrease in interest rates on the Corporation's derivative holdings would result in a 2.2% positive variance in net interest income.

The effects of hypothetical fluctuations in interest rates on the Corporation's securities classified as "trading" under SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities," are not significant, and, as such, separate quantitative disclosure is not presented.

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Corporation's management, with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report. No change in the Corporation's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the last fiscal quarter that materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

The Corporation and its subsidiaries are subject to various claims and legal actions that have arisen in the normal 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.

Item 1A. Risk Factors

There has been no material change in the risk factors previously disclosed under Item 1A. of the Corporation's 2007 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information with respect to purchases made by or on behalf of the Corporation or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Corporation's common stock during the three months ended June 30, 2008.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan at the End of the Period
April 1, 2008 to April 30, 2008	-	$ -	-	-
May 1, 2008 to May 31, 2008	154 (1)	55.67	-	-
June 1, 2008 to June 30, 2008	397 (1)	53.34	-	-
Total	551	$ 53.99	-	-

(1) Repurchases of shares made in connection with the exercise of certain employee stock options and the vesting of certain share awards.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

At the Corporation's Annual Meeting of Shareholders held on April 24, 2008, shareholders voted on the following matters:

(1) To elect four Class III director nominees to serve until the 2011 Annual Meeting of Shareholders. Each director nominee was elected.

Name of Nominee	Total Votes For	Total Votes Withheld
Class III		
R. Denny Alexander	52,395,398	842,252
Carlos Alvarez	52,843,945	393,705
Royce S. Caldwell	52,471,299	766,351
Ida Clement Steen	52,467,101	770,549

Other directors whose term of office as a director continued after the meeting were as follows:

Class I (Terms Expiring in 2009)	Class II (Terms Expiring in 2010)
Crawford H. Edwards	Richard W. Evans, Jr.
Ruben M. Escobedo	Karen E. Jennings
Patrick B. Frost	Richard M. Kleberg III
Robert S. McClane	Horace Wilkins, Jr.

(2) To ratify the selection of Ernst & Young LLP to act as independent auditors of the Corporation for the fiscal year that began January 1, 2008.

Total Votes For	52,428,002
Total Votes Against	738,274
Total Abstentions	71,375

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description
31. 1	Rule 13a-14(a) Certification of the Corporation's Chief Executive Officer
31. 2	Rule 13a-14(a) Certification of the Corporation's Chief Financial Officer
32. 1+	Section 1350 Certification of the Corporation's Chief Executive Officer
32. 2+	Section 1350 Certification of the Corporation's Chief Financial Officer

\+ This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Signatures

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

Cullen/Frost Bankers, Inc.
(Registrant)

Date: July 23, 2008

By: /s/ Phillip D. Green
Phillip D. Green
Group Executive Vice President
and Chief Financial Officer
(Duly Authorized Officer, Principal Financial
Officer and Principal Accounting Officer)