FIRST CITIZENS BANCSHARES INC /DE/
Form 10-Q
November 07, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013
or

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

Commission File Number: 001-16715

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

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

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of 'accelerated filer' and 'large accelerated filer' in Rule 12b-2 of the Exchange Act:

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

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

Class A Common Stock—$1 Par Value—8,586,058 shares
Class B Common Stock—$1 Par Value—1,032,883 shares
(Number of shares outstanding, by class, as of November 7, 2013)

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Part 1

Item 1. Financial Statements (Unaudited)

First Citizens BancShares, Inc. and Subsidiaries
Consolidated Balance Sheets

	September 30* 2013	December 31# 2012
	(dollars in thousands, except share data)	
Assets		
Cash and due from banks	$569,118	$639,730
Overnight investments	1,354,131	443,180
Investment securities available for sale	5,161,585	5,226,228
Investment securities held to maturity	1,013	1,342
Loans held for sale	43,054	86,333
Loans and leases:		
Acquired	1,188,281	1,809,235
Originated	11,884,585	11,576,115
Less allowance for loan and lease losses	237,799	319,018
Net loans and leases	12,835,067	13,066,332
Premises and equipment	868,001	882,768
Other real estate owned:		
Covered under loss share agreements	58,769	102,577
Not covered under loss share agreements	40,338	43,513
Income earned not collected	46,110	47,666
Receivable from FDIC for loss share agreements	100,553	270,192
Goodwill	102,625	102,625
Other intangible assets	1,696	3,556
Other assets	329,292	367,610
Total assets	$21,511,352	$21,283,652
Liabilities		
Deposits:		
Noninterest-bearing	$5,323,051	$4,885,700
Interest-bearing	12,740,268	13,200,325
Total deposits	18,063,319	18,086,025
Short-term borrowings	604,435	568,505
Long-term obligations	510,963	444,921
Payable to FDIC for loss share agreements	107,419	101,641
Other liabilities	243,159	218,553
Total liabilities	19,529,295	19,419,645
Shareholders' Equity		
Common stock:		
Class A - $1 par value (11,000,000 shares authorized; 8,586,058 shares issued and outstanding at September 30, 2013; 8,588,031 shares issued and outstanding at December 31, 2012)	8,586	8,588
Class B - $1 par value (2,000,000 shares authorized; 1,032,883 shares issued and outstanding at September 30, 2013; 1,032,883 shares issued and	1,033	1,033

outstanding at December 31, 2012)		
Surplus	143,766	143,766
Retained earnings	1,924,217	1,792,726
Accumulated other comprehensive loss	(95,545)	(82,106)
Total shareholders’ equity	1,982,057	1,864,007
Total liabilities and shareholders’ equity	$21,511,352	$21,283,652

* Unaudited

Derived from 2012 Annual Report on Form 10-K.

See accompanying Notes to Consolidated Financial Statements.

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

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
	(dollars in thousands, except per share data, unaudited)			
Interest income				
Loans and leases	$182,201	$226,812	$579,115	$696,813
Investment securities:				
U. S. Treasury	392	559	1,355	1,968
Government agency	2,809	3,692	9,203	12,401
Mortgage-backed securities	6,415	4,792	15,500	8,883
Corporate bonds	—	278	—	2,319
State, county and municipal	2	6	10	30
Other	78	108	231	301
Total investment securities interest and dividend income	9,696	9,435	26,299	25,902
Overnight investments	737	427	1,750	1,230
Total interest income	192,634	236,674	607,164	723,945
Interest expense				
Deposits	7,923	13,850	27,233	45,369
Short-term borrowings	744	1,114	2,128	4,089
Long-term obligations	4,784	6,354	14,210	22,747
Total interest expense	13,451	21,318	43,571	72,205
Net interest income	179,183	215,356	563,593	651,740
Provision for loan and lease losses	(7,683)	17,623	(39,531)	78,005
Net interest income after provision for loan and lease losses	186,866	197,733	603,124	573,735
Noninterest income				
Cardholder services	12,791	11,505	35,887	33,540
Merchant services	14,887	13,220	42,619	38,332
Service charges on deposit accounts	15,546	15,549	45,428	45,456
Wealth management services	15,112	14,129	44,724	42,414
Fees from processing services	4,539	9,521	15,209	25,640
Securities gains (losses)	—	31	—	(11)
Other service charges and fees	4,043	3,377	11,775	10,392
Mortgage income	2,277	1,619	9,734	4,718
Insurance commissions	2,772	2,568	8,146	7,562
ATM income	1,316	1,263	3,798	3,999
Adjustments to FDIC receivable for loss share agreements	(23,298)	(16,858)	(61,790)	(57,788)
Other	21,933	(4,082)	38,896	1,827
Total noninterest income	71,918	51,842	194,426	156,081
Noninterest expense				
Salaries and wages	76,463	76,675	228,384	229,145
Employee benefits	21,889	18,741	70,136	59,548
Occupancy expense	18,844	18,860	56,117	55,467
Equipment expense	18,822	17,983	56,466	54,147
FDIC insurance expense	2,706	2,016	7,795	7,739

Foreclosure-related expenses	4,287	7,255	12,059	27,248
Other	49,132	48,547	144,108	134,911
Total noninterest expense	192,143	190,077	575,065	568,205
Income before income taxes	66,641	59,498	222,485	161,611
Income taxes	25,659	19,974	82,012	49,009
Net income	$40,982	$39,524	$140,473	$112,602
Average shares outstanding	9,618,941	10,264,159	9,618,955	10,273,082
Net income per share	$4.26	$3.85	$14.60	$10.96

See accompanying Notes to Consolidated Financial Statements.

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

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
	(dollars in thousands, unaudited)			
Net income	$40,982	$39,524	$140,473	$112,602
Other comprehensive income (loss)				
Unrealized gains and losses on securities:				
Change in unrealized securities gains and losses arising during period	3,470	14,783	(36,998)	16,376
Deferred tax benefit (expense)	(1,177)	(5,949)	14,657	(6,582)
Reclassification adjustment for gains included in income before income taxes	—	(31)	—	(34)
Deferred tax expense	—	12	—	13
Total change in unrealized gains and losses on securities, net of tax	2,293	8,815	(22,341)	9,773
Change in fair value of cash flow hedges:				
Change in unrecognized loss on cash flow hedges	(544)	(919)	26	(2,750)
Deferred tax benefit (expense)	214	364	(11)	1,086
Reclassification adjustment for losses included in income before income taxes	831	769	2,463	2,294
Deferred tax benefit	(400)	(304)	(1,044)	(906)
Total change in unrecognized loss on cash flow hedges, net of tax	101	(90)	1,434	(276)
Change in pension obligation:				
Reclassification adjustment for losses included in income before income taxes	4,298	2,788	12,896	8,368
Deferred tax benefit	(2,061)	(1,092)	(5,428)	(3,277)
Total change in pension obligation, net of tax	2,237	1,696	7,468	5,091
Other comprehensive income (loss)	4,631	10,421	(13,439)	14,588
Total comprehensive income	$45,613	$49,945	$127,034	$127,190

See accompanying Notes to Consolidated Financial Statements.

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

	Class A Common Stock	Class B Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	(dollars in thousands, except share data, unaudited)					
Balance at December 31, 2011	$8,644	$ 1,640	$143,766	$1,773,652	$ (66,574)	$1,861,128
Net income	—	—	—	112,602	—	112,602
Other comprehensive income, net of tax	—	—	—	—	14,588	14,588
Repurchase of 15,497 shares of Class A common stock	(15)	—	—	(2,520)	—	(2,535)
Repurchase of 12,875 shares of Class B common stock	—	(13)	—	(2,401)	—	(2,414)
Cash dividends ($0.90 per share)	—	—	—	(9,245)	—	(9,245)
Balance at September 30, 2012	$8,629	$ 1,627	$143,766	$1,872,088	$ (51,986)	$1,974,124
Balance at December 31, 2012	$8,588	$ 1,033	$143,766	$1,792,726	$ (82,106)	$1,864,007
Net income	—	—	—	140,473	—	140,473
Other comprehensive loss, net of tax	—	—	—	—	(13,439)	(13,439)
Repurchase of 1,973 shares of Class A common stock	(2)	—	—	(319)	—	(321)
Cash dividends ($0.90 per share)	—	—	—	(8,663)	—	(8,663)
Balance at September 30, 2013	$8,586	$ 1,033	$143,766	$1,924,217	$ (95,545)	$1,982,057

See accompanying Notes to Consolidated Financial Statements.

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

	Nine months ended September 30	
	2013	2012
	(dollars in thousands, unaudited)	
OPERATING ACTIVITIES		
Net income	$140,473	$112,602
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan and lease losses	(39,531)	78,005
Deferred tax expense (benefit)	(18,000)	5,999
Change in current taxes payable	(37,737)	23,051
Depreciation	52,212	50,685
Change in accrued interest payable	(3,302)	(12,574)
Change in income earned not collected	1,556	(9,349)
Gain on sale of processing services, net	(4,085)	—
Securities losses	—	11
Origination of loans held for sale	(323,665)	(415,527)
Proceeds from sale of loans held for sale	376,395	433,489
Gain on sale of loans	(9,451)	(4,033)
Net writedowns/losses on other real estate	4,574	31,070
Net amortization of premiums and discounts	(96,091)	(90,461)
FDIC receivable for loss share agreements	58,802	(15,240)
Net change in other assets	107,757	26,617
Net change in other liabilities	56,440	5,316
Net cash provided by operating activities	266,347	219,661
INVESTING ACTIVITIES		
Net change in loans outstanding	364,916	592,015
Purchases of investment securities available for sale	(1,940,198)	(4,241,879)
Proceeds from maturities/calls of investment securities held to maturity	329	363
Proceeds from maturities/calls of investment securities available for sale	1,951,735	3,293,188
Proceeds from sales of investment securities available for sale	—	56
Net change in overnight investments	(910,951)	(253,221)
Cash received from the FDIC for loss share agreements	45,103	223,863
Proceeds from sale of other real estate	120,712	114,357
Additions to premises and equipment	(38,887)	(73,616)
Net cash used by investing activities	(407,241)	(344,874)
FINANCING ACTIVITIES		
Net change in time deposits	(529,675)	(756,798)
Net change in demand and other interest-bearing deposits	506,969	1,072,739
Net change in short-term borrowings	35,930	62,551
Repayment of long-term obligations	(3,958)	(223,779)
Origination of long-term obligations	70,000	—
Repurchase of common stock	(321)	(4,949)
Cash dividends paid	(8,663)	(9,245)
Net cash provided by financing activities	70,282	140,519
Change in cash and due from banks	(70,612)	15,306
Cash and due from banks at beginning of period	639,730	590,801
Cash and due from banks at end of period	$569,118	$606,107

CASH PAYMENTS FOR:		
Interest	$46,873	$84,779
Income taxes	99,398	35,208
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Change in unrealized securities gains and losses	$(36,998)	$16,342
Change in fair value of cash flow hedge	2,489	(456)
Change in pension obligation	12,896	8,368
Transfers of loans to other real estate	78,303	117,363
Reclassification of reserve for unfunded commitments to allowance for loan and lease losses	7,368	—

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands, except per share amounts)
Note A
Accounting Policies and Basis of Presentation

First Citizens BancShares, Inc. (BancShares) is a financial holding company organized under the laws of Delaware and conducts operations through its banking subsidiary, First-Citizens Bank & Trust Company (FCB), which is headquartered in Raleigh, North Carolina.

On August 28, 2013, BancShares' bank subsidiary, FCB and 1st Financial Services Corporation (1st Financial) announced that they had entered into a definitive merger agreement. The agreement provides for the merger of Hendersonville, N.C.-based 1st Financial and its bank subsidiary, Mountain 1st Bank & Trust Company (Mountain 1st), into FCB. The agreement has been approved by the Boards of Directors of 1st Financial, Mountain 1st and FCB. The transaction is expected to close no later than the first quarter of 2014, subject to the receipt of regulatory approvals, the approval of 1st Financial's shareholders, and other customary closing conditions. Under the terms of the agreement, cash consideration of $10,000 will be split between the U.S. Treasury, which will receive $8,000 of the cash consideration in order for 1st Financial to exit from the federal TARP program, and 1st Financial's common shareholders, who will receive $2,000.

General

These consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q and, therefore, do not include all information and notes necessary for a complete presentation of financial position, results of operations and cash flow activity required in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the consolidated financial position and consolidated results of operations have been made. The unaudited interim consolidated financial statements included in this Form 10-Q should be read in conjunction with the consolidated financial statements and footnotes included in BancShares' Annual Report on Form 10-K for the year ended December 31, 2012.

BancShares evaluates all subsequent events prior to filing this Form 10-Q.

Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to the current financial statement presentation. Such reclassifications had no effect on previously reported cash flows, shareholders' equity or net income.

During the third quarter, management reevaluated its fair value leveling methodology and the inputs utilized by the 3rd party pricing services for the current and prior periods. Management concluded that due to the reliance on significant observable inputs, the fair values of its US Treasury, Government agency, and other securities should be classified as level 2 rather than the level 1 previously disclosed. Management also concluded that its equity securities should be classified as level 2 rather than the level 1 previously disclosed due to the inactive nature of the markets in which these securities trade.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates, and different assumptions in the application of these policies could result in material changes in BancShares' consolidated financial position, the consolidated results of its operations or related disclosures. Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan and lease losses; determination of the fair value of financial instruments; pension plan assumptions; cash flow estimates on acquired loans; the receivable from and payable to the FDIC for loss share agreements; purchase accounting-related adjustments; and income tax assets, liabilities and expense.

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Goodwill Impairment

Annual impairment tests are conducted as of July 31 each year. Based on the July 31, 2013, impairment test, management concluded there was no indication of goodwill impairment. In addition to the annual testing requirement, impairment tests are performed if various other events occur including significant adverse changes in the business climate, considering various qualitative and quantitative factors to determine whether impairment exists. There were no such events during the third quarter of 2013.

Critical Accounting Policies Update

As discussed below, during the second quarter of 2013, BancShares implemented enhancements to the process to estimate the allowance for loan and lease losses (ALLL) and the reserve for unfunded commitments. Through detailed analysis of historical loss data, the process enhancements enabled allocation of the previously unallocated 'nonspecific' ALLL and a portion of the reserve for unfunded loan commitments to specific loan classes. The enhanced ALLL estimates implicitly include the risk of draws on open lines within each loan class. The remaining reserve for unfunded commitments relates to irrevocable commitments, such as letters of credit and financial guarantees. Other than the modifications described above, the enhancements to the methodology had no material impact on the ALLL.

For originated commercial loans and leases, BancShares increased the granularity of the historical net loss data used to develop the applicable loss rates by utilizing information that further considers the class of the commercial loan and associated risk rating. For the originated noncommercial segment, BancShares incorporated specific loan class and delinquency status trends into the loss rates. Prior to the second quarter of 2013, management applied a general reserve methodology that estimated commercial loan allowances based upon loss rates by credit grade with the loss rates derived in part from migration analysis among grades and noncommercial allowances based upon loss rates derived primarily from historical losses.

Management also developed an enhanced qualitative framework for considering economic conditions, loan concentrations and other relevant factors at a loan class level. Prior to the second quarter of 2013, these factors were considered in determining the nonspecific portion of the ALLL, which was not allocated to any specific loan class. Management believes that the methodology enhancements will improve the granularity of historical net loss data and the precision of the segment analysis. As a result of the enhanced process to determine the ALLL, management has updated the accounting policy disclosures for the ALLL and the reserve for unfunded commitments.

Allowance for Loan and Lease Losses

The ALLL represents management's best estimate of probable credit losses within the loan and lease portfolio at the balance sheet date. Management determines the ALLL based on an ongoing evaluation. This evaluation is inherently subjective because it requires material estimates, including the amount and timing of cash flows expected to be received on acquired loans. Those estimates are susceptible to significant change. Adjustments to the ALLL are recorded with a corresponding entry to provision for loan and lease losses. Loan and lease balances deemed to be uncollectible are charged off against the ALLL. Recoveries of amounts previously charged off are credited to the ALLL.

Accounting standards require the presentation of certain information at the portfolio segment level, which represents the level at which an entity develops and documents a systematic methodology to determine its ALLL. BancShares evaluates its loan and lease portfolio using three portfolio segments: originated commercial, originated noncommercial and acquired. The originated commercial segment includes commercial construction and land development, commercial mortgage, commercial and industrial, lease financing and other commercial real estate loans, and the related ALLL is calculated based on a risk-based approach as reflected in credit grades assigned to commercial segment loans. The originated noncommercial segment includes noncommercial construction and land development, residential mortgage, revolving mortgage and consumer loans, and the associated ALLL was determined using a delinquency-based approach. The ALLL for acquired loans was determined based on the expected cash flows approach.

BancShares' methodology for calculating the ALLL includes estimating a general allowance for pools of loans and specific allocations for significant individual credits. The general allowance is based on net historical loan loss experience for homogeneous groups of loans with similar risk characteristics and performance trends. The general allowance estimate also contains qualitative components that allow management to adjust reserves based on historical loan loss experience for changes

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in the economic environment, portfolio trends and other factors. The specific allowance component is determined when management believes that the collectability of an individually reviewed loan has been impaired and a loss is probable. The fair value of impaired loans is based on the present value of expected cash flows, market prices of the loans, if available, or the value of the underlying collateral. Expected cash flows are discounted at the loans' effective interest rates.

The general allowance considers probable, incurred losses that are inherent within the loan portfolio but have not been specifically identified. Loans are divided into segments for analysis based in part on the risk profile inherent in each segment. Loans are further segmented into classes to appropriately recognize changes in inherent risk. A primary component of determining the general allowance for performing and classified loans not analyzed specifically is the actual loss history of the various classes. Loan loss factors based on historical experience may be adjusted for significant factors that, in management's judgment, affect the collectability of the portfolio at the balance sheet date. For originated commercial loans and leases, management incorporates historical net loss data to develop the applicable loan loss factors by utilizing information that further considers the class of the commercial loan and associated risk rating. For the originated noncommercial segment, management incorporates specific loan class and delinquency status trends into the loan loss factors. Loan loss factors may be adjusted quarterly based on changes in the level of historical net charge-offs and model adjustment parameter updates by management, such as the number of periods included in the calculation of loss factors, loss severity and portfolio attrition.

The quarterly ALLL evaluation process also includes a qualitative framework that considers economic conditions, composition of the loan portfolio, trends in delinquent and nonperforming loans, historical loss experience by categories of loans, concentrations of credit, changes in lending policies and underwriting standards, regulatory exam results and other factors indicative of potential losses remaining in the portfolio. Management may adjust the ALLL calculated based on historical loan loss factors when assessing changes in the factors in the qualitative framework. The adjustments to the ALLL for the qualitative framework are based on economic data, data analysis of portfolio trends and management judgment. These adjustments are specific to the loan class level. Prior to the second quarter of 2013, a portion of the allowance for loan and lease losses was not allocated to any specific class of loans. This nonspecific portion reflected management's best estimate of the elements of imprecision and estimation risk inherent in the calculation of the overall allowance.

A loan is considered to be impaired under ASC Topic 310 Receivables when, based upon current information and events, it is probable that BancShares will be unable to collect all amounts due according to the contractual terms of the loan. Originated impaired loans are placed on nonaccrual status. Originated loan relationships rated substandard or worse that are greater than or equal to $500 are reviewed for potential impairment on a quarterly basis. Loans classified as trouble debt restructures (TDRs) are also reviewed for potential impairment. Specific valuation allowances are established or partial charge-offs are recorded on impaired loans for the difference between the loan amount and the estimated fair value.

Management continuously monitors and actively manages the credit quality of the entire loan portfolio and adjusts the ALLL to an appropriate level. By assessing the probable estimated incurred losses in the loan portfolio on a quarterly basis, management is able to adjust specific and general loss estimates based upon the most recent information available. Future adjustments to the ALLL may be necessary based on changes in economic and other conditions. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review BancShares' ALLL. Such agencies may require the recognition of adjustments to the ALLL based on their judgments of information available to them at the time of their examination. Management considers the established ALLL adequate to absorb probable losses that relate to loans and leases outstanding as of September 30, 2013.

Each portfolio segment and the classes within those segments are subject to risks that could have an adverse impact on the credit quality of the loan and lease portfolio and the related ALLL. Management has identified the most significant risks as described below that are generally similar among the segments and classes. While the list is not exhaustive, it provides a description of the risks management has determined are the most significant.

Originated Commercial Loans and Leases

Each commercial loan or lease is centrally underwritten based primarily upon the customer's ability to generate the required cash flow to service the debt in accordance with the contractual terms and conditions of the loan agreement. A complete understanding of the borrower's business, including the experience and background of the principals, is obtained prior to approval. To the extent that the loan or lease is secured by collateral, which is true for the majority of commercial loans and leases, the likely value of the collateral and what level of strength the collateral brings to the transaction is evaluated. To the extent that the principals or other parties provide personal guarantees, the relative financial strength and liquidity of each guarantor is assessed.

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The significant majority of relationships in the originated commercial segment are assigned credit risk grades based upon an assessment of conditions that affect the borrower's ability to meet contractual obligations under the loan agreement. This process includes reviewing the borrowers' financial information, payment history, credit documentation, public information and other information specific to each borrower. Credit risk grades are reviewed annually, or at any point management becomes aware of information affecting the borrowers' ability to fulfill their obligations. Our risk grading standards are described in Note C.

The impairment assessment and determination of the related specific reserve for each impaired loan is based on a loan's characteristics. Impairment measurement for loans that are not collateral dependent is based on the present value of expected cash flows discounted at the loan's effective interest rate. Specific valuation allowances are established or partial charge-offs are recorded for the difference between the loan amount and the estimated fair value. Impairment measurement for most real estate loans, particularly when a loan is considered to be a probable foreclosure, is based on the fair value of the underlying collateral. Collateral is appraised and market value, appropriately adjusted for an assessment of the sales and marketing costs as well as the expected holding period, is used to calculate an anticipated fair value.

General reserves for collective impairment are based on estimated incurred losses related to non-impaired commercial loans and leases as of the balance sheet date. Incurred loss estimates for the originated commercial segment are based on average loss rates, which are estimated using historical experience and current risk mix as indicated by the risk grading process. Incurred loss estimates may be adjusted through a qualitative assessment to reflect current economic conditions and portfolio trends including credit quality, concentrations, aging of the portfolio and significant policy and underwriting changes.

Common risks to each class of commercial loans include general economic conditions within the markets BancShares serves, as well as risks that are specific to each transaction including demand for products and services, personal events, such as disability or change in marital status, and reductions in the value of collateral. Due to the concentration of loans in the medical, dental and related fields, BancShares is susceptible to risks that governmental actions, including implementation of the Affordable Care Act, will fundamentally alter the medical care industry in the United States.

In addition to these common risks for the majority of the originated commercial segment, additional risks are inherent in certain classes of originated commercial loans and leases.

Commercial construction and land development

Commercial construction and land development loans are highly dependent on the supply and demand for commercial real estate in the markets served by BancShares as well as the demand for newly constructed residential homes and lots that customers are developing. Deterioration in demand could result in decreases in collateral values and could make repayment of the outstanding loans more difficult for customers.

Commercial mortgage, commercial and industrial and lease financing

Commercial mortgage loans, commercial and industrial loans and lease financing are primarily dependent on the ability of borrowers to achieve business results consistent with those projected at loan origination resulting in cash flow sufficient to service the debt. To the extent that a customer's business results are significantly unfavorable versus the original projections, the ability for the loan to be serviced on a basis consistent with the contractual terms may be at risk. While these loans and leases are generally secured by real property, personal property, or business assets such as inventory or accounts receivable, it is possible that the liquidation of the collateral will not fully satisfy the obligation.

Other commercial real estate

Other commercial real estate loans consist primarily of loans secured by multifamily housing and agricultural loans. The primary risk associated with multifamily loans is the ability of the income-producing property that collateralizes the loan to produce adequate cash flow to service the debt. High unemployment or generally weak economic conditions may result in customers having to provide rental rate concessions to achieve adequate occupancy rates. The performance of agricultural loans is highly dependent on favorable weather, reasonable costs for seed and fertilizer and the ability to successfully market the product at a profitable margin. The demand for these products is also dependent on macroeconomic conditions that are beyond the control of the borrower.

Originated Noncommercial Loans and Leases

Each originated noncommercial loan is centrally underwritten using automated credit scoring and analysis tools. These credit scoring tools take into account factors such as payment history, credit utilization, length of credit history, types of credit currently in use and recent credit inquiries. To the extent that the loan is secured by collateral, the likely value of that collateral is evaluated.

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The ALLL for the originated noncommercial segment is primarily calculated on a pool basis using a delinquency-based approach. Estimates of incurred losses are based on historical loss experience and the current risk mix as indicated by prevailing delinquency rates. These estimates may be adjusted through a qualitative assessment to reflect current economic conditions, portfolio trends and other factors. The remaining portion of the ALLL related to the originated noncommercial segment results from loans that are deemed impaired. The impairment assessment and determination of the related specific reserve for each impaired loan is based on a loan's characteristics. Impairment measurement for loans that are not collateral dependent is based on the present value of expected cash flows discounted at the loan's effective interest rate. Specific valuation allowances are established or partial charge-offs are recorded for the difference between the loan amount and the estimated fair value. Impairment measurement for most real estate loans, particularly when a loan is considered to be a probable foreclosure, is based on the fair value of the underlying collateral. Collateral is appraised and market value, appropriately adjusted for an assessment of the sales and marketing costs as well as the expected holding period, is used to calculate an anticipated fair value.

Common risks to each class of noncommercial loans include risks that are not specific to individual transactions such as general economic conditions within the markets BancShares serves, particularly unemployment and potential declines in real estate values. Personal events such as disability or change in marital status also add risk to noncommercial loans.

In addition to these common risks for the majority of noncommercial loans, additional risks are inherent in certain classes of noncommercial loans.

Revolving mortgage

Revolving mortgage loans are often secured by second liens on residential real estate, thereby making such loans particularly susceptible to declining collateral values. A substantial decline in collateral value could render a second lien position to be effectively unsecured. Additional risks include lien perfection inaccuracies, disputes with first lienholders and uncertainty regarding the customer's performance with respect to the first lien that may further weaken the collateral position. Further, the open-end structure of these loans creates the risk that customers may draw on the lines in excess of the collateral value if there have been significant declines since origination.

Consumer

The consumer loan portfolio includes loans secured by personal property such as automobiles, marketable securities, other titled recreational vehicles including boats and motorcycles, as well as unsecured consumer debt. The value of underlying collateral within this class is especially volatile due to potential rapid depreciation in values since date of loan origination, potentially in excess of principal balances.

Residential mortgage and noncommercial construction and land development

Residential mortgage and noncommercial construction and land development loans are made to individuals and are typically secured by 1-4 family residential property, undeveloped land and partially developed land in anticipation of pending construction of a personal residence. Significant and rapid declines in real estate values can result in residential mortgage loan borrowers having debt levels in excess of the current market value of the collateral. Noncommercial construction and land development projects can experience delays in completion and cost overruns that exceed the borrower's financial ability to complete the project. Such cost overruns can routinely result in foreclosure of partially completed and unmarketable collateral.

Acquired loans

The risks associated with acquired loans are generally consistent with the risks identified for commercial and noncommercial originated loans and the classes of loans within those segments. However, these loans were underwritten by other institutions with weaker lending standards. Additionally, in some cases, collateral for acquired loans is located in regions that have experienced profound erosion of real estate values. Therefore, there exists a significant risk that acquired loans are not adequately supported by borrower cash flow or the values of underlying collateral.

Reserve for Unfunded Commitments

The reserve for unfunded commitments represents the estimated probable losses related to unfunded lending commitments, such as letters of credit and financial guarantees. The reserve is calculated in a manner similar to the loans evaluated collectively for impairment, considering the likelihood that the available credit will be utilized as well as the exposure to default. The reserve for unfunded commitments is presented within other liabilities on the consolidated balance sheets, distinct from the ALLL, and adjustments to the reserve for unfunded commitments are included in other noninterest expense in the consolidated statements of income.

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Recent Accounting and Regulatory Pronouncements

Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2013-11, “Income Taxes (Topic 740)”
This ASU states that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require BancShares to use, and BancShares does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date.
The provisions of this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted.
The provisions of this ASU will be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. BancShares will adopt this ASU by the date required and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

FASB ASU 2013-10, “Derivatives and Hedging (Topic 815)"
This ASU permits the use of the Fed Funds Effective Swap Rate (OIS) by BancShares as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to United States Treasury (UST) and London Interbank Offered Rate (LIBOR). The amendments also remove the restriction on using different benchmark rates for similar hedges.
The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. Adoption of this ASU during the third quarter of 2013 did not have a material effect on BancShares' financial position or results of operations.

FASB ASU 2013-04, “Liabilities”
This ASU provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, except for obligations addressed within existing guidance in GAAP.
The updated guidance requires BancShares to measure those obligations as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount the reporting entity expects to pay on behalf of its co-obligors. The guidance in this ASU also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations.
The amendments in this update are effective for fiscal years beginning after December 31, 2013. Early adoption is permitted. BancShares will adopt the methodologies prescribed by this ASU by the date required, and does not anticipate that the ASU will have a material effect on its financial position or results of operations.

FASB ASU 2013-02, “Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income”
This ASU requires BancShares to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts, BancShares is required to cross-reference to other disclosures required under GAAP that provide additional detail about those

amounts.
For public entities, the amendments are effective prospectively for reporting periods beginning after December 15, 2012. BancShares adopted the methodologies prescribed by this ASU by the date required. Adoption of this ASU did not have a material effect on BancShares' financial position or results of operations. BancShares has included the required disclosures in Note L.

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FASB ASU 2013-01, “Balance Sheet”

This ASU clarifies that the scope of ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities, applies to derivatives including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or are subject to a master netting arrangement or similar agreement.

BancShares is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. The effective date is the same as the effective date of Update 2011-11. BancShares adopted the methodologies prescribed by this ASU by the date required. Adoption of this ASU did not have a material effect on BancShares' financial position or results of operations.

Note B

Investments

The aggregate values of investment securities at September 30, 2013, and December 31, 2012, along with unrealized gains and losses determined on an individual security basis are as follows:

	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
	(dollars in thousands)			
Investment securities available for sale				
September 30, 2013				
U.S. Treasury	$448,201	$372	$41	$448,532
Government agency	2,583,888	2,320	1,428	2,584,780
Mortgage-backed securities	2,131,099	5,452	30,519	2,106,032
Equity securities	543	20,681	—	21,224
State, county and municipal	186	1	—	187
Other	857	—	27	830
Total investment securities available for sale	$5,164,774	$28,826	$32,015	$5,161,585
December 31, 2012				
U.S. Treasury	$823,241	$403	$12	$823,632
Government agency	3,052,040	3,501	337	3,055,204
Mortgage-backed securities	1,315,211	14,787	341	1,329,657
Equity securities	543	15,822	—	16,365
State, county and municipal	546	4	—	550
Other	838	—	18	820
Total investment securities available for sale	$5,192,419	$34,517	$708	$5,226,228
Investment securities held to maturity				
September 30, 2013				
Mortgage-backed securities	$1,013	$67	$—	$1,080
December 31, 2012				
Mortgage-backed securities	$1,342	$133	$27	$1,448

Investments in mortgage-backed securities primarily represent securities issued by the Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation.

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The following table provides the maturity distribution for non-amortizing securities. Repayments of mortgage-backed securities are dependent on the repayments of the underlying loan balances. Equity securities do not have a stated maturity date.

	September 30, 2013		December 31, 2012	
	Cost	Fair value	Cost	Fair value
	(dollars in thousands)			
Investment securities available for sale				
Amortizing securities maturing in:				
One year or less	$864,992	$865,925	$2,285,159	$2,286,403
One through five years	2,168,080	2,168,344	1,590,608	1,592,923
Five through 10 years	60	60	898	880
Over 10 years	—	—	—	—
Mortgage-backed securities	2,131,099	2,106,032	1,315,211	1,329,657
Equity securities	543	21,224	543	16,365
Total investment securities available for sale	$5,164,774	$5,161,585	$5,192,419	$5,226,228
Investment securities held to maturity				
Mortgage-backed securities held to maturity	$1,013	$1,080	$1,342	$1,448

For each period presented, securities gains (losses) include the following:

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
	(dollars in thousands)			
Gross gains on sales of investment securities available for sale	$—	$31	$—	$36
Gross losses on sales of investment securities available for sale	—	—	—	(2)
Other than temporary impairment loss on equity securities	—	—	—	(45)
Total securities gains (losses)	$—	$31	$—	$(11)

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The following table provides information regarding securities with unrealized losses as of September 30, 2013, and December 31, 2012.

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(dollars in thousands)					
September 30, 2013						
Investment securities available for sale:						
U.S. Treasury	$51,836	$41	$—	$—	$51,836	$41
Government agency	953,103	1,428	—	—	953,103	1,428
Mortgage-backed securities	1,820,909	29,712	27,949	807	1,848,858	30,519
Other	830	27	—	—	830	27
Total	$2,826,678	$31,208	$27,949	$807	$2,854,627	$32,015
Investment securities held to maturity:						
Mortgage-backed securities	$—	$—	$—	$—	$—	$—
December 31, 2012						
Investment securities available for sale:						
U.S. Treasury	$120,045	$12	$—	$—	$120,045	$12
Government agency	407,498	337	—	—	407,498	337
Mortgage-backed securities	135,880	214	9,433	127	145,313	341
Other	820	18	—	—	820	18
Total	$664,243	$581	$9,433	$127	$673,676	$708
Investment securities held to maturity:						
Mortgage-backed securities	$—	$—	$17	$27	$17	$27

Investment securities with an aggregate fair value of $27,949 have had continuous unrealized losses for more than 12 months as of September 30, 2013, with an aggregate unrealized loss of $807. These 17 investments are mortgage-backed securities. None of the unrealized losses identified as of September 30, 2013, or December 31, 2012, relate to the marketability of the securities or the issuer's ability to honor redemption obligations. For all periods presented, BancShares had the ability and intent to retain these securities for a period of time sufficient to recover all unrealized losses. Therefore, none of the securities were deemed to be other than temporarily impaired.

Investment securities having an aggregate carrying value of $2,547,581 at September 30, 2013, and $2,351,072 at December 31, 2012, were pledged as collateral to secure public funds on deposit and certain short-term borrowings, and for other purposes as required by law.

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Note C
Loans and Leases
Loans and leases outstanding include the following as of the dates indicated:

	September 30, 2013	December 31, 2012
	(dollars in thousands)	
Acquired loans	$1,188,281	$1,809,235
Originated loans and leases:		
Commercial:		
Construction and land development	300,266	309,190
Commercial mortgage	6,308,192	6,029,435
Other commercial real estate	177,599	160,980
Commercial and industrial	1,009,641	1,038,530
Lease financing	365,967	330,679
Other	180,435	125,681
Total commercial loans	8,342,100	7,994,495
Noncommercial:		
Residential mortgage	927,426	822,889
Revolving mortgage	2,113,240	2,210,133
Construction and land development	121,553	131,992
Consumer	380,266	416,606
Total noncommercial loans	3,542,485	3,581,620
Total originated loans and leases	11,884,585	11,576,115
Total loans and leases	$13,072,866	$13,385,350

	September 30, 2013			December 31, 2012		
	Impaired at acquisition date	All other acquired loans	Total	Impaired at acquisition date	All other acquired loans	Total
	(dollars in thousands)					
Acquired loans:						
Commercial:						
Construction and land development	$23,136	$70,827	$93,963	$71,225	$166,681	$237,906
Commercial mortgage	81,389	662,960	744,349	107,281	947,192	1,054,473
Other commercial real estate	8,713	42,395	51,108	35,369	71,750	107,119
Commercial and industrial	144	24,304	24,448	3,932	45,531	49,463
Other	—	1,003	1,003	—	1,074	1,074
Total commercial loans	113,382	801,489	914,871	217,807	1,232,228	1,450,035
Noncommercial:						
Residential mortgage	32,389	199,921	232,310	48,077	249,849	297,926
Revolving mortgage	8,416	26,418	34,834	9,606	29,104	38,710
Construction and land development	5,145	192	5,337	15,136	5,657	20,793
Consumer	—	929	929	—	1,771	1,771
Total noncommercial loans	45,950	227,460	273,410	72,819	286,381	359,200

Total acquired loans	$159,332	$1,028,949	$1,188,281	$290,626	$1,518,609	$1,809,235

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At September 30, 2013, $2,534,250 in originated loans were pledged to secure debt obligations, compared to $2,570,773 at December 31, 2012.

Credit quality indicators

Loans and leases are monitored for credit quality on a recurring basis. The credit quality indicators used are dependent on the portfolio segment to which the loan relates. Originated commercial loans and leases, originated noncommercial loans and leases and acquired loans have different credit quality indicators as a result of the methods used to monitor each of these loan segments.

The credit quality indicators for originated commercial loans and leases and all acquired loans and leases are developed through review of individual borrowers on an ongoing basis. Each borrower is evaluated at least annually with more frequent evaluation of more severely criticized loans or leases. The indicators represent the rating for loans or leases as of the date presented based on the most recent assessment performed. These credit quality indicators are defined as follows:

Pass – A pass rated asset is not adversely classified because it does not display any of the characteristics for adverse classification.

Special mention – A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, such potential weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention assets are not adversely classified and do not warrant adverse classification.

Substandard – A substandard asset is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Assets classified as substandard generally have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These assets are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Doubtful – An asset classified as doubtful has all the weaknesses inherent in an asset classified substandard with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions and values.

Loss – Assets classified as loss are considered uncollectible and of such little value that it is inappropriate to be carried as an asset. This classification is not necessarily equivalent to no potential for recovery or salvage value, but rather that it is not appropriate to defer a full charge-off even though partial recovery may be effected in the future.

Ungraded – Ungraded loans represent loans that are not included in the individual credit grading process due to their relatively small balances or borrower type. The majority of originated, ungraded loans at September 30, 2013, relate to business credit cards and tobacco buyout loans classified as commercial and industrial loans. Business credit card loans with an outstanding balance of $73,701 at September 30, 2013, are subject to automatic charge-off when they become 120 days past due in the same manner as unsecured consumer lines of credit. Tobacco buyout loans with an outstanding balance of $21,808 at September 30, 2013, are secured by assignments of receivables made pursuant to the Fair and Equitable Tobacco Reform Act of 2004. The credit risk associated with these loans is considered low as the payments that began in 2005 and continue through 2014 are made by the Commodity Credit Corporation, which is part of the United States Department of Agriculture.

The credit quality indicators for originated, noncommercial loans are based on the delinquency status of the borrower. As the borrower becomes more delinquent, the likelihood of loss increases.

The composition of the loans and leases outstanding at September 30, 2013, and December 31, 2012, by credit quality indicator is provided below:

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Grade:	Construction and land development	Commercial mortgage	Other commercial real estate	Commercial and industrial	Lease financing	Other	Total originated commercial loans and leases
	Originated commercial loans and leases						
	(dollars in thousands)						
September 30, 2013							
Pass	$285,044	$6,019,286	$ 172,341	$885,691	$ 359,195	$179,085	$7,900,642
Special mention	12,060	125,280	1,241	17,260	2,664	1,350	159,855
Substandard	3,109	155,593	3,709	6,606	3,335	—	172,352
Doubtful	53	6,703	75	1,428	773	—	9,032
Ungraded	—	1,330	233	98,656	—	—	100,219
Total	$300,266	$6,308,192	$ 177,599	$1,009,641	$ 365,967	$180,435	$8,342,100
December 31, 2012							
Pass	$274,480	$5,688,541	$ 151,549	$894,998	$ 325,626	$124,083	$7,459,277
Special mention	14,666	166,882	2,812	13,275	1,601	837	200,073
Substandard	18,761	157,966	5,038	12,073	1,663	756	196,257
Doubtful	952	13,475	98	1,040	771	—	16,336
Ungraded	331	2,571	1,483	117,144	1,018	5	122,552
Total	$309,190	$6,029,435	$ 160,980	$1,038,530	$ 330,679	$125,681	$7,994,495

	Residential mortgage	Revolving mortgage	Construction and land development	Consumer	Total originated noncommercial loans
	Originated noncommercial loans and leases				
	(dollars in thousands)				
September 30, 2013					
Current	$900,625	$2,097,658	$119,395	$376,237	$3,493,915
30-59 days past due	11,840	9,921	1,907	2,502	26,170
60-89 days past due	3,312	1,556	85	1,015	5,968
90 days or greater past due	11,649	4,105	166	512	16,432
Total	$927,426	$2,113,240	$121,553	$380,266	$3,542,485
December 31, 2012					
Current	$786,626	$2,190,186	$128,764	409,218	$3,514,794
30-59 days past due	15,711	12,868	1,941	4,405	34,925
60-89 days past due	7,559	3,200	490	1,705	12,954
90 days or greater past due	12,993	3,879	797	1,278	18,947
Total	$822,889	$2,210,133	$131,992	$416,606	$3,581,620

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	Acquired loans								
Grade:	Construction and land development - commercial	Commercial mortgage	Other commercial real estate	Commercial and industrial	Residential mortgage	Revolving mortgage	Construction and land development - noncommercial	Consumer and other	Total acquired loans
	(dollars in thousands)								
September 30, 2013									
Pass	$3,373	$308,809	$22,007	$7,553	$145,735	$26,291	$ 139	$1,468	$ 515,375
Special mention	18,395	176,338	6,602	9,268	8,676	2,865	—	26	222,170
Substandard	62,472	209,383	13,786	5,908	57,156	3,329	4,903	—	356,937
Doubtful	8,013	49,165	8,713	1,502	2,660	2,349	295	—	72,697
Ungraded	1,710	654	—	217	18,083	—	—	438	21,102
Total	$93,963	$744,349	$51,108	$24,448	$232,310	$34,834	$ 5,337	$1,932	$ 1,188,281
December 31, 2012									
Pass	$17,010	$376,974	$33,570	$ 19,451	$172,165	$29,540	$ 334	$1,617	$ 650,661
Special mention	25,734	259,264	17,518	12,465	14,863	1,736	—	34	331,614
Substandard	105,061	344,542	44,335	14,698	83,193	7,434	17,190	239	616,692
Doubtful	87,445	73,016	11,696	2,757	4,268	—	3,269	117	182,568
Ungraded	2,656	677	—	92	23,437	—	—	838	27,700
Total	$237,906	$1,054,473	$107,119	$49,463	$297,926	$38,710	$ 20,793	$2,845	$ 1,809,235

The aging of the outstanding loans and leases, by class, at September 30, 2013, and December 31, 2012, (excluding loans and leases acquired with deteriorated credit quality) is provided in the table below. The calculation of days past due begins on the day after payment is due and includes all days through which all required interest or principal has not been paid. Loans and leases 30 days or less past due are considered current due to various grace periods that allow borrowers to make payments within a stated period after the due date and still remain in compliance with the loan agreement.

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	30-59 days past due	60-89 days past due	90 days or greater	Total past due	Current	Total loans and leases
	(dollars in thousands)					
September 30, 2013						
Originated loans and leases:						
Construction and land development - commercial	$1,755	$49	$562	$2,366	$297,900	$300,266
Commercial mortgage	15,917	10,522	18,449	44,888	6,263,304	6,308,192
Other commercial real estate	103	400	1,169	1,672	175,927	177,599
Commercial and industrial	2,633	796	1,675	5,104	1,004,537	1,009,641
Lease financing	2,317	—	178	2,495	363,472	365,967
Other	—	—	—	—	180,435	180,435
Residential mortgage	11,840	3,312	11,649	26,801	900,625	927,426
Revolving mortgage	9,921	1,556	4,105	15,582	2,097,658	2,113,240
Construction and land development - noncommercial	1,907	85	166	2,158	119,395	121,553
Consumer	2,502	1,015	512	4,029	376,237	380,266
Total originated loans and leases	$48,895	$17,735	$38,465	$105,095	$11,779,490	$11,884,585
December 31, 2012						
Originated loans and leases:						
Construction and land development - commercial	$927	$—	$7,878	$8,805	$300,385	$309,190
Commercial mortgage	24,447	4,179	21,327	49,953	5,979,482	6,029,435
Other commercial real estate	387	1,240	1,034	2,661	158,319	160,980
Commercial and industrial	2,833	1,096	605	4,534	1,033,996	1,038,530
Lease financing	991	138	621	1,750	328,929	330,679
Other	18	13	—	31	125,650	125,681
Residential mortgage	15,711	7,559	12,993	36,263	786,626	822,889
Revolving mortgage	12,868	3,200	3,879	19,947	2,190,186	2,210,133
Construction and land development - noncommercial	1,941	490	797	3,228	128,764	131,992
Consumer	4,405	1,705	1,278	7,388	409,218	416,606
Total originated loans and leases	$64,528	$19,620	$50,412	$134,560	$11,441,555	$11,576,115

The recorded investment, by class, in loans and leases on nonaccrual status, and loans and leases greater than 90 days past due and still accruing at September 30, 2013, and December 31, 2012, (excluding loans and leases acquired with deteriorated credit quality) are as follows:

	September 30, 2013		December 31, 2012	
	Nonaccrual loans and leases	Loans and leases > 90 days and accruing	Nonaccrual loans and leases	Loans and leases > 90 days and accruing
	(dollars in thousands)			
Originated loans and leases:				
Construction and land development - commercial	$493	$164	$14,930	$541
Commercial mortgage	44,818	601	50,532	1,671
Commercial and industrial	2,978	238	6,972	466

Lease financing	1,000	69	1,075	—
Other commercial real estate	1,937	800	2,319	—
Construction and land development - noncommercial	463	166	668	111
Residential mortgage	15,119	2,708	12,603	3,337
Revolving mortgage	—	4,105	—	3,877
Consumer	32	512	746	1,269
Total originated loans and leases	$66,840	$9,363	$89,845	$11,272

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Acquired Loans

The following table provides changes in the carrying value of acquired loans impaired at acquisition date and all other acquired loans during the nine months ended September 30, 2013, and 2012:

	2013		2012	
	Impaired at acquisition date	All other acquired loans	Impaired at acquisition date	All other acquired loans
	(dollars in thousands)			
Balance, January 1	$290,626	$1,518,609	$458,305	$1,903,847
Reductions for repayments, foreclosures and changes in carrying value, net of accretion	(131,294)	(489,660)	(167,581)	(297,474)
Balance, September 30	$159,332	$1,028,949	$290,724	$1,606,373
Outstanding principal balance at September 30	$670,256	$1,412,617	$1,077,975	$2,253,660

The carrying value of loans on the cost recovery method was $29,194 at September 30, 2013, and $74,479 at December 31, 2012. Prior to the third quarter of 2012, the cost recovery method was being applied to nonperforming loans acquired from four of the six FDIC-assisted transactions. During the third and fourth quarters of 2012, those loans were installed on an acquired loan accounting system that estimated cash flows for all loans. Based on these improved cash flow estimates, loans that were previously accounted for under the cost recovery method began to accrete yield. The cost recovery method continues to be applied to loans when the timing of the cash flows is no longer reasonably estimable due to subsequent nonperformance by the borrower or uncertainty in the ultimate disposition of the asset.

For acquired loans, improved cash flow estimates and receipt of unscheduled loan payments result in the reclassification of nonaccretable difference to accretable yield. During the third and fourth quarters of 2012, the improved ability to estimate cash flows due to expanded use of an acquired loan accounting system also contributed to significant increases in accretable yield. Accretable yield resulting from the improved ability to estimate future cash flows generally does not represent amounts previously identified as nonaccretable difference.

The following table documents changes to the amount of accretable yield for the first nine months of 2013 and 2012. Other, net includes reclassifications from nonaccretable difference to accretable yield and changes to accretable yield attributable to revised cash flow estimates.

	2013	2012
	(dollars in thousands)	
Balance, January 1	$539,564	$276,690
Accretion	(179,792)	(193,438)
Other, net	107,300	498,874
Balance, September 30	$467,072	$582,126

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Note D

Allowance for Loan and Lease Losses

Activity in the allowance for loan and lease losses, ending balances of loans and leases and related allowance by class of loans is summarized as follows:

	Construction and land development - commercial	Commercial mortgage	Other commercial real estate	Commercial and industrial	Lease financing	Other	Residential mortgage	Revolving mortgage	Construction and land development - non-commercial	Consumer	Non-specific
	(dollars in thousands)										
Originated Loans											
Allowance for loan and lease losses:											
Nine months ended September 30, 2013											
Balance at January 1	$6,031	$80,229	$2,059	$14,050	$3,521	$1,175	$3,836	$25,185	$1,721	$25,389	$15,85
Reclassification [(1)]	5,141	27,421	(815)	7,551	(253)	(1,288)	5,717	(9,838)	(478)	(10,018)	(15,77
Charge-offs	(4,570)	(1,662)	(77)	(3,917)	(123)	(6)	(1,987)	(4,540)	(304)	(7,601)	—
Recoveries	722	740	75	1,003	90	1	353	462	180	1,850	—
Provision	3,259	(7,695)	(207)	3,951	1,358	307	2,126	4,546	(571)	4,183	(78
Balance at September 30	$10,583	$99,033	$1,035	$22,638	$4,593	$189	$10,045	$15,815	$548	$13,803	$—
Nine months ended September 30, 2012											
Balance at January 1	$5,467	$67,486	$2,169	$23,723	$3,288	$1,315	$8,879	$27,045	$1,427	$25,962	$14,12
Charge-offs	(9,504)	(5,448)	(254)	(3,766)	(335)	(28)	(3,381)	(7,885)	(914)	(7,590)	—
Recoveries	370	1,230	6	616	75	4	433	501	168	1,366	—
Provision	10,134	18,168	318	(6,937)	419	(115)	1,255	6,726	1,441	6,944	1,147
Balance at September 30	$6,467	$81,436	$2,239	$13,636	$3,447	$1,176	$7,186	$26,387	$2,122	$26,682	$15,26
Three months ended September 30, 2013											
Balance at July 1	$11,732	$104,842	$1,057	$19,309	$4,992	$360	$9,996	$14,997	$720	$13,777	$—
Reclassification [(1)]	—	—	—	—	—	—	—	—	—	—	—
Charge-offs	(3,030)	(794)	(5)	(1,671)	(31)	—	(719)	(1,472)	(59)	(2,445)	—
Recoveries	84	241	39	344	71	—	253	84	101	577	—
Provision	1,797	(5,256)	(56)	4,656	(439)	(171)	515	2,206	(214)	1,894	—
Balance at September 30	$10,583	$99,033	$1,035	$22,638	$4,593	$189	$10,045	$15,815	$548	$13,803	$—
Three months ended September 30, 2012											

Balance at July 1	$5,056	$81,573	$2,413	$14,308	$3,515	$1,183	$7,639	$26,700	$1,815	$24,988	$15,94
Charge-offs	(283)	(1,428)	—	(720)	—	—	(1,090)	(1,613)	(239)	(2,307)	—
Recoveries	101	222	6	179	27	—	121	87	16	439	—
Provision	1,593	1,069	(180)	(131)	(95)	(7)	516	1,213	530	3,562	(673
Balance at September 30	$6,467	$81,436	$2,239	$13,636	$3,447	$1,176	$7,186	$26,387	$2,122	$26,682	$15,26

(1) Reclassification results from enhancements to the ALLL calculation during the second quarter of 2013 that resulted in the allocation of $15,772 previously designated as 'non-specific' to other loan classes and the absorption of $7,368 of the reserve for unfunded commitments related to unfunded, revocable loan commitments into the ALLL. Further discussion is contained in Note A.

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	Construction and land development - commercial	Commercial mortgage	Other commercial real estate	Commercial and industrial	Lease financing	Other	Residential mortgage	Revolving mortgage	Construction and land development - non-commercial	Consumer	Non-specific	Total
	(dollars in thousands)											
Allowance for loan and lease losses:												
September 30, 2013												
ALLL for loans and leases individually evaluated for impairment	$435	$8,506	$133	$2,500	$177	$—	$1,113	$1,167	$52	$133	$—	$14,216
ALLL for loans and leases collectively evaluated for impairment	10,148	90,527	902	20,138	4,416	189	8,932	14,648	496	13,670	—	164,066
Total allowance for loan and lease losses	$10,583	$99,033	$1,035	$22,638	$4,593	$189	$10,045	$15,815	$548	$13,803	$—	$178,282
December 31, 2012												
ALLL for loans and leases individually evaluated for impairment	$2,469	$11,697	$298	$2,133	$202	$53	$959	$1	$287	$256	$—	$18,355
ALLL for loans and leases collectively evaluated for impairment	3,562	68,532	1,761	11,917	3,319	1,122	2,877	25,184	1,434	25,133	—	144,841
Nonspecific ALLL	—	—	—	—	—	—	—	—	—	—	15,850	15,850
Total allowance for loan and lease losses	$6,031	$80,229	$2,059	$14,050	$3,521	$1,175	$3,836	$25,185	$1,721	$25,389	$15,850	$179,046
Loans and leases:												

September 30, 2013										
Loans and leases individually evaluated for impairment	$2,290	$116,222	$2,835	$11,282	$309	$—	$14,333	$6,495	$938	$1,212
Loans and leases collectively evaluated for impairment	297,976	6,191,970	174,764	998,359	365,658	180,435	913,093	2,106,745	120,615	379,054
Total loan and leases	$300,266	$6,308,192	$177,599	$1,009,641	$365,967	$180,435	$927,426	$2,113,240	$121,553	$380,266
December 31, 2012										
Loans and leases individually evaluated for impairment	$17,075	$133,804	$3,375	$22,619	$804	$707	$15,836	$4,203	$1,321	$2,509
Loans and leases collectively evaluated for impairment	292,115	5,895,631	157,605	1,015,911	329,875	124,974	807,053	2,205,930	130,671	414,097
Total loan and leases	$309,190	$6,029,435	$160,980	$1,038,530	$330,679	$125,681	$822,889	$2,210,133	$131,992	$416,606

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	Construction and land development - commercial	Commercial mortgage	Other commercial real estate	Commercial and industrial	Lease financing	Residential mortgage	Revolving mortgage	Construction and land development - noncommercial	Consumer and other	Total
	(dollars in thousands)									
Acquired Loans										
Allowance for loan and lease losses:										
Nine months ended September 30, 2013										
Balance at January 1	$31,186	$50,275	$11,234	$8,897	$—	$19,837	$9,754	$8,287	$502	$139,972
Charge-offs	(3,435)	(10,146)	(6,622)	(5,190)	—	(1,973)	—	—	(2,379)	(29,745)
Recoveries	—	—	—	—	—	—	—	—	—	—
Provision	(25,132)	(10,809)	(2,689)	2,067	—	(3,546)	(4,918)	(7,739)	2,056	(50,710)
Balance at September 30	$2,619	$29,320	$1,923	$5,774	$—	$14,318	$4,836	$548	$179	$59,517
Nine months ended September 30, 2012										
Balance at January 1	$16,693	$39,557	$16,862	$5,500	$13	$5,433	$77	$4,652	$474	$89,261
Charge-offs	(6,460)	(18,396)	(831)	(7,916)	—	(3,431)	—	(301)	(66)	(37,401)
Recoveries	—	—	—	—	—	142	—	—	—	142
Provision	7,502	19,983	(11,477)	6,125	(13)	7,366	5,417	2,577	1,025	38,505
Balance at September 30	$17,735	$41,144	$4,554	$3,709	$—	$9,510	$5,494	$6,928	$1,433	$90,507
Three months ended September 30, 2013										
Balance at July 1	$7,589	$33,588	$4,596	$5,936	$—	$17,272	$6,031	$1,232	$290	$76,534
Charge-offs	(1,263)	(2,324)	—	(89)	—	(509)	—	(217)	—	(4,402)
Recoveries	—	—	—	—	—	—	—	—	—	—
Provision	(3,707)	(1,944)	(2,673)	(73)	—	(2,445)	(1,195)	(467)	(111)	(12,615)
Balance at September 30	$2,619	$29,320	$1,923	$5,774	$—	$14,318	$4,836	$548	$179	$59,517
Three months ended September 30, 2012										
Balance at July 1	$15,983	$35,991	$9,194	$14,724	$—	$5,575	$2,548	$3,780	$2	$87,797

Charge-offs	(1,434)	(3,006)	(34)	(1,901)	—	(819)	—	(292)	(30)	(7,516)
Recoveries	—	—	—	—	—	—	—	—	—	—
Provision	3,186	8,159	(4,606)	(9,114)	—	4,754	2,946	3,440	1,461	10,226
Balance at September 30	$17,735	$41,144	$4,554	$3,709	$—	$9,510	$5,494	$6,928	$1,433	$90,507
Allowance for loan and lease losses:										
September 30, 2013										
ALLL for loans and leases acquired with deteriorated credit quality	$2,619	$29,320	$1,923	$5,774	$—	$14,318	$4,836	$548	$179	$59,517
December 31, 2012										
ALLL for loans and leases acquired with deteriorated credit quality	31,186	50,275	11,234	8,897	—	19,837	9,754	8,287	502	139,972
Loans and leases:										
September 30, 2013										
Loans and leases acquired with deteriorated credit quality	93,963	744,349	51,108	24,448	—	232,310	34,834	5,337	1,932	1,188,281
December 31, 2012										
Loans and leases acquired with deteriorated credit quality	237,906	1,054,473	107,119	49,463	—	297,926	38,710	20,793	2,845	1,809,235

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The following tables provide information on originated impaired loans and leases, exclusive of loans and leases evaluated collectively as a homogeneous group, including interest income recognized in the period during which the loans and leases were considered impaired.

	With a recorded allowance	With no recorded allowance	Total	Unpaid principal balance	Related allowance recorded
	(dollars in thousands)				
September 30, 2013					
Impaired originated loans and leases					
Construction and land development - commercial	$1,941	$349	$2,290	$7,364	$435
Commercial mortgage	71,829	44,393	116,222	120,254	8,506
Other commercial real estate	1,210	1,625	2,835	3,131	133
Commercial and industrial	10,911	371	11,282	11,512	2,500
Lease financing	309	—	309	309	177
Other	—	—	—	—	—
Residential mortgage	11,652	2,681	14,333	14,534	1,113
Revolving mortgage	4,888	1,607	6,495	6,495	1,167
Construction and land development - noncommercial	475	463	938	938	52
Consumer	1,212	—	1,212	1,212	133
Nonspecific	—	—	—	—	—
Total impaired originated loans and leases	$104,427	$51,489	$155,916	$165,749	$14,216
December 31, 2012					
Impaired originated loans and leases					
Construction and land development - commercial	$6,960	$10,115	$17,075	$31,879	$2,469
Commercial mortgage	61,644	72,160	133,804	123,964	11,697
Other commercial real estate	1,552	1,823	3,375	3,348	298
Commercial and industrial	11,248	11,371	22,619	9,583	2,133
Lease financing	723	81	804	746	202
Other	53	654	707	707	53
Residential mortgage	11,596	4,240	15,836	13,978	959
Revolving mortgage	1,238	2,965	4,203	4,203	1
Construction and land development - noncommercial	1,162	159	1,321	1,321	287
Consumer	1,609	900	2,509	2,509	256
Nonspecific	—	—	—	—	—
Total impaired originated loans and leases	$97,785	$104,468	$202,253	$192,238	$18,355

At September 30, 2013, acquired loans that have had an adverse change in expected cash flows since the date of acquisition equaled $514,166, for which $59,517 in related allowance for loan losses has been recorded.

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	YTD Average Balance	YTD Interest Income Recognized
	(dollars in thousands)	
Nine months ended September 30, 2013		
Originated impaired loans and leases:		
Construction and land development - commercial	$7,793	$242
Commercial mortgage	107,929	4,413
Other commercial real estate	2,893	121
Commercial and industrial	13,811	533
Lease financing	399	19
Other	—	—
Residential mortgage	15,441	253
Revolving mortgage	6,337	459
Construction and land development - noncommercial	907	39
Consumer	1,508	33
Total originated impaired loans and leases	$157,018	$6,112
Three months ended September 30, 2013		
Originated impaired loans and leases:		
Construction and land development - commercial	$5,553	$29
Commercial mortgage	117,584	1,575
Other commercial real estate	2,852	39
Commercial and industrial	12,136	127
Lease financing	312	5
Other	—	—
Residential mortgage	15,137	181
Revolving mortgage	6,564	47
Construction and land development - noncommercial	943	14
Consumer	1,253	4
Total originated impaired loans and leases	$162,334	$2,021
Nine months ended September 30, 2012		
Originated impaired loans and leases:		
Construction and land development - commercial	$24,595	$756
Commercial mortgage	90,544	3,621
Other commercial real estate	2,502	83
Commercial and industrial	11,847	682
Lease financing	412	22
Other	327	—
Residential mortgage	15,278	536
Revolving mortgage	2,507	40
Construction and land development - noncommercial	3,017	122
Consumer	1,631	23
Total originated impaired loans and leases	$152,660	$5,885
Three months ended September 30, 2012		
Originated impaired loans and leases:		
Construction and land development - commercial	$24,046	$239
Commercial mortgage	100,751	1,332
Other commercial real estate	2,191	33
Commercial and industrial	13,414	186

Lease financing	689	11
Other	734	—
Residential mortgage	16,111	206
Revolving mortgage	3,592	20
Construction and land development - noncommercial	3,012	33
Consumer	1,978	7
Total originated impaired loans and leases	$166,518	$2,067

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Troubled Debt Restructurings

BancShares accounts for certain loan modifications or restructurings as troubled debt restructurings (TDRs). In general, the modification or restructuring of a loan is considered a TDR if, for economic reasons or legal reasons related to a borrower's financial difficulties, a concession is granted to the borrower that creditors would not otherwise consider. Concessions may relate to the contractual interest rate, maturity date, payment structure or other actions. In accordance with GAAP, loans acquired under ASC 310-30 are not initially considered to be TDRs. The following table provides a summary of total TDRs by accrual status.

	September 30, 2013			December 31, 2012		
	Accruing	Nonaccruing	Total	Accruing	Nonaccruing	Total
	(dollars in thousands)					
Commercial loans						
Construction and land development - commercial	$24,394	$2,505	$26,899	$47,368	$26,920	$74,288
Commercial mortgage	105,775	26,669	132,444	151,728	37,603	189,331
Other commercial real estate	3,548	1,330	4,878	10,137	2,194	12,331
Commercial and industrial	10,364	894	11,258	10,940	7,237	18,177
Lease	148	—	148	224	—	224
Total commercial loans	144,229	31,398	175,627	220,397	73,954	294,351
Noncommercial						
Residential	24,913	3,996	28,909	28,777	5,828	34,605
Revolving mortgage	3,058	—	3,058	48	—	48
Construction and land development - noncommercial	476	463	939	1,657	—	1,657
Consumer and other	1,212	—	1,212	2,509	—	2,509
Total noncommercial loans	29,659	4,459	34,118	32,991	5,828	38,819
Total loans	$173,888	$35,857	$209,745	$253,388	$79,782	$333,170

Total troubled debt restructurings at September 30, 2013, equaled $209,745, of which $114,231 were acquired and $95,514 were originated. TDRs at December 31, 2012, totaled $333,170, which consisted of $193,207 acquired and $139,963 that were originated.

The majority of TDRs are included in the special mention, substandard or doubtful grading categories, which results in more elevated loss expectations when determining the expected cash flows that are used to determine the allowance for loan losses associated with these loans. When a restructured loan subsequently defaults, it is evaluated and downgraded if appropriate. The more severely graded the loan, the lower the estimated expected cash flows and the greater the allowance recorded. Further, TDRs over $500 and graded substandard or lower are evaluated individually for impairment through review of collateral values.

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The following tables provide the types of TDRs made during the three months ended September 30, 2013, and 2012, as well as a summary of loans that were modified as a TDR during the 12 months ended September 30, 2013, and 2012 that subsequently defaulted during the three months ended September 30, 2013, and 2012. BancShares defines payment default as movement of the TDR to nonaccrual status, foreclosure or charge-off, whichever occurs first.

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	Three months ended September 30, 2013				Three months ended September 30, 2012			
	All restructurings		Restructurings with payment default		All restructurings		Restructurings with payment default	
	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end
	(dollars in thousands)							
Originated loans								
Interest only period provided								
Commercial mortgage	—	$ —	—	$ —	3	$ 1,009	—	$ —
Commercial and industrial	1	203	—	—	2	580	—	—
Total interest only	1	203	—	—	5	1,589	—	—
Loan term extension								
Commercial mortgage	5	2,372	4	1,303	10	3,505	4	1,220
Commercial and industrial	—	—	—	—	2	513	—	—
Residential mortgage	2	590	—	—	2	133	—	—
Consumer	1	21	—	—	1	22	—	—
Total loan term extension	8	2,983	4	1,303	15	4,173	4	1,220
Below market interest rate								
Construction and land development - commercial	1	45	—	—	—	—	—	—
Commercial mortgage	4	859	5	5,125	3	1,385	—	—
Commercial and industrial	—	—	1	173	1	113	—	—
Residential mortgage	1	319	—	—	1	8	—	—
Revolving mortgage	3	43	1	73	—	—	—	—
Construction & land development - noncommercial	2	42	—	—	—	—	—	—
Total below market interest rate	11	1,308	7	5,371	5	1,506	—	—
Discharged from bankruptcy								
Residential mortgage	—	—	2	44	—	—	—	—
Revolving mortgage	3	125	2	47	—	—	—	—
Total discharged from bankruptcy	3	125	4	91	—	—	—	—
Total originated restructurings	23	$ 4,619	15	$ 6,765	25	$ 7,268	4	$ 1,220

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	Three months ended September 30, 2013				Three months ended September 30, 2012			
	All restructurings		Restructurings with payment default		All restructurings		Restructurings with payment default	
	Number of loans	Recorded investment at period end	Number of loans	Recorded investment at period end	Number of loans	Recorded investment at period end	Number of loans	Recorded investment at period end
	(dollars in thousands)							
Acquired loans								
Interest only period provided								
Construction and land development - commercial	—	$ —	1	$ 2,628	1	$ 336	1	$ 336
Commercial mortgage	—	—	—	—	3	3,822	1	159
Total interest only	—	—	1	2,628	4	4,158	2	495
Loan term extension								
Commercial mortgage	1	157	—	—	—	—	—	—
Commercial and industrial	1	121	—	—	1	118	—	—
Residential mortgage	—	—	1	198	3	5,078	1	4,606
Total loan term extension	2	278	1	198	4	5,196	1	4,606
Below market interest rate								
Construction and land development - commercial	—	—	2	1,067	2	52	—	—
Commercial mortgage	1	291	2	1,290	5	3,173	1	1,015
Commercial and industrial	—	—	—	—	1	1,137	—	—
Residential mortgage	—	—	4	842	10	170	4	11
Total below market interest rate	1	291	8	3,199	18	4,532	5	1,026
Total acquired restructurings	3	$ 569	10	$ 6,025	26	$ 13,886	8	$ 6,127

For the three months ended September 30, 2013, the recorded investment in troubled debt restructurings subsequent to modification was not materially impacted by the modification since forgiveness of principal is not a restructuring option frequently used by BancShares.

The following tables provide the types of TDRs made during the nine months ended September 30, 2013, and 2012, as well as a summary of loans that were modified as a TDR during the 12 months ended September 30, 2013, and 2012 that subsequently defaulted during the
nine months ended September 30, 2013, and 2012. BancShares defines payment default as movement of the TDR to nonaccrual status, foreclosure or charge-off, whichever occurs first.

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	Nine months ended September 30, 2013				Nine months ended September 30, 2012			
	All restructurings		Restructurings with payment default		All restructurings		Restructurings with payment default	
	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end
	(dollars in thousands)							
Originated loans								
Interest only period provided								
Construction and land development - commercial	—	$—	—	$—	2	$316	—	$—
Commercial mortgage	9	3,242	—	—	12	4,562	2	952
Commercial and industrial	2	403	—	—	2	580	—	—
Other commercial real estate	1	98	—	—	—	—	—	—
Residential mortgage	1	630	—	—	1	338	1	338
Total interest only	13	4,373	—	—	17	5,796	3	1,290
Loan term extension								
Construction and land development - commercial	—	—	—	—	2	7,606	—	—
Commercial mortgage	12	4,935	5	1,524	45	16,314	10	3,389
Other commercial real estate	—	—	—	—	3	1,334	—	—
Commercial and industrial	2	623	—	—	10	1,371	3	150
Lease financing	—	—	—	—	3	172	—	—
Residential mortgage	9	879	1	570	7	493	1	47
Construction and land development - noncommercial	—	—	—	—	1	1,701	—	—
Consumer	2	64	—	—	6	1,124	—	—
Total loan term extension	25	6,501	6	2,094	77	30,115	14	3,586
Below market interest rate								
Construction and land development - commercial	2	265	—	—	1	228	—	—
Commercial mortgage	29	10,248	5	5,125	7	5,462	—	—
Commercial and industrial	4	829	1	173	4	226	—	—
Other commercial real estate	3	738	—	—	—	—	—	—
Residential mortgage	14	826	—	—	10	1,853	3	785
Revolving mortgage	6	215	1	73	1	49	1	49
Construction & land development - noncommercial	4	555	—	—	—	—	—	—
Consumer	3	227	—	—	2	11	—	—
Total below market interest rate	65	13,903	7	5,371	25	7,829	4	834
Discharged from bankruptcy								
Residential mortgage	4	130	2	44	—	—	—	—
Revolving mortgage	31	2,520	2	47	—	—	—	—
Total discharged from bankruptcy	35	2,650	4	91	—	—	—	—

Other concession								
Commercial mortgage	—	—	—	—	2	924	—	—
Residential mortgage	—	—	—	—	1	385	—	—
Total other concession	—	—	—	—	3	1,309	—	—
Total originated restructurings	138	$27,427	17	$7,556	122	$45,049	21	$5,710

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	Nine months ended September 30, 2013				Nine months ended September 30, 2012			
	All restructurings		Restructurings with payment default		All restructurings		Restructurings with payment default	
	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end	Number of Loans	Recorded investment at period end
	(dollars in thousands)							
Acquired loans								
Interest only period provided								
Construction and land development - commercial	1	$2,628	1	$2,628	2	$474	1	$336
Commercial mortgage	2	1,060	2	1,990	4	12,317	1	159
Commercial and industrial	1	23	—	—	1	158	—	—
Residential mortgage	2	181	—	—	1	100	—	—
Total interest only	6	3,892	3	4,618	8	13,049	2	495
Loan term extension								
Construction and land development - commercial	5	2,517	—	—	9	5,449	1	2,634
Commercial mortgage	1	157	—	—	2	1,413	—	—
Commercial and industrial	2	1,042	—	—	2	147	—	—
Residential mortgage	1	198	1	198	4	5,125	1	4,606
Total loan term extension	9	3,914	1	198	17	12,134	2	7,240
Below market interest rate								
Construction and land development - commercial	5	3,489	2	1,067	10	1,464	2	929
Commercial mortgage	9	11,428	2	1,290	14	13,493	5	2,747
Other commercial real estate	—	—	—	—	2	1,766	—	—
Commercial and industrial	3	510	—	—	4	1,137	2	—
Residential mortgage	10	2,871	6	1,545	18	1,522	7	72
Construction and land development - noncommercial	—	—	—	—	1	—	1	—
Total below market interest rate	27	18,298	10	3,902	49	19,382	17	3,748
Total acquired restructurings	42	$26,104	14	$8,718	74	$44,565	21	$11,483

Note E
Other Real Estate Owned

The following table explains changes in other real estate owned during the nine months ended September 30, 2013, and 2012.

	Covered	Noncovered	Total
	(dollars in thousands)		
Balance at December 31, 2011	$148,599	$50,399	$198,998

Additions	89,811	27,552	117,363
Sales	(100,620)	(24,960)	(125,580)
Writedowns	(21,385)	(7,928)	(29,313)
Balance at September 30, 2012	$116,405	$45,063	$161,468
Balance at December 31, 2012	$102,577	$43,513	$146,090
Additions	50,365	28,756	79,121
Sales	(78,597)	(29,266)	(107,863)
Writedowns	(15,576)	(2,665)	(18,241)
Balance at September 30, 2013	$58,769	$40,338	$99,107

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Note F
Receivable from the FDIC for Loss Share Agreements

The following table provides changes in the receivable from the FDIC for the three-month and nine-month periods ended September 30, 2013, and 2012.

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
	(dollars in thousands)			
Balance at beginning of period	$158,013	$405,626	$270,192	$617,377
Accretion of discounts and premiums, net	(20,553)	(32,398)	(65,734)	(79,135)
Cash payments to/(from) FDIC	1,431	(31,765)	(45,103)	(223,863)
Post-acquisition and other adjustments, net	(38,338)	(11,844)	(58,802)	15,240
Balance at end of period	$100,553	$329,619	$100,553	$329,619

The receivable from the FDIC for loss share agreements is measured separately from the related covered assets and is recorded at fair value at the acquisition date using projected cash flows related to the loss share agreements based on the expected reimbursements for losses and the applicable loss share percentages. See Note J for information related to BancShares' recorded payable to the FDIC for loss share agreements.

Post-acquisition adjustments represent the net change in loss estimates related to acquired loans and covered OREO as a result of changes in expected cash flows and the allowance for loan and lease losses related to those covered loans. For loans covered by loss share agreements, subsequent decreases in the amount expected to be collected from the borrower or collateral liquidation result in a provision for loan and lease losses, an increase in the allowance for loan and lease losses and a proportional adjustment to the receivable from the FDIC for the estimated amount to be reimbursed. Subsequent increases in the amount expected to be collected from the borrower or collateral liquidation result in the reversal of any previously recorded provision for loan and lease losses and related allowance for loan and lease losses and adjustments to the receivable from the FDIC, or prospective adjustment to the accretable yield and the related receivable from the FDIC if no provision for loan and lease losses had been recorded previously. Other adjustments include those resulting from unexpected recoveries of amounts previously charged off.

Note G
Estimated Fair Values

Fair value estimates are intended to represent the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. Where there is no active market for a financial instrument, BancShares has made estimates using discounted cash flow or other valuation techniques. Inputs to these valuation methods are subjective in nature, involve uncertainties and require significant judgment and therefore cannot be determined with precision. Accordingly, the derived fair value estimates presented below are not necessarily indicative of the amounts BancShares could realize in a current market exchange.

Assets and liabilities are recorded at fair value according to a fair value hierarchy comprised of three levels. The levels are based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The level of an asset or liability within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows:

- Level 1 values are based on quoted prices for identical instruments in active markets.
- Level 2 values are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 values are generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation techniques include the use of discounted cash flow models and similar techniques.

The methodologies used to estimate the fair value of financial assets and financial liabilities are discussed below:

Investment securities. U.S.Treasury, government agency, mortgage-backed securities and state, county, and municipal securities are measured at fair value using significant observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, benchmark securities and bids/offers. The inputs used for these securities are considered level 2 inputs. Equity securities are measured at fair value using observable closing prices. Management also considers the level of market activity by examining the trade volume of each security. Due to the relatively inactive nature of the markets, the inputs used for these securities are considered level 2 inputs.

Loans held for sale. Fair value for loans held for sale is generally based on market prices for loans with similar characteristics or external valuations. The inputs used in the fair value measurements for loans held for sale are considered level 2 inputs.

Loans and leases (acquired and originated). For variable rate loans, carrying value is a reasonable estimate of fair value. For fixed rate loans, fair values are estimated based on discounted future cash flows using the current interest rates at which loans with similar terms would be made to borrowers of similar credit quality. Additional valuation adjustments are made for liquidity and credit risk. The inputs used in the fair value measurements for loans and leases are considered level 3 inputs.

Receivable from the FDIC for loss share agreements. Fair value is estimated based on discounted future cash flows using current discount rates. Due to post-acquisition improvements in expected losses, significant portions of the FDIC receivable will be recovered through amortization of the receivable over the remaining life of the loss share agreement rather than by cash flows from the FDIC. The estimated amounts to be amortized in future periods have no fair value. The inputs used in the fair value measurements for the FDIC receivable are considered level 3 inputs. The FDIC loss share agreements are not transferable and, accordingly, there is no market for this receivable.

FHLB stock. The carrying amount of FHLB stock is a reasonable estimate of fair value as these securities are not readily marketable and are evaluated for impairment based on the ultimate recoverability of the par value. BancShares considers positive and negative evidence, including the profitability and asset quality of the issuer, dividend payment history and recent redemption experience, when determining the ultimate recoverability of the par value. BancShares believes its investment in FHLB stock is ultimately recoverable at par.

Preferred stock issued under the TARP program. Preferred securities issued under the Troubled Asset Recovery Program are recorded at cost and are evaluated quarterly for impairment based on the ultimate recoverability of the purchase price. The fair value of these securities is derived from a third-party proprietary model that is considered to be a level 3 input.

Deposits. For non-time deposits and variable rate time deposits, carrying value is a reasonable estimate of fair value. The fair value of fixed rate time deposits is estimated by discounting future cash flows using the interest rates currently offered for deposits of similar remaining maturities. The inputs used in the fair value measurements for deposits are considered level 2 inputs.

Long-term obligations. For fixed rate trust preferred securities, the fair values are determined based on recent trades of the actual security. For other long-term obligations, fair values are estimated by discounting future cash flows using current interest rates for similar financial instruments. The inputs used in the fair value measurements for long-term obligations are considered level 2 inputs.

Payable to the FDIC for loss share agreements. The fair value of the payable to the FDIC for loss share agreements is determined by the projected cash flows based on expected payments to the FDIC in accordance with the loss share agreements. Cash flows are discounted to reflect the timing of the estimated amounts due to the FDIC. The inputs used in the fair value measurements for the payable to the FDIC are considered level 3 inputs. See Note J for more information on the payable to the FDIC.

Interest rate swap. Under the terms of the existing cash flow hedge, BancShares pays a fixed payment to the counterparty in exchange for receipt of a variable payment that is determined based on the three-month LIBOR rate. The fair value of the cash flow hedge is, therefore, based on projected LIBOR rates for the duration of the hedge, values that, while observable in the market, are subject to adjustment due to pricing considerations for the specific instrument. If the fair value of the swap is a net asset, the risk of default by the counterparty is considered in the determination of fair value and is considered a level 3 input. The inputs used in the fair value measurements of the interest rate swap are considered level 2 inputs.

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Off-balance-sheet commitments and contingencies. Carrying amounts are reasonable estimates of the fair values for such financial instruments. Carrying amounts include unamortized fee income and, in some cases, reserves for any credit losses from those financial instruments. These amounts are not material to BancShares' financial position.

For all other financial assets and financial liabilities, the carrying value is a reasonable estimate of the fair value as of September 30, 2013, and December 31, 2012. The carrying value and fair value for these assets and liabilities are equivalent because they are relatively short term in nature and there is no interest rate or credit risk relating to them that would cause the fair value to differ from the carrying value.

	September 30, 2013		December 31, 2012	
	Carrying value	Fair value	Carrying value	Fair value
	(dollars in thousands)			
Cash and due from banks	$569,118	$569,118	$639,730	$639,730
Overnight investments	1,354,131	1,354,131	443,180	443,180
Investment securities available for sale	5,161,585	5,161,585	5,226,228	5,226,228
Investment securities held to maturity	1,013	1,080	1,342	1,448
Loans held for sale	43,054	44,819	86,333	87,654
Acquired loans, net of allowance for loan and lease losses	1,128,764	1,106,189	1,669,263	1,635,878
Originated loans, net of allowance for loan and lease losses	11,706,303	11,480,252	11,397,069	11,238,597
Receivable from the FDIC for loss share agreements (1)	100,553	28,450	270,192	100,161
Income earned not collected	46,110	46,110	47,666	47,666
Stock issued by:				
Federal Home Loan Bank of Atlanta	31,938	31,938	36,139	36,139
Federal Home Loan Bank of San Francisco	7,024	7,024	10,107	10,107
Federal Home Loan Bank of Seattle	4,290	4,290	4,410	4,410
Preferred stock	31,749	32,996	40,768	40,793
Deposits	18,063,319	18,089,336	18,086,025	18,126,893
Short-term borrowings	604,435	604,435	568,505	568,505
Long-term obligations	510,963	530,080	444,921	472,642
Payable to the FDIC for loss share agreements	107,419	123,321	101,641	125,065
Accrued interest payable	6,051	6,051	9,353	9,353
Interest rate swap	7,909	7,909	10,398	10,398

(1) The fair value of the FDIC receivable excludes receivable related to accretable yield to be amortized in prospective periods.

Among BancShares’ assets and liabilities, investment securities available for sale and interest rate swaps accounted for as cash flow hedges are reported at their fair values on a recurring basis. Certain other assets are adjusted to their fair value on a nonrecurring basis, including loans held for sale, which are carried at the lower of cost or fair value. Impaired loans, OREO, goodwill and other intangible assets are periodically tested for impairment. Loans held for investment, deposits, short-term borrowings and long-term obligations are not reported at fair value. BancShares did not elect to voluntarily report any assets or liabilities at fair value.

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For assets and liabilities carried at fair value on a recurring basis, the following table provides fair value information as of September 30, 2013, and December 31, 2012.

Description	Fair value	Fair value measurements using: Level 1	Level 2	Level 3
	(dollars in thousands)			
September 30, 2013				
Assets measured at fair value				
Investment securities available for sale				
U.S. Treasury	$448,532	$—	$448,532	$—
Government agency	2,584,780	—	2,584,780	—
Mortgage-backed securities	2,106,032	—	2,106,032	—
Equity securities	21,224	—	21,224	—
State, county, municipal	187	—	187	—
Other	830	—	830	—
Total	$5,161,585	$—	$5,161,585	$—
Liabilities measured at fair value				
Interest rate swaps accounted for as cash flow hedges	$7,909	$—	$7,909	$—
December 31, 2012				
Assets measured at fair value				
Investment securities available for sale				
U.S. Treasury	$823,632	$—	$823,632	$—
Government agency	3,055,204	—	3,055,204	—
Mortgage-backed securities	1,329,657	—	1,329,657	—
Equity securities	16,365	—	16,365	—
State, county, municipal	550	—	550	—
Other	820	—	820	—
Total	$5,226,228	$—	$5,226,228	$—
Liabilities measured at fair value				
Interest rate swaps accounted for as cash flow hedges	$10,398	$—	$10,398	$—

During the third quarter, management reevaluated its fair value leveling methodology and the inputs utilized by the 3rd party pricing services for the current and prior periods. Management concluded that due to the reliance on significant observable inputs, the fair values of its US Treasury, Government agency and other securities should be classified as level 2 rather than the level 1 previously disclosed. Management also concluded that its equity securities should be classified as level 2 rather than the level 1 previously disclosed due to the inactive nature of the markets in which these securities trade.

There were no transfers between levels during the nine months ended September 30, 2013, and 2012 other than the reclassification referenced above, which was made for all periods presented.

Certain financial assets and liabilities are carried at fair value on a nonrecurring basis. Loans held for sale are carried at the lower of aggregate cost or fair value and are, therefore, carried at fair value only when fair value is less than the asset cost. Certain impaired loans are also carried at fair value. Noncovered OREO that has been recently remeasured is deemed to be at fair value. For financial assets and liabilities carried at fair value on a nonrecurring basis, the following table provides fair value information as of September 30, 2013, and December 31, 2012.

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Description	Fair value	Fair value measurements using: Level 1	Level 2	Level 3
	(dollars in thousands)			
September 30, 2013				
Loans held for sale	$23,728	$—	$23,728	$—
Originated impaired loans	90,211	—	—	90,211
Other real estate not covered under loss share agreements remeasured during current year	4,596	—	—	4,596
December 31, 2012				
Loans held for sale	65,244	—	65,244	—
Originated impaired loans	51,644	—	—	51,644
Other real estate not covered under loss share agreements remeasured during current year	21,113	—	—	21,113

The value of loans held for sale are generally based on market prices for loans with similar characteristics or external valuations.

The value of impaired loans is determined by either collateral valuations or discounted present value of the expected cash flow calculations. Collateral values are determined using appraisals or other third-party value estimates of the subject property with discounts generally between 10 and 14 percent applied for estimated holding and selling costs and other external factors that may impact the marketability of the property. Impaired loans are assigned to an asset manager and monitored monthly for significant changes since the last valuation. If significant changes are noted, the asset manager orders a new valuation or adjusts the valuation accordingly. Expected cash flows are determined using expected loss rates developed from historic experience for loans with similar risk characteristics.

OREO is measured and reported at fair value using level 3 inputs for valuations based on unobservable criteria. The values of OREO are determined by collateral valuations. Collateral values are determined using appraisals or other third-party value estimates of the subject property with discounts generally between 10 and 14 percent applied for estimated holding and selling costs and other external factors that may impact the marketability of the property. Changes to the value of the assets between scheduled valuation dates are monitored through continued communication with brokers and monthly reviews by the asset manager assigned to each asset. The asset manager uses the information gathered from brokers and other market sources to identify any significant changes in the market or the subject property as they occur. Valuations are then adjusted or new appraisals are ordered to ensure the reported values reflect the most current information.

No financial liabilities were carried at fair value on a nonrecurring basis as of September 30, 2013, and December 31, 2012.

Note H
Employee Benefit Plans
Pension expense is a component of employee benefits expense. For the three-month and nine-month periods ended September 30, 2013, and 2012 the components of pension expense are as follows:

	Three months ended September 30		Nine months ended September 30	
	2013	2012	2013	2012
	(dollars in thousands)			

Service cost	$3,765	$4,012	$12,248	$10,387
Interest cost	5,460	7,151	17,764	17,293
Expected return on assets	(6,393)	(8,576)	(20,798)	(20,710)
Amortization of prior service cost	53	53	158	158
Amortization of net actuarial loss	4,245	2,735	12,738	8,210
Total pension expense	$7,130	$5,375	$22,110	$15,338

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The assumed discount rate for 2013 is 4.00 percent, the expected long-term rate of return on plan assets is 7.25 percent and the assumed rate of salary increases is 4.00 percent. For 2012 the assumed discount rate was 4.75 percent, expected long-term rate of return was 7.50 percent and the assumed rate of salary increases was 4.00 percent.

Note I
Income Taxes

Income tax expense totaled $25,659 and $19,974 for the third quarters of 2013 and 2012, representing effective tax rates of 38.5 percent and 33.6 percent during the respective periods. For the first nine months of 2013, income tax expense totaled $82,012 compared to $49,009 during 2012. The effective tax rates for the nine-month periods equals 36.9 percent and 30.3 percent, respectively.

During the third quarter of 2013, BancShares adjusted its net deferred tax asset as a result of reductions in the North Carolina corporate income tax rate that were enacted July 23, 2013, and will become effective January 1, 2014, and January 1, 2015. The lower corporate income tax rate resulted in a reduction in the deferred tax asset and an increase in current period income tax expense. The lower effective tax rate for the first nine months of 2012 also reflects the impact of a $6,449 credit to income tax expense resulting from the favorable outcome of state tax audits for the period 2008-2010, net of additional federal taxes.

Note J
Commitments and Contingencies

To meet the financing needs of its customers, BancShares and its subsidiaries have financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, standby letters of credit and recourse obligations on mortgage loans sold. These instruments involve elements of credit, interest rate or liquidity risk.

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. Established credit standards control the credit risk exposure associated with these commitments. In some cases, BancShares requires that collateral be pledged to secure the commitment, including cash deposits, securities and other assets. At September 30, 2013, BancShares had unused commitments totaling $5,788,492, compared to $5,467,998 at December 31, 2012.

Standby letters of credit are commitments guaranteeing performance of a customer to a third party. Those guarantees are issued primarily to support public and private borrowing arrangements. To minimize its exposure, BancShares' credit policies govern the issuance of standby letters of credit. At September 30, 2013, and December 31, 2012, BancShares had standby letters of credit amounting to $56,941 and $63,085, respectively. The credit risk related to the issuance of these letters of credit is essentially the same as that involved in extending loans to clients and, therefore, these letters of credit are collateralized when necessary.

Residential mortgage loans are sold with standard representations and warranties relating to documentation and underwriting requirements for the loans. If deficiencies are discovered at any point in the life of the loan, the investor may require BancShares to repurchase the loan. As of September 30, 2013, and December 31, 2012, other liabilities included a reserve of $3,641 and $4,065, respectively, for estimated losses arising from the repurchase of loans under these provisions.

In addition to standard representations and warranties, residential mortgage loans sold with limited recourse liability represent guarantees to repurchase the loans or repay a portion of the sale proceeds in the event of nonperformance by the borrower. The recourse period is generally 120 days or fewer after sale. At September 30, 2013, and December 31, 2012, BancShares has sold loans of approximately $200,379 and $205,888, respectively, for which the recourse period had not yet elapsed.

BancShares has recorded a receivable from the FDIC for the expected reimbursement of losses on assets covered under the various loss share agreements. These loss share agreements impose certain obligations on us that, in the event of noncompliance, could result in the delay or disallowance of some or all of our rights under those agreements. Requests for reimbursement are subject to FDIC review and may be delayed or disallowed for noncompliance. The loss share agreements are subject to interpretation by both the FDIC and FCB, and disagreements may arise regarding coverage of losses, expenses and contingencies.

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The loss share agreements for four FDIC-assisted transactions include provisions related to contingent payments that may be owed to the FDIC at the termination of the agreements (clawback liability).The clawback liability represents an estimated payment by BancShares to the FDIC if actual cumulative losses on acquired covered assets are lower than the cumulative losses originally estimated by the FDIC at the time of acquisition. The clawback liability is estimated by discounting estimated future payments and is recorded in the Consolidated Balance Sheets as a payable to the FDIC for loss share agreements. As of September 30, 2013, and December 31, 2012, the clawback liability was $107,419 and $101,641, respectively.

BancShares and various subsidiaries have been named as defendants in legal actions arising from their normal business activities in which damages in various amounts are claimed. BancShares is also exposed to litigation risk relating to the prior business activities of banks from which assets were acquired and liabilities assumed in the various FDIC-assisted transactions. Although the amount of any ultimate liability with respect to such matters cannot be determined, in the opinion of management, any such liability will not have a material effect on BancShares' consolidated financial statements.

On February 18, 2011, United Western Bank, United Western Bank's parent company, United Western Bancorp, and five of their directors filed a complaint in the United States District Court for the District of Columbia against the Office of Thrift Supervision (OTS), its Acting Director and the FDIC in its corporate and receivership capacities, alleging that the seizure of United Western Bank by the OTS and the subsequent appointment of the FDIC as receiver were illegal. The complaint requested the court to direct the OTS to remove the FDIC as receiver and return control of United Western Bank to the plaintiffs. Neither BancShares nor FCB was named as a party. In June 2011, the Court dismissed all plaintiffs other than United Western Bank and dismissed the FDIC in both capacities, leaving United Western Bank and the OTS and its Acting Director as the only parties. In July 2011, following passage of the Dodd-Frank Act, the Office of the Comptroller of the Currency (OCC) and the Acting Comptroller were substituted for the OTS and its Acting Director as the only defendants. On March 5, 2013, the court entered a final, appealable order denying United Western Bank's Motion for Summary Judgment and granting OCC's and the Comptroller's Motion for Summary Judgment. On April 26, 2013, United Western Bank filed its Notice of Appeal to the U.S. Court of Appeals for the District of Columbia. On June 20, 2013, United Western Bank filed a Motion for the Voluntary Dismissal of its appeal. The Motion was granted and the appeal was dismissed on July 3, 2013.
During March 2012, FCB received communications from the US Small Business Administration (SBA) asserting that the SBA is entitled to receive a share of amounts paid or to be paid by the FDIC to FCB relating to certain specific SBA-guaranteed loans pursuant to the loss share agreement between FCB and the FDIC applicable to Temecula Valley Bank. FCB disputes the validity of the SBA claims and is pursuing administrative relief through the SBA. During the second quarter of 2013, SBA advised that it will no longer pursue this claim.

Note K
Derivatives

At September 30, 2013, BancShares had an interest rate swap entered into during 2011 that qualifies as a cash flow hedge under GAAP. For all periods presented, the fair value of the outstanding derivative is included in other liabilities in the consolidated balance sheets, and the net change in fair value is included in the consolidated statements of cash flows under the caption net change in other liabilities.

The interest rate swap is used for interest rate risk management purposes and converts variable-rate exposure on outstanding debt to a fixed rate. The 2011 interest rate swap has a notional amount of $93,500, representing the amount of variable rate trust preferred capital securities issued during 2006 and still outstanding at the swap inception date. The 2011 interest rate swap hedges interest payments through June 2016 and requires fixed-rate payments by BancShares at 5.50 percent in exchange for variable-rate payments of 175 basis points above the three-month LIBOR, which is equal to the interest paid to the holders of the trust preferred capital securities. Settlement of the swap occurs quarterly. As of September 30, 2013, collateral with a fair value of $9,651 was pledged to secure the existing obligation under the interest rate swap.

	September 30, 2013		December 31, 2012	
	Notional amount	Estimated fair value of liability	Notional amount	Estimated fair value of liability
	(dollars in thousands)			
2011 interest rate swap hedging variable rate exposure on trust preferred securities 2011-2016	$93,500	$7,909	$93,500	$10,398

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For cash flow hedges, the effective portion of the gain or loss due to changes in the fair value of the derivative hedging instrument is included in other comprehensive income (loss), while the ineffective portion, representing the excess of the cumulative change in the fair value of the derivative over the cumulative change in expected future discounted cash flows on the hedged transaction, is recorded in the consolidated income statement. BancShares' interest rate swap has been fully effective since inception. Therefore, changes in the fair value of the interest rate swap has had no impact on net income. For the three-month periods ended September 30, 2013, and 2012, BancShares recognized interest expense of $831 and $769, respectively, resulting from incremental interest paid to the interest rate swap counterparty, none of which related to ineffectiveness. For the nine-month periods ended September 30, 2013, and 2012, BancShares recognized interest expense of $2,463 and $2,294, respectively, resulting from incremental interest paid to the interest rate swap counterparty, none of which related to ineffectiveness.

The estimated net amount in accumulated other comprehensive loss at September 30, 2013, that is expected to be reclassified into earnings within the next 12 months is a net after-tax loss of $1,927.

The following table discloses activity in accumulated other comprehensive income (loss) related to the interest rate swap during the nine-month periods ended September 30, 2013, and 2012.

	2013	2012
	(dollars in thousands)	
Accumulated other comprehensive loss resulting from interest rate swaps as of January 1	$(10,398)	$(10,714)
Other comprehensive income (loss) recognized during the nine-month period ended September 30	2,489	(456)
Accumulated other comprehensive loss resulting from interest rate swaps as of September 30	$(7,909)	$(11,170)

BancShares monitors the credit risk of the interest rate swap counterparty.

Note L

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss included the following as of September 30, 2013, and December 31, 2012:

	September 30, 2013			December 31, 2012		
	Accumulated other comprehensive loss	Deferred tax benefit	Accumulated other comprehensive loss, net of tax	Accumulated other comprehensive income (loss)	Deferred tax expense (benefit)	Accumulated other comprehensive income (loss), net of tax
	(dollars in thousands)					
Unrealized (losses) gains on investment securities available for sale	$(3,189)	$(1,365)	$(1,824)	$33,809	$13,292	$20,517
Funded status of defined benefit plan	(145,438)	(56,575)	(88,863)	(158,334)	(62,003)	(96,331)
Unrealized loss on cash flow hedge	(7,909)	(3,051)	(4,858)	(10,398)	(4,106)	(6,292)
Total	$(156,536)	$(60,991)	$(95,545)	$(134,923)	$(52,817)	$(82,106)

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The following table highlights changes in accumulated other comprehensive income by component for three and nine months ended September 30, 2013, and 2012:

	Gains and losses on cash flow hedges[1]	Unrealized gains and losses on available-for-sale securities[1]	Defined benefit pension items[1]	Total
	(dollars in thousands)			
Three months ended September 30, 2013				
Beginning balance	$(4,959)	$(4,117)	$(91,100)	$(100,176)
Other comprehensive income (loss) before reclassifications	(330)	2,293	—	1,963
Amounts reclassified from accumulated other comprehensive income	431	—	2,237	2,668
Net current period other comprehensive income (loss)	101	2,293		