

FULTON FINANCIAL CORP  
Form 10-Q  
August 09, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D. C. 20459

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2010,

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-10587

**FULTON FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

**PENNSYLVANIA**  
(State or other jurisdiction of

incorporation or organization)

**23-2195389**  
(I.R.S. Employer

Identification No.)

**One Penn Square, P.O. Box 4887, Lancaster, Pennsylvania**  
(Address of principal executive offices)

**17604**  
(Zip Code)

**(717) 291-2411**

(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 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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 in Rule 12b-2 of the Exchange Act.

Large accelerated filer

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

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

Common Stock, \$.50 Par Value 198,792,000 shares outstanding as of July 31, 2010.

**Table of Contents**

**FULTON FINANCIAL CORPORATION**

**FORM 10-Q FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010**

**INDEX**

| <b>Description</b>  | <b>Page</b> |
|---|-------------|
| <b>PART I. FINANCIAL INFORMATION</b>  |             |
| Item 1. <u>Financial Statements (Unaudited):</u>  |             |
| (a) <u>Consolidated Balance Sheets -<br/>June 30, 2010 and December 31, 2009</u>  | 3           |
| (b) <u>Consolidated Statements of Income -<br/>Three and Six Months ended June 30, 2010 and 2009</u>                              | 4           |
| (c) <u>Consolidated Statements of Shareholders' Equity and Comprehensive Income -<br/>Six months ended June 30, 2010 and 2009</u> | 5           |
| (d) <u>Consolidated Statements of Cash Flows -<br/>Six months ended June 30, 2010 and 2009</u>                                    | 6           |
| (e) <u>Notes to Consolidated Financial Statements</u>   | 7           |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                              | 29          |
| Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | 53          |
| Item 4. <u>Controls and Procedures</u>  | 59          |
| <b>PART II. OTHER INFORMATION</b>   |             |
| Item 1. <u>Legal Proceedings</u>  | 60          |
| Item 1A. <u>Risk Factors</u>  | 60          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 60          |
| Item 3. <u>Defaults Upon Senior Securities</u>  | 60          |
| Item 4. <u>Reserved</u>   | 60          |
| Item 5. <u>Other Information</u>  | 60          |
| Item 6. <u>Exhibits</u>   | 61          |
| <u>Signatures</u>   | 62          |
| <u>Exhibit Index</u>  | 63          |
| Certifications  | 64          |

**Table of Contents****Item 1. Financial Statements****FULTON FINANCIAL CORPORATION****CONSOLIDATED BALANCE SHEETS**

(in thousands, except per-share data)

|  | June 30<br>2010<br>(unaudited) | December 31<br>2009 |
|--|--------------------------------|---------------------|
| <b><u>ASSETS</u></b>   |                                |                     |
| Cash and due from banks  | \$ 268,371                     | \$ 284,508          |
| Interest-bearing deposits with other banks                                     | 433,687                        | 16,591              |
| Loans held for sale  | 93,504                         | 85,384              |
| Investment securities:   |                                |                     |
| Held to maturity (estimated fair value of \$8,145 in 2010 and \$8,797 in 2009) | 8,054                          | 8,700               |
| Available for sale   | 2,884,836                      | 3,258,386           |
| Loans, net of unearned income  | 11,943,384                     | 11,972,424          |
| Less: Allowance for loan losses  | (272,042)                      | (256,698)           |
| <i>Net Loans</i>   | <b>11,671,342</b>              | 11,715,726          |
| Premises and equipment   | 205,299                        | 204,203             |
| Accrued interest receivable  | 54,763                         | 58,515              |
| Goodwill   | 535,256                        | 534,862             |
| Intangible assets  | 15,046                         | 17,701              |
| Other assets   | 456,719                        | 451,059             |
| <i>Total Assets</i>  | <b>\$ 16,626,877</b>           | \$ 16,635,635       |
| <b><u>LIABILITIES</u></b>  |                                |                     |
| Deposits:  |                                |                     |
| Noninterest-bearing  | \$ 2,147,153                   | \$ 2,012,837        |
| Interest-bearing   | 10,198,319                     | 10,085,077          |
| <i>Total Deposits</i>  | <b>12,345,472</b>              | 12,097,914          |
| Short-term borrowings:   |                                |                     |
| Federal funds purchased  | 9,567                          | 378,067             |
| Other short-term borrowings  | 448,767                        | 490,873             |
| <i>Total Short-Term Borrowings</i>   | <b>458,334</b>                 | 868,940             |
| Accrued interest payable   | 43,292                         | 46,596              |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|  |                      |               |
|--|----------------------|---------------|
| Other liabilities  | <b>182,880</b>       | 144,930       |
| Federal Home Loan Bank advances and long-term debt   | <b>1,365,688</b>     | 1,540,773     |
| <b>Total Liabilities</b>   | <b>14,395,666</b>    | 14,699,153    |
| <b>SHAREHOLDERS' EQUITY</b>  |                      |               |
| Preferred stock, \$1,000 par value, 376,500 shares authorized and outstanding  | <b>371,009</b>       | 370,290       |
| Common stock, \$2.50 par value, 600 million shares authorized, 214.9 million shares issued in 2010 and 193.0 million shares issued in 2009 | <b>537,370</b>       | 482,491       |
| Additional paid-in capital   | <b>1,430,270</b>     | 1,257,730     |
| Retained earnings  | <b>109,287</b>       | 71,999        |
| Accumulated other comprehensive income:  |                      |               |
| Unrealized gains on investment securities not other-than-temporarily impaired  | <b>49,470</b>        | 24,975        |
| Unrealized non-credit related losses on other-than-temporarily impaired debt securities  | <b>(5,844)</b>       | (8,349)       |
| Unrecognized pension and postretirement plan costs   | <b>(5,905)</b>       | (5,942)       |
| Unamortized effective portions of losses on forward-starting interest rate swaps   | <b>(3,159)</b>       | (3,226)       |
| <i>Accumulated other comprehensive income</i>  | <b>34,562</b>        | 7,458         |
| Treasury stock, 16.5 million shares in 2010 and 16.6 million shares in 2009, at cost   | <b>(251,287)</b>     | (253,486)     |
| <b>Total Shareholders' Equity</b>  | <b>2,231,211</b>     | 1,936,482     |
| <b>Total Liabilities and Shareholders' Equity</b>  | <b>\$ 16,626,877</b> | \$ 16,635,635 |

See Notes to Consolidated Financial Statements

**Table of Contents****FULTON FINANCIAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

(in thousands, except per-share data)

|   | Three Months Ended<br>June 30 |            | Six Months Ended<br>June 30 |            |
|---|-------------------------------|------------|-----------------------------|------------|
|   | 2010                          | 2009       | 2010                        | 2009       |
| <b><u>INTEREST INCOME</u></b>   |                               |            |                             |            |
| Loans, including fees   | \$ 157,628                    | \$ 162,276 | \$ 315,162                  | \$ 324,590 |
| Investment securities:  |                               |            |                             |            |
| Taxable   | 25,146                        | 29,422     | 53,295                      | 56,272     |
| Tax-exempt  | 3,348                         | 4,176      | 6,943                       | 8,652      |
| Dividends   | 660                           | 555        | 1,389                       | 1,172      |
| Loans held for sale   | 667                           | 1,628      | 1,223                       | 2,889      |
| Other interest income   | 231                           | 40         | 256                         | 89         |
| <i>Total Interest Income</i>  | <b>187,680</b>                | 198,097    | <b>378,268</b>              | 393,664    |
| <b><u>INTEREST EXPENSE</u></b>  |                               |            |                             |            |
| Deposits  | 31,819                        | 48,007     | 65,557                      | 97,902     |
| Short-term borrowings   | 390                           | 921        | 939                         | 2,358      |
| Long-term debt  | 16,313                        | 21,225     | 34,105                      | 41,344     |
| <i>Total Interest Expense</i>   | <b>48,522</b>                 | 70,153     | <b>100,601</b>              | 141,604    |
| <i>Net Interest Income</i>  | <b>139,158</b>                | 127,944    | <b>277,667</b>              | 252,060    |
| Provision for loan losses   | 40,000                        | 50,000     | 80,000                      | 100,000    |
| <i>Net Interest Income After Provision for Loan Losses</i>                    | <b>99,158</b>                 | 77,944     | <b>197,667</b>              | 152,060    |
| <b><u>OTHER INCOME</u></b>  |                               |            |                             |            |
| Service charges on deposit accounts   | 15,482                        | 15,061     | 29,749                      | 29,955     |
| Other service charges and fees  | 10,522                        | 9,595      | 19,894                      | 17,949     |
| Investment management and trust services                                      | 8,655                         | 7,876      | 16,743                      | 15,779     |
| Gains on sales of mortgage loans  | 3,063                         | 7,395      | 6,427                       | 15,986     |
| Other   | 5,339                         | 5,373      | 9,938                       | 9,626      |
| Total other-than-temporary impairment losses                                  | (4,334)                       | (8,168)    | (9,585)                     | (14,024)   |
| Less: Portion of loss recognized in other comprehensive income (before taxes) | 836                           | 4,789      | 1,110                       | 7,605      |
| Net other-than-temporary impairment losses                                    | (3,498)                       | (3,379)    | (8,475)                     | (6,419)    |
| Net gains on sale of investment securities                                    | 4,402                         | 3,456      | 7,156                       | 9,415      |
| Net investment securities gains (losses)                                      | 904                           | 77         | (1,319)                     | 2,996      |
| <i>Total Other Income</i>   | <b>43,965</b>                 | 45,377     | <b>81,432</b>               | 92,291     |
| <b><u>OTHER EXPENSES</u></b>  |                               |            |                             |            |
| Salaries and employee benefits  | 54,654                        | 55,799     | 106,999                     | 111,103    |
| Net occupancy expense   | 10,519                        | 10,240     | 22,169                      | 21,263     |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|  |                  |          |                  |           |
|--|------------------|----------|------------------|-----------|
| FDIC insurance expense                             | 5,136            | 12,206   | 10,090           | 16,494    |
| Professional fees                                  | 3,035            | 2,088    | 5,581            | 4,316     |
| Equipment expense                                  | 2,663            | 3,300    | 5,754            | 6,379     |
| Data processing                                    | 2,364            | 2,907    | 4,988            | 5,979     |
| Marketing  | 2,271            | 1,724    | 4,101            | 4,295     |
| Telecommunications                                 | 2,086            | 2,181    | 4,356            | 4,344     |
| Intangible amortization                            | 1,341            | 1,434    | 2,655            | 2,897     |
| Operating risk loss                                | 640              | 144      | 1,151            | 6,345     |
| Other  | 15,449           | 15,783   | 31,543           | 30,763    |
| <i>Total Other Expenses</i>                        | <b>100,158</b>   | 107,806  | <b>199,387</b>   | 214,178   |
| <i>Income Before Income Taxes</i>                  | <b>42,965</b>    | 15,515   | <b>79,712</b>    | 30,173    |
| Income taxes                                       | 11,283           | 2,404    | 20,550           | 3,977     |
| <i>Net Income</i>                                  | <b>31,682</b>    | 13,111   | <b>59,162</b>    | 26,196    |
| Preferred stock dividends and discount accretion   | (5,066)          | (5,046)  | (10,131)         | (10,077)  |
| <i>Net Income Available to Common Shareholders</i> | <b>\$ 26,616</b> | \$ 8,065 | <b>\$ 49,031</b> | \$ 16,119 |
| <b>PER COMMON SHARE:</b>                           |                  |          |                  |           |
| Net income (basic)                                 | \$ 0.14          | \$ 0.05  | \$ 0.27          | \$ 0.09   |
| Net income (diluted)                               | 0.14             | 0.05     | 0.27             | 0.09      |
| Cash dividends                                     | 0.03             | 0.03     | 0.06             | 0.06      |

See Notes to Consolidated Financial Statements

**Table of Contents****FULTON FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (UNAUDITED)****SIX MONTHS ENDED JUNE 30, 2010 AND 2009**

|   | Preferred<br>Stock | Common Stock<br>Shares<br>Outstanding | Common Stock<br>Amount | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(in thousands) | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Total         |
|---|--------------------|---------------------------------------|------------------------|----------------------------------|--|---|-------------------|---------------|
| Balance at December 31, 2009  | \$ 370,290         | 176,364                               | \$ 482,491             | \$ 1,257,730                     | \$ 71,999                              | \$ 7,458  | \$ (253,486)      | \$ 1,936,482  |
| Comprehensive income:   |                    |                                       |                        |                                  |  |   |                   |               |
| Net income  |                    |                                       |                        |                                  | 59,162                                 |   |                   | 59,162        |
| Other comprehensive income  |                    |                                       |                        |                                  |  | 27,104  |                   | 27,104        |
| <i>Total comprehensive income</i>   |                    |                                       |                        |                                  |  |   |                   | <b>86,266</b> |
| Stock issued, including related tax benefits  |                    | 22,099                                | 54,879                 | 171,929                          |  |   | 2,199             | 229,007       |
| Stock-based compensation awards   |                    |                                       |                        | 611                              |  |   |                   | 611           |
| Preferred stock discount accretion  | 719                |                                       |                        |                                  | (719)                                  |   |                   | 0             |
| Preferred stock cash dividends  |                    |                                       |                        |                                  | (9,412)                                |   |                   | (9,412)       |
| Common stock cash dividends - \$0.06 per share  |                    |                                       |                        |                                  | (11,743)                               |   |                   | (11,743)      |
| Balance at June 30, 2010  | \$ 371,009         | 198,463                               | \$ 537,370             | \$ 1,430,270                     | \$ 109,287                             | \$ 34,562   | \$ (251,287)      | \$ 2,231,211  |
| Balance at December 31, 2008  | \$ 368,944         | 175,044                               | \$ 480,978             | \$ 1,260,947                     | \$ 31,075                              | \$ (17,907)   | \$ (264,390)      | \$ 1,859,647  |
| Cumulative effect of FSP FAS 115-2 and FAS 124-2 adoption (net of \$3.4 million tax effect) |                    |                                       |                        |                                  | 6,298                                  | (6,298)   |                   | 0             |
| Comprehensive income:   |                    |                                       |                        |                                  |  |   |                   |               |
| Net income  |                    |                                       |                        |                                  | 26,196                                 |   |                   | 26,196        |
| Other comprehensive loss  |                    |                                       |                        |                                  |  | (482)   |                   | (482)         |
| <i>Total comprehensive income</i>   |                    |                                       |                        |                                  |  |   |                   | <b>25,714</b> |
| Stock issued, including related tax benefits  |                    | 662                                   | 441                    | (3,147)                          |  |   | 7,412             | 4,706         |
| Stock-based compensation awards   |                    |                                       |                        | 827                              |  |   |                   | 827           |
| Preferred stock discount accretion  | 666                |                                       |                        |                                  | (666)                                  |   |                   | 0             |
| Preferred stock cash dividends  |                    |                                       |                        |                                  | (7,424)                                |   |                   | (7,424)       |
| Common stock cash dividends - \$0.06 per share  |                    |                                       |                        |                                  | (10,542)                               |   |                   | (10,542)      |
| Balance at June 30, 2009  | \$ 369,610         | 175,706                               | \$ 481,419             | \$ 1,258,627                     | \$ 44,937                              | \$ (24,687)   | \$ (256,978)      | \$ 1,872,928  |



*See Notes to Consolidated Financial Statements*

**Table of Contents****FULTON FINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(in thousands)

|   | Six Months Ended<br>June 30 |                  |
|---|-----------------------------|------------------|
|   | 2010                        | 2009             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                             |                  |
| Net Income  | \$ 59,162                   | \$ 26,196        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                             |                  |
| Provision for loan losses   | 80,000                      | 100,000          |
| Depreciation and amortization of premises and equipment                           | 10,261                      | 10,148           |
| Net amortization of investment securities premiums                                | 1,187                       | 1,081            |
| Investment securities (gains) losses  | 1,319                       | (2,996)          |
| Net increase in loans held for sale   | (8,120)                     | (146,599)        |
| Amortization of intangible assets   | 2,655                       | 2,897            |
| Stock-based compensation  | 611                         | 827              |
| Decrease in accrued interest receivable   | 3,752                       | 489              |
| Increase in other assets  | (256)                       | (24,941)         |
| (Decrease) increase in accrued interest payable                                   | (3,304)                     | 7,793            |
| Increase in other liabilities   | 3,236                       | 14,987           |
| <b>Total adjustments</b>  | <b>91,341</b>               | <b>(36,314)</b>  |
| <i>Net cash provided by (used in) operating activities</i>                        | <b>150,503</b>              | <b>(10,118)</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                             |                  |
| Proceeds from sales of securities available for sale                              | 276,691                     | 179,083          |
| Proceeds from maturities of securities held to maturity                           | 227                         | 3,101            |
| Proceeds from maturities of securities available for sale                         | 388,152                     | 401,328          |
| Purchase of securities held to maturity   | (122)                       | (3,056)          |
| Purchase of securities available for sale   | (245,875)                   | (1,349,391)      |
| Increase in short-term investments  | (417,096)                   | (4,180)          |
| Net (increase) decrease in loans  | (28,136)                    | 116,619          |
| Net purchases of premises and equipment   | (11,357)                    | (12,565)         |
| <i>Net cash used in investing activities</i>                                      | <b>(37,516)</b>             | <b>(669,061)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                             |                  |
| Net increase in demand and savings deposits                                       | 523,628                     | 718,931          |
| Net (decrease) increase in time deposits  | (276,070)                   | 445,450          |
| Additions to long-term debt   | 45,000                      | 0                |
| Repayments of long-term debt  | (220,085)                   | (36,830)         |
| Decrease in short-term borrowings   | (410,606)                   | (445,477)        |
| Dividends paid  | (19,998)                    | (38,947)         |
| Net proceeds from issuance of stock   | 229,007                     | 4,706            |
| <i>Net cash (used in) provided by financing activities</i>                        | <b>(129,124)</b>            | <b>647,833</b>   |

|   |                 |                 |
|---|-----------------|-----------------|
| <b>Net Decrease in Cash and Due From Banks</b>      | <b>(16,137)</b> | <b>(31,346)</b> |
| <b>Cash and Due From Banks at Beginning of Year</b> | <b>284,508</b>  | <b>331,164</b>  |

|   |                   |                   |
|---|-------------------|-------------------|
| <b>Cash and Due From Banks at End of Period</b> | <b>\$ 268,371</b> | <b>\$ 299,818</b> |
|---|-------------------|-------------------|

**Supplemental Disclosures of Cash Flow Information**

Cash paid during the period for:

|                     |                   |                   |
|---------------------|-------------------|-------------------|
| <b>Interest</b>     | <b>\$ 103,905</b> | <b>\$ 133,811</b> |
| <b>Income taxes</b> | <b>24,039</b>     | <b>9,014</b>      |

*See Notes to Consolidated Financial Statements*

**Table of Contents****FULTON FINANCIAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****NOTE A Basis of Presentation**

The accompanying unaudited consolidated financial statements of Fulton Financial Corporation (the Corporation) have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts of assets and liabilities as of the date of the financial statements as well as revenues and expenses during the period. Actual results could differ from those estimates. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six-month periods ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The Corporation evaluates subsequent events through the date of filing with the Securities and Exchange Commission (SEC).

**NOTE B Net Income Per Common Share and Other Comprehensive Income (Loss)**

The Corporation's basic net income per common share is calculated as net income available to common shareholders divided by the weighted average number of common shares outstanding. Net income available to common shareholders is calculated as net income less accrued dividends and discount accretion related to preferred stock.

For diluted net income per common share, net income available to common shareholders is divided by the weighted average number of common shares outstanding plus the incremental number of shares added as a result of converting common stock equivalents, calculated using the treasury stock method. The Corporation's common stock equivalents consist of outstanding stock options, restricted stock and common stock warrants.

A reconciliation of weighted average common shares outstanding used to calculate basic net income per common share and diluted net income per common share follows.

|  | Three months<br>ended<br>June 30 |         | Six months ended<br>June 30 |         |
|--|----------------------------------|---------|-----------------------------|---------|
|  | 2010                             | 2009    | 2010                        | 2009    |
|  | (in thousands)                   |         |                             |         |
| Weighted average shares outstanding (basic)  | <b>190,221</b>                   | 175,554 | <b>183,236</b>              | 175,435 |
| Effect of dilutive securities  | <b>606</b>                       | 170     | <b>557</b>                  | 202     |
| Weighted average shares outstanding (diluted)  | <b>190,827</b>                   | 175,724 | <b>183,793</b>              | 175,637 |
| Stock options and common stock warrants excluded from the diluted net income per share computation as their effect would have been anti-dilutive | <b>4,887</b>                     | 11,957  | <b>8,001</b>                | 11,887  |

**Table of Contents**

The following table presents the components of other comprehensive income (loss):

|   | Six months ended<br>June 30 |                 |
|---|-----------------------------|-----------------|
|   | 2010                        | 2009            |
|   | (in thousands)              |                 |
| Unrealized gain on securities (net of \$15.2 million and \$2.1 million tax effect in 2010 and 2009, respectively)   | \$ 28,277                   | \$ 3,929        |
| Non-credit related unrealized loss on other-than-temporarily impaired debt securities (net of \$1.2 million and \$2.7 million tax effect, respectively)       | (2,137)                     | (4,944)         |
| Unrealized gain on derivative financial instruments (net of \$36,000 tax effect in 2010 and 2009) (1)   | 68                          | 68              |
| Unrealized postretirement gains arising in 2009 due to plan amendment (net of \$1.2 million tax effect)   | 0                           | 2,125           |
| Amortization of unrecognized pension and postretirement costs (net of \$20,000 and \$155,000 tax effect in 2010 and 2009, respectively)                       | 38                          | 288             |
| Reclassification adjustment for securities losses (gains) included in net income (net of \$461,000 tax benefit in 2010 and \$1.0 million tax expense in 2009) | 858                         | (1,948)         |
| <b>Other comprehensive income (loss)</b>  | <b>\$ 27,104</b>            | <b>\$ (482)</b> |

- (1) Amounts represent the amortization of the effective portions of losses on forward-starting interest rate swaps, designated as cash flow hedges and entered into in prior years in connection with the issuance of fixed-rate debt. The total amount recorded as a reduction to accumulated other comprehensive income upon settlement of these derivatives is being amortized to interest expense over the life of the related securities using the effective interest method. The amount of net losses in accumulated other comprehensive income that will be reclassified into earnings during the next twelve months is expected to be approximately \$135,000.

**NOTE C Common Stock Offering**

On May 5, 2010, the Corporation issued 21.8 million shares of its common stock, in an underwritten public offering, for total proceeds of \$226.3 million, net of underwriting discounts and commissions. The Corporation intended to use the net proceeds from this offering, together with other funds, to redeem all of the Series A Preferred Stock that it issued to the U.S. Department of the Treasury (UST) upon receipt of all required regulatory approvals.

See Note M, Subsequent Event for details related to the redemption of the Series A Preferred Stock.

**Table of Contents****NOTE D Investment Securities**

The following tables present the amortized cost and estimated fair values of investment securities:

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|----------------------------|
|   | (in thousands)    |                              |                               |                            |
| <b><u>Held to Maturity at June 30, 2010</u></b> |                   |                              |                               |                            |
| U.S. Government sponsored agency securities     | \$ 6,294          | \$ 10                        | \$ 0                          | \$ 6,304                   |
| State and municipal securities                  | 503               | 0                            | 0                             | 503                        |
| Mortgage-backed securities                      | 1,257             | 81                           | 0                             | 1,338                      |
|   | \$ 8,054          | \$ 91                        | \$ 0                          | \$ 8,145                   |

**Available for Sale at June 30, 2010**

|   |              |            |             |              |
|---|--------------|------------|-------------|--------------|
| Equity securities                           | \$ 139,624   | \$ 3,290   | \$ (2,972)  | \$ 139,942   |
| U.S. Government securities                  | 1,324        | 0          | 0           | 1,324        |
| U.S. Government sponsored agency securities | 11,937       | 368        | (3)         | 12,302       |
| State and municipal securities              | 349,634      | 10,192     | (5)         | 359,821      |
| Corporate debt securities                   | 147,096      | 2,003      | (25,855)    | 123,244      |
| Collateralized mortgage obligations         | 1,003,164    | 36,087     | (526)       | 1,038,725    |
| Mortgage-backed securities                  | 882,175      | 50,764     | 0           | 932,939      |
| Auction rate securities                     | 282,765      | 2,109      | (8,335)     | 276,539      |
|   | \$ 2,817,719 | \$ 104,813 | \$ (37,696) | \$ 2,884,836 |

**Held to Maturity at December 31, 2009**

|   |          |       |      |          |
|---|----------|-------|------|----------|
| U.S. Government sponsored agency securities | \$ 6,713 | \$ 7  | \$ 0 | \$ 6,720 |
| State and municipal securities              | 503      | 0     | 0    | 503      |
| Mortgage-backed securities                  | 1,484    | 90    | 0    | 1,574    |
|   | \$ 8,700 | \$ 97 | \$ 0 | \$ 8,797 |

**Available for Sale at December 31, 2009**

|   |              |           |             |              |
|---|--------------|-----------|-------------|--------------|
| Equity securities                           | \$ 142,531   | \$ 2,758  | \$ (4,919)  | \$ 140,370   |
| U.S. Government securities                  | 1,325        | 0         | 0           | 1,325        |
| U.S. Government sponsored agency securities | 91,079       | 905       | (28)        | 91,956       |
| State and municipal securities              | 406,011      | 9,819     | (57)        | 415,773      |
| Corporate debt securities                   | 154,029      | 424       | (37,714)    | 116,739      |
| Collateralized mortgage obligations         | 1,102,169    | 25,631    | (4,804)     | 1,122,996    |
| Mortgage-backed securities                  | 1,043,518    | 36,948    | (442)       | 1,080,024    |
| Auction rate securities                     | 292,145      | 3,227     | (6,169)     | 289,203      |
|   | \$ 3,232,807 | \$ 79,712 | \$ (54,133) | \$ 3,258,386 |

**Table of Contents**

The amortized cost and estimated fair value of debt securities as of June 30, 2010, by contractual maturity, are shown in the following table. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                     | Held to Maturity |                      | Available for Sale |                      |
|-------------------------------------|------------------|----------------------|--------------------|----------------------|
|                                     | Amortized Cost   | Estimated Fair Value | Amortized Cost     | Estimated Fair Value |
| (in thousands)                      |                  |                      |                    |                      |
| Due in one year or less             | \$ 6,451         | \$ 6,461             | \$ 57,891          | \$ 58,559            |
| Due from one year to five years     | 346              | 346                  | 117,245            | 120,442              |
| Due from five years to ten years    | 0                | 0                    | 87,124             | 89,199               |
| Due after ten years                 | 0                | 0                    | 530,496            | 505,030              |
|                                     | 6,797            | 6,807                | 792,756            | 773,230              |
| Collateralized mortgage obligations | 0                | 0                    | 1,003,164          | 1,038,725            |
| Mortgage-backed securities          | 1,257            | 1,338                | 882,175            | 932,939              |
|                                     | \$ 8,054         | \$ 8,145             | \$ 2,678,095       | \$ 2,744,894         |

The following table presents information related to the Corporation's gains and losses on the sales of equity and debt securities, and losses recognized for the other-than-temporary impairment of investments:

|  | Gross Realized Gains | Gross Realized Losses | Other-than-temporary Impairment Losses | Net Gains (Losses) |
|--|----------------------|-----------------------|--|--------------------|
|  | (in thousands)       |                       |  |                    |
| <b>Three months ended June 30, 2010:</b> |                      |                       |  |                    |
| Equity securities                        | \$ 14                | \$ 0                  | \$ (509)                               | \$ (495)           |
| Debt securities                          | 4,401                | (13)                  | (2,989)                                | 1,399              |
| Total                                    | \$ 4,415             | \$ (13)               | \$ (3,498)                             | \$ 904             |
| <b>Three months ended June 30, 2009:</b> |                      |                       |  |                    |
| Equity securities                        | \$ 479               | \$ (65)               | \$ (728)                               | \$ (314)           |
| Debt securities                          | 3,042                |                       | (2,651)                                | 391                |
| Total                                    | \$ 3,521             | \$ (65)               | \$ (3,379)                             | \$ 77              |
| <b>Six months ended June 30, 2010:</b>   |                      |                       |  |                    |
| Equity securities                        | \$ 850               | \$ 0                  | \$ (1,333)                             | \$ (483)           |
| Debt securities                          | 6,324                | (18)                  | (7,142)                                | (836)              |
| Total                                    | \$ 7,174             | \$ (18)               | \$ (8,475)                             | \$ (1,319)         |
| <b>Six months ended June 30, 2009:</b>   |                      |                       |  |                    |
| Equity securities                        | \$ 591               | \$ (281)              | \$ (1,790)                             | \$ (1,480)         |
| Debt securities                          | 9,213                | (108)                 | (4,629)                                | 4,476              |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|       |          |          |            |          |
|-------|----------|----------|------------|----------|
| Total | \$ 9,804 | \$ (389) | \$ (6,419) | \$ 2,996 |
|-------|----------|----------|------------|----------|



**Table of Contents**

The following table presents a summary of other-than-temporary impairment charges recorded by the Corporation, by investment security type:

|  | Three months ended<br>June 30 |                 | Six months ended<br>June 30 |                 |
|--|-------------------------------|-----------------|-----------------------------|-----------------|
|  | 2010                          | 2009            | 2010                        | 2009            |
|  | (in thousands)                |                 |                             |                 |
| Financial institution stocks                         | \$ 509                        | \$ 728          | \$ 1,333                    | \$ 1,684        |
| Mutual funds   |                               |                 |                             | 106             |
| <b>Total equity securities charges</b>               | <b>509</b>                    | <b>728</b>      | <b>1,333</b>                | <b>1,790</b>    |
| Debt securities - pooled trust preferred securities  | <b>2,989</b>                  | 2,651           | <b>7,142</b>                | 4,629           |
| <b>Total other-than-temporary impairment charges</b> | <b>\$ 3,498</b>               | <b>\$ 3,379</b> | <b>\$ 8,475</b>             | <b>\$ 6,419</b> |

The \$509,000 and \$1.3 million of other-than-temporary impairment charges related to financial institution stocks during the three and six months ended June 30, 2010, respectively, were due to the increasing severity and duration of the declines in fair values of certain bank stock holdings, in conjunction with management's assessment of the near-term prospects of each specific issuer. As of June 30, 2010, after other-than-temporary impairment charges, the financial institutions stock portfolio had a cost basis of \$30.9 million and a fair value of \$31.1 million.

During the three and six months ended June 30, 2010, the Corporation recorded \$3.0 million and \$7.1 million, respectively, of other-than-temporary impairment losses for pooled trust preferred securities based on an expected cash flows model.

The following table presents a summary of the cumulative credit related other-than-temporary impairment charges, recognized as components of earnings, for securities still held by the Corporation:

|   | Three months ended<br>June 30 |                    | Six months ended<br>June 30 |                    |
|---|-------------------------------|--------------------|-----------------------------|--------------------|
|   | 2010                          | 2009               | 2010                        | 2009               |
|   | (in thousands)                |                    |                             |                    |
| Balance of cumulative credit losses on pooled trust preferred securities, beginning of period         | \$ (19,765)                   | \$ (8,120)         | \$ (15,612)                 | \$ (6,142)         |
| Additions for credit losses recorded which were not previously recognized as components of earnings   | (2,989)                       | (2,651)            | (7,142)                     | (4,629)            |
| <b>Ending balance of cumulative credit losses on pooled trust preferred securities, end of period</b> | <b>\$ (22,754)</b>            | <b>\$ (10,771)</b> | <b>\$ (22,754)</b>          | <b>\$ (10,771)</b> |

**Table of Contents**

The following table presents the gross unrealized losses and estimated fair values of investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2010:

|   | Less than 12 months  |                   | 12 months or longer  |                   | Total                |                   |
|---|----------------------|-------------------|----------------------|-------------------|----------------------|-------------------|
|   | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
|   |                      |                   | (in thousands)       |                   |                      |                   |
| U.S. Government sponsored agency securities | \$ 0                 | \$ 0              | \$ 403               | \$ (3)            | \$ 403               | \$ (3)            |
| State and municipal securities              | 0                    | 0                 | 400                  | (5)               | 400                  | (5)               |
| Corporate debt securities                   | 4,521                | (487)             | 76,275               | (25,368)          | 80,796               | (25,855)          |
| Collateralized mortgage obligations         | 21,847               | (526)             | 0                    | 0                 | 21,847               | (526)             |
| Auction rate securities                     | 20,511               | (947)             | 178,042              | (7,388)           | 198,553              | (8,335)           |
| Total debt securities                       | 46,879               | (1,960)           | 255,120              | (32,764)          | 301,999              | (34,724)          |
| Equity securities                           | 12,696               | (2,383)           | 1,755                | (589)             | 14,451               | (2,972)           |
|   | \$ 59,575            | \$ (4,343)        | \$ 256,875           | \$ (33,353)       | \$ 316,450           | \$ (37,696)       |

For its investments in equity securities, most notably its investments in stocks of financial institutions, management evaluates the near-term prospects of the issuers in relation to the severity and duration of the impairment. Based on that evaluation and the Corporation's ability and intent to hold those investments for a reasonable period of time sufficient for a recovery of fair value, the Corporation does not consider those investments with unrealized holding losses as of June 30, 2010 to be other-than-temporarily impaired.

The unrealized holding losses on investments in student loan auction rate securities, also known as auction rate certificates (ARCs), are attributable to liquidity issues resulting from the failure of periodic auctions. Fulton Financial Advisors (FFA), the investment management and trust division of the Corporation's Fulton Bank, N.A. subsidiary, held ARCs for some of its customers' accounts. FFA had previously sold ARCs to customers as short-term investments with fair values that could be derived based on periodic auctions under normal market conditions. During 2008 and 2009, the Corporation purchased ARCs from customers due to the failure of these periodic auctions, which made these previously short-term investments illiquid.

As of June 30, 2010, approximately \$231 million, or 84%, of the ARCs were rated above investment grade, with approximately \$175 million, or 63%, AAA rated by at least one ratings agency. Approximately \$29 million, or 11%, of ARCs were rated below investment grade by at least one ratings agency. Of this amount, approximately \$17 million, or 57%, of the student loans underlying the ARCs have principal payments which are guaranteed by the Federal government. In total, approximately \$245 million, or 88%, of the student loans underlying the ARCs have principal payments which are guaranteed by the Federal government. At June 30, 2010, all ARCs were current and making scheduled interest payments. Because the Corporation does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost, the Corporation does not consider these investments to be other-than-temporarily impaired as of June 30, 2010.

The Corporation's collateralized mortgage obligations have contractual terms that generally do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the decline in market value of these securities is attributable to changes in interest rates and not credit quality, and because the Corporation does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost, the Corporation does not consider those investments to be other-than-temporarily impaired as of June 30, 2010.

**Table of Contents**

The following table presents the amortized cost and estimated fair values of corporate debt securities:

|  | June 30, 2010     |                         | December 31, 2009 |                         |
|--|-------------------|-------------------------|-------------------|-------------------------|
|  | Amortized<br>cost | Estimated<br>fair value | Amortized<br>cost | Estimated<br>fair value |
| (in thousands)   |                   |                         |                   |                         |
| Single-issuer trust preferred securities                   | \$ 95,524         | \$ 81,012               | \$ 95,481         | \$ 75,811               |
| Subordinated debt  | 34,941            | 34,835                  | 34,886            | 32,722                  |
| Pooled trust preferred securities                          | 13,513            | 4,279                   | 20,435            | 4,979                   |
| Corporate debt securities issued by financial institutions | 143,978           | 120,126                 | 150,802           | 113,512                 |
| Other corporate debt securities                            | 3,118             | 3,118                   | 3,227             | 3,227                   |
| Available for sale corporate debt securities               | \$ 147,096        | \$ 123,244              | \$ 154,029        | \$ 116,739              |

The Corporation's investments in single-issuer trust preferred securities had an unrealized loss of \$14.5 million as of June 30, 2010. The Corporation did not record any other-than-temporary impairment charges for single-issuer trust preferred securities during the three and six months ended June 30, 2010 or 2009, respectively. The Corporation holds 11 single-issuer trust preferred securities that were rated below investment grade by at least one ratings agency, with an amortized cost of \$37.1 million and an estimated fair value of \$32.2 million as of June 30, 2010. The majority of the single-issuer trust preferred securities rated below investment grade were rated BB or Baa. Single-issuer trust preferred securities with an amortized cost of \$13.7 million and an estimated fair value of \$10.6 million as of June 30, 2010, were not rated by any ratings agency.

The Corporation holds ten pooled trust preferred securities. Nine of these securities, with an amortized cost of \$12.6 million and an estimated fair value of \$3.7 million, were rated below investment grade by at least one ratings agency, with ratings ranging from C to Ca. For each of the nine pooled trust preferred securities rated below investment grade, the class of securities held by the Corporation is below the most senior tranche, with the Corporation's interests being subordinate to other investors in the pool. The Corporation determines the fair value of pooled trust preferred securities based on quotes provided by third-party brokers.

The amortized cost of pooled trust preferred securities is the purchase price of the securities, net of cumulative credit related other-than-temporary impairment charges, determined using an expected cash flows model. The most significant input to the expected cash flows model was the expected payment deferral rate for each pooled trust preferred security. The Corporation evaluates the financial metrics, such as capital ratios and non-performing asset ratios, of the individual financial institution issuers that comprise each pooled trust preferred security to estimate its expected deferral rate. The actual weighted average cumulative defaults and deferrals as a percentage of original collateral were approximately 30% as of June 30, 2010. The discounted cash flow modeling for pooled trust preferred securities held by the Corporation as of June 30, 2010 assumed, on average, an additional 12% expected deferral rate.

Based on management's other-than-temporary impairment evaluations, and because the Corporation does not have the intent to sell and does not believe it will more likely than not be required to sell any of these securities prior to a recovery of their fair value to amortized cost, which may be maturity, corporate debt securities with a fair value of \$123.2 million were not considered to be other-than-temporarily impaired as of June 30, 2010.

**Table of Contents****NOTE E Loans and Allowance for Credit Losses**

The following table presents a summary of gross loans, by type:

|   | June 30,<br>2010     | December 31,<br>2009 |
|---|----------------------|----------------------|
|   | (in thousands)       |                      |
| Real-estate commercial mortgage                   | \$ 4,330,630         | \$ 4,292,300         |
| Commercial industrial, financial and agricultural | 3,664,603            | 3,699,198            |
| Real-estate home equity                           | 1,637,171            | 1,644,260            |
| Real-estate residential mortgage                  | 985,345              | 921,741              |
| Real-estate construction                          | 893,305              | 978,267              |
| Consumer  | 368,631              | 360,698              |
| Leasing and other                                 | 65,287               | 69,922               |
| Overdrafts  | 6,589                | 13,753               |
|   | <b>11,951,561</b>    | 11,980,139           |
| Unearned income                                   | (8,177)              | (7,715)              |
|   | <b>\$ 11,943,384</b> | \$ 11,972,424        |

The following table presents the components of the allowance for credit losses:

|  | June 30,<br>2010  | December 31,<br>2009 |
|--|-------------------|----------------------|
|  | (in thousands)    |                      |
| Allowance for loan losses                | \$ 272,042        | \$ 256,698           |
| Reserve for unfunded lending commitments | 8,335             | 855                  |
|  | <b>\$ 280,377</b> | \$ 257,553           |

The following table presents non-performing assets:

|  | June 30,<br>2010  | December 31,<br>2009 |
|--|-------------------|----------------------|
|  | (in thousands)    |                      |
| Non-accrual loans                            | \$ 263,227        | \$ 238,360           |
| Accruing loans greater than 90 days past due | 53,707            | 43,359               |
| Other real estate owned                      | 25,681            | 23,309               |
|  | <b>\$ 342,615</b> | \$ 305,028           |

Excluded from non-accrual loans above were \$57.7 million and \$41.1 million of loans whose terms were modified under a troubled debt restructuring and were current under their modified terms at June 30, 2010 and December 31, 2009, respectively. As of June 30, 2010, such troubled debt restructurings included \$32.0 million of residential mortgages, \$14.9 million of commercial mortgages, \$6.2 million of construction loans, \$4.3 million of commercial loans and \$266,000 of consumer loans. As of December 31, 2009, troubled debt restructurings included \$24.6 million of residential mortgages and \$16.5 million of commercial loans.

Impaired Loans

Impaired loans are loans for which the Corporation believes it is probable that all amounts will not be collected according to the contractual terms of the loan agreement.

The Corporation uses an internal risk rating process for its commercial loans, commercial mortgages and construction loans, consisting of nine general classifications ranging from excellent to loss . Risk ratings

## **Table of Contents**

are initially assigned to loans by the loan officers and are reviewed on a regular basis by loan review staff in the normal course of their loan review procedures. Risk rating allows management to identify riskier credits in a timely manner and to allocate resources to managing troubled accounts.

Larger balance commercial loans, commercial mortgages and construction loans with risk ratings of substandard or lower are individually reviewed for impairment under Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Section 310-10-35. A loan with a substandard credit rating is inadequately protected by the current net worth and paying capacity of the borrower or by the collateral pledged, if any. In addition, there exists a well-defined weakness or weaknesses that jeopardize the normal repayment of the debt. Collection of principal may be collateral-intensive. Substandard credits are usually characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. As of June 30, 2010 and December 31, 2009, respectively, the estimated fair value of substantially all of the Corporation's impaired loans were measured based on the estimated fair value of the loan's collateral. Collateral could be in the form of real estate in the case of impaired residential mortgages, commercial mortgages and construction loans, or business assets, such as accounts receivable or inventory, in the case of commercial and industrial loans. Commercial and industrial loans may also be secured by real property.

For loans secured by real estate, estimated fair values are determined primarily through certified third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including: the age of the most recent appraisal; the loan-to-value based on the original appraisal; the condition of the property; the Corporation's experience and knowledge of the market; the purpose of the loan; environmental factors; payment status; the strength of any guarantors; and the existence and age of other indications of value such as broker price opinions, among others. When the Corporation concludes that an updated appraisal is not necessary, estimated fair values for real estate collateral are based on one or more of the following: the original appraisal, a less formal broker price opinion, or a discounted cash flow analysis.

As of June 30, 2010 and December 31, 2009, respectively, approximately 25% and 40% of impaired loans secured by real estate with principal balances greater than \$1 million were measured at estimated fair value using certified third-party appraisals that had been updated within 12 months. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For loans secured by non-real estate collateral, such as accounts receivable or inventory, estimated fair values are determined based on borrower financial statements, inventory listings, accounts receivable agings or borrowing base certificates. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets. Liquidation or collection discounts are applied to these assets based upon existing loan evaluation policies.

**Table of Contents**

The recorded investment in loans that were considered to be impaired, as defined by FASB ASC Section 310-10-35, and the related allowance for loan losses is summarized as follows:

|                             | June 30, 2010       |                                 | December 31, 2009   |                                 |
|-----------------------------|---------------------|---------------------------------|---------------------|---------------------------------|
|                             | Recorded Investment | Related Allowance for Loan Loss | Recorded Investment | Related Allowance for Loan Loss |
|                             | (in thousands)      |                                 |                     |                                 |
| Accruing loans              | \$ 581,428          | \$ (85,757)                     | \$ 653,445          | \$ (100,734)                    |
| Non-accrual loans           | 243,043             | (44,014)                        | 116,425             | (26,247)                        |
| <b>Total impaired loans</b> | <b>\$ 824,471</b>   | <b>\$ (129,771)</b>             | <b>\$ 769,870</b>   | <b>\$ (126,981)</b>             |

As of June 30, 2010 and December 31, 2009 there were \$347.4 million and \$295.6 million, respectively, of impaired loans that did not have a related allowance for loan loss. The estimated fair values of the collateral for these loans exceeded the carrying amount of the loans and, accordingly, no specific valuation allowance was considered to be necessary.

The average recorded investment in impaired performing loans during the three and six months ended June 30, 2010 was approximately \$811.5 million and \$797.6 million, respectively. The average recorded investment in impaired non-accrual loans during the three and six months ended June 30, 2010 was approximately \$228.6 million and \$191.2 million, respectively. For 2009, the average recorded investment in impaired performing loans and impaired non-accrual loans was approximately \$492.6 million and \$115.1 million, respectively.

The Corporation generally applies all payments received on non-accruing impaired loans to principal until such time as the principal is paid off, after which time any additional payments received are recognized as interest income. For the three and six months ended June 30, 2010, the Corporation recognized interest income of approximately \$7.7 million and \$15.9 million on impaired loans, respectively. For 2009, the Corporation recognized interest income of approximately \$26.5 million on impaired loans.

**NOTE F Stock-Based Compensation**

The fair value of equity awards granted to employees is recognized as compensation expense over the period during which employees are required to provide service in exchange for such awards. The Corporation grants equity awards to employees, consisting of stock options and restricted stock, under its Stock Option and Compensation Plans (Option Plan). In addition, employees may purchase stock under the Corporation's Employee Stock Purchase Plan.

The following table presents compensation expense and the related tax benefits for equity awards recognized in the consolidated statements of income:

|   | Three months ended June 30 |               | Six months ended June 30 |               |
|---|----------------------------|---------------|--------------------------|---------------|
|   | 2010                       | 2009          | 2010                     | 2009          |
|   | (in thousands)             |               |                          |               |
| Stock-based compensation expense                    | \$ 318                     | \$ 447        | \$ 611                   | \$ 827        |
| Tax benefit   | (66)                       | (37)          | (128)                    | (75)          |
| <b>Stock-based compensation expense, net of tax</b> | <b>\$ 252</b>              | <b>\$ 410</b> | <b>\$ 483</b>            | <b>\$ 752</b> |

Under the Option Plan, stock options and restricted stock are granted to key employees. Restricted stock fair values and stock option exercise prices are equal to the average trading price of the Corporation's stock on the date of grant. Stock options carry terms of up to ten years. Restricted stock awards earn dividends during the vesting period, which are forfeitable if the awards do not vest. Stock options and restricted stock are typically granted annually on July 1st and become fully vested over or after a three-year





**Table of Contents**

vesting period. Certain events, as defined in the Option Plan, result in the acceleration of the vesting of both stock options and restricted stock. As of June 30, 2010, the Option Plan had 13.7 million shares reserved for future grants through 2013. On July 1, 2010, the Corporation granted approximately 578,000 stock options and 265,000 shares of restricted stock under its Option Plan.

In connection with the Corporation's participation in the U.S. Capital Purchase Program (CPP) component of the Troubled Asset Relief Program, the 2009 and 2010 restricted stock granted to certain key employees is subject to the requirements and limitations contained in the Emergency Economic Stabilization Act of 2008, as amended, and related regulations. Among other things, restricted stock grants to these key employees may not fully vest until the longer of: two years after the date of grant, or the Corporation's participation in the CPP ends. None of the key employees who received 2009 and 2010 restricted stock grants subject to the CPP vesting restrictions received 2009 or 2010 stock option awards.

**NOTE G Employee Benefit Plans**

The Corporation maintains a defined benefit pension plan (Pension Plan) for certain employees. Contributions to the Pension Plan are actuarially determined and funded annually, if required. Pension Plan assets are invested in: money markets; fixed income securities, including corporate bonds, U.S. Treasury securities and common trust funds; and equity securities, including common stocks and common stock mutual funds. In 2007, the Corporation curtailed the Pension Plan, discontinuing the accrual of benefits for all existing participants effective January 1, 2008.

The Corporation currently provides medical and life insurance benefits under a postretirement benefits plan (Postretirement Plan) to certain retired full-time employees who were employees of the Corporation prior to January 1, 1998. Certain full-time employees may become eligible for these discretionary benefits if they reach retirement age while working for the Corporation.

The Corporation recognizes the funded status of its Pension Plan and Postretirement Plan on the consolidated balance sheets and recognizes the changes in that funded status through other comprehensive income.

The net periodic benefit cost for the Corporation's Pension Plan and Postretirement Plan, as determined by consulting actuaries, consisted of the following components for the three and six months ended June 30:

|                                  | <b>Pension Plan</b>       |             |                         |             |
|----------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                  | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|                                  | <b>June 30</b>            |             | <b>June 30</b>          |             |
|                                  | <b>2010</b>               | <b>2009</b> | <b>2010</b>             | <b>2009</b> |
|                                  | <b>(in thousands)</b>     |             |                         |             |
| Service cost (1)                 | <b>\$ 26</b>              | \$ 37       | <b>\$ 52</b>            | \$ 74       |
| Interest cost                    | <b>842</b>                | 818         | <b>1,684</b>            | 1,637       |
| Expected return on plan assets   | <b>(802)</b>              | (722)       | <b>(1,604)</b>          | (1,444)     |
| Net amortization and deferral    | <b>119</b>                | 262         | <b>238</b>              | 524         |
| <b>Net periodic benefit cost</b> | <b>\$ 185</b>             | \$ 395      | <b>\$ 370</b>           | \$ 791      |

- (1) The Pension Plan service cost recorded for the three and six months ended June 30, 2010 and 2009, respectively, was related to administrative costs associated with the plan and not due to the accrual of additional participant benefits.

**Table of Contents**

|                                  | Postretirement Plan |               |                  |               |
|----------------------------------|---------------------|---------------|------------------|---------------|
|                                  | Three months ended  |               | Six months ended |               |
|                                  | June 30             |               | June 30          |               |
|                                  | 2010                | 2009          | 2010             | 2009          |
|                                  | (in thousands)      |               |                  |               |
| Service cost                     | \$ 48               | \$ 75         | \$ 98            | \$ 181        |
| Interest cost                    | 110                 | 151           | 220              | 317           |
| Expected return on plan assets   | (1)                 | (1)           | (2)              | (2)           |
| Net accretion and deferral       | (91)                | (81)          | (182)            | (81)          |
| <b>Net periodic benefit cost</b> | <b>\$ 66</b>        | <b>\$ 144</b> | <b>\$ 134</b>    | <b>\$ 415</b> |

**NOTE H Derivative Financial Instruments**

In connection with its mortgage banking activities, the Corporation enters into commitments to originate fixed-rate residential mortgage loans for customers, also referred to as interest rate locks. In addition, the Corporation enters into forward commitments for the future sale or purchase of mortgage-backed securities to or from third-party investors to hedge the effect of changes in interest rates on the values of the interest rate locks. Forward sales commitments may also be in the form of commitments to sell individual mortgage loans at a fixed price on a future date. Both the interest rate locks and the forward commitments are accounted for as derivatives and carried at fair value, determined as the amount that would be necessary to settle each derivative financial instrument at the end of the period. Gross derivative assets and liabilities are recorded within other assets and other liabilities on the consolidated balance sheets, with changes in fair value during the period recorded within gains on sales of mortgage loans on the consolidated statements of income.

The following table presents a summary of the notional amounts and fair values of derivative financial instruments recorded on the consolidated balance sheets, none of which have been designated as hedging instruments:

|   | June 30, 2010      |                      | December 31, 2009  |                      |
|---|--------------------|----------------------|--------------------|----------------------|
|   | Notional<br>Amount | Asset<br>(Liability) | Notional<br>Amount | Asset<br>(Liability) |
|   |                    | Fair Value           |                    | Fair Value           |
|   | (in thousands)     |                      |                    |                      |
| <b><u>Interest Rate Locks with Customers:</u></b> |                    |                      |                    |                      |
| Positive fair values                              | \$ 187,963         | \$ 2,227             | \$ 58,165          | \$ 534               |
| Negative fair values                              | 38,262             | (117)                | 106,921            | (945)                |
| Net Interest Rate Locks with Customers            |                    | 2,110                |                    | (411)                |
| <b><u>Forward Commitments:</u></b>                |                    |                      |                    |                      |
| Positive fair values                              | 98,110             | 290                  | 232,310            | 1,819                |
| Negative fair values                              | 280,014            | (5,182)              | 59,432             | (535)                |
| Net Forward Commitments                           |                    | (4,892)              |                    | 1,284                |
|   |                    | <b>\$ (2,782)</b>    |                    | <b>\$ 873</b>        |

The following table presents a summary of the fair value gains and losses on derivative financial instruments for the three and six months ended June 30:

|  | Three months ended June 30 |            | Six months ended June 30, |          |
|--|----------------------------|------------|---------------------------|----------|
|  | 2010                       | 2009       | 2010                      | 2009     |
|  | (in thousands)             |            |                           |          |
| Interest rate locks with customers (1) | \$ 1,499                   | \$ (4,674) | \$ 2,521                  | \$ (711) |
| Forward commitments (1)                | (4,878)                    | 4,591      | (6,176)                   | 2,463    |

|                     |                   |         |                   |          |
|---------------------|-------------------|---------|-------------------|----------|
| Interest rate swaps | <b>0</b>          | 0       | <b>0</b>          | (18)     |
|                     | <b>\$ (3,379)</b> | \$ (83) | <b>\$ (3,655)</b> | \$ 1,734 |

- (1) Fair value gains and losses recorded as components of gains on sales of mortgage loans on the consolidated statements of income.

**Table of Contents****NOTE I Commitments and Contingencies****Commitments**

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. Those financial instruments include commitments to extend credit and letters of credit, which involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized on the Corporation's consolidated balance sheets. Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the outstanding amount of those instruments.

The outstanding amounts of commitments to extend credit and letters of credit were as follows:

|                              | June 30,<br>2010 | December<br>31,<br>2009 |
|------------------------------|------------------|-------------------------|
|                              | (in thousands)   |                         |
| Commitments to extend credit | \$ 3,880,690     | \$ 4,479,546            |
| Standby letters of credit    | 516,069          | 551,064                 |
| Commercial letters of credit | 36,144           | 37,662                  |

The Corporation records a reserve for unfunded lending commitments, which represents management's estimate of losses associated with unused commitments to extend credit on loans impaired under FASB ASC Section 310-10-35. See Note E, *Loans and Allowance for Credit Losses* for additional details.

**Residential Lending**

Residential mortgages are originated and sold by the Corporation through Fulton Mortgage Company, which operates as a division of each of the Corporation's subsidiary banks. The loans originated and sold are predominantly prime loans that conform to published standards of government sponsored agencies. Prior to 2008, the Corporation's former Resource Bank subsidiary operated a national wholesale mortgage lending operation which originated and sold significant volumes of non-prime loans from the time the Corporation acquired Resource Bank in 2004 through 2007.

Beginning in 2007, Resource Bank experienced an increase in requests from secondary market purchasers to repurchase non-prime loans sold to those investors. These repurchase requests resulted in the Corporation recording charges representing the write-downs that were necessary to reduce the loan balances to their estimated net realizable values, based on valuations of the underlying properties, as adjusted for market factors and other considerations. Many of the loans the Corporation repurchased were delinquent and were settled through foreclosure and sale of the underlying collateral.

**Table of Contents**

The following table presents a summary of the approximate principal balances and related reserves/write-downs recognized on the Corporation's consolidated balance sheets, by general category:

|  | June 30, 2010 |  | December 31, 2009 |                          |
|--|---------------|--|-------------------|--------------------------|
|  | Principal     | Reserves/<br>Write-downs<br>(in thousands) | Principal         | Reserves/<br>Write-downs |
| Outstanding repurchase requests (1) (2)  | \$ 5,730      | \$ (2,970)                                 | \$ 6,130          | \$ (3,750)               |
| No repurchase request received sold loans with identified potential misrepresentations of borrower information (1) (2) | 3,260         | (820)                                      | 3,650             | (1,260)                  |
| Repurchased loans (3)  | 4,300         | (440)                                      | 5,580             | (870)                    |
| Foreclosed real estate (OREO) (4)  | 5,770         | 0  | 9,140             | 0                        |
| <b>Total reserves/write-downs</b>  |               | <b>\$ (4,230)</b>                          |                   | <b>\$ (5,880)</b>        |

- (1) Principal balances had not been repurchased and, therefore, are not included on the consolidated balance sheets as of June 30, 2010 and December 31, 2009.
- (2) Reserve balance included as a component of other liabilities on the consolidated balance sheets as of June 30, 2010 and December 31, 2009.
- (3) Principal balances, net of write-downs, are included as a component of loans, net of unearned income on the consolidated balance sheets as of June 30, 2010 and December 31, 2009.
- (4) OREO is written down to its estimated fair value upon transfer from loans receivable.

Management believes that the reserves recorded as of June 30, 2010 are adequate for the known potential repurchases. However, continued declines in collateral values or the identification of additional loans to be repurchased could necessitate additional reserves in the future.

**NOTE J Fair Value Option**

FASB ASC Subtopic 825-10 permits entities to measure many financial instruments and certain other items at fair value and requires certain disclosures for amounts for which the fair value option is applied.

The Corporation elected to measure mortgage loans held for sale at fair value to more accurately reflect the financial performance of its mortgage banking activities in its consolidated financial statements. Derivative financial instruments related to these activities are also recorded at fair value, as noted within Note H, Derivative Financial Instruments. The Corporation determines fair value for its mortgage loans held for sale based on the price that secondary market investors would pay for loans with similar characteristics, including interest rate and term, as of the date fair value is measured. Changes in fair value during the period are recorded as components of gains on sales of mortgage loans on the consolidated statements of income. Interest income earned on mortgage loans held for sale is recorded within interest income on the consolidated statements of income.

The following table presents a summary of the Corporation's fair value elections for mortgage loans held for sale:

|                              | June 30,<br>2010 | December<br>31,<br>2009 |
|------------------------------|------------------|-------------------------|
|                              | (in thousands)   |                         |
| Cost (1)                     | \$ 90,361        | \$ 78,819               |
| Fair value                   | 93,504           | 79,577                  |
| <b>Fair value adjustment</b> | <b>\$ 3,143</b>  | <b>\$ 758</b>           |

- (1) Cost basis of mortgage loans held for sale represents the unpaid principal balance.

**Table of Contents**

**NOTE K Fair Value Measurements**

***FASB ASC Topic 820 Fair Value Measurements***

FASB ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into the following three categories (from highest to lowest priority):

Level 1 Inputs that represent quoted prices for identical instruments in active markets.

Level 2 Inputs that represent quoted prices for similar instruments in active markets, or quoted prices for identical instruments in non-active markets. Also includes valuation techniques whose inputs are derived principally from observable market data other than quoted prices, such as interest rates or other market-corroborated means.

Level 3 Inputs that are largely unobservable, as little or no market data exists for the instrument being valued.

The Corporation has categorized all assets and liabilities measured at fair value on both a recurring and nonrecurring basis into the above three levels.

In January 2010, the FASB issued ASC Update No. 2010-06, *Improving Disclosures About Fair Value Measurements* (ASC Update 2010-06). ASC Update 2010-06 requires companies to disclose, and provide the reasons for, all transfers of assets and liabilities between the Level 1 and 2 fair value categories. ASC Update 2010-06 also clarifies that companies should disclose fair value measurement disclosures for classes of assets and liabilities which are subsets of line items within the balance sheet, if necessary. In addition, ASC Update 2010-06 provides additional clarification related to disclosures about the fair value techniques and inputs for assets and liabilities classified within Level 2 or 3 categories. The disclosure requirements prescribed by ASC Update No. 2010-06 were effective for the Corporation on March 31, 2010. The Corporation did not record any transfers of assets or liabilities between the Level 1 and Level 2 fair value categories during the three or six months ended June 30, 2010.

ASC Update 2010-06 also requires companies to reconcile changes in Level 3 assets and liabilities by separately providing information about Level 3 purchases, sales, issuances and settlements on a gross basis. This provision of ASC Update 2010-06 is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, or March 31, 2011 for the Corporation. The adoption of this provision of ASC Update 2010-06 is not expected to materially impact the Corporation's fair value measurement disclosures.

**Table of Contents**Items Measured at Fair Value on a Recurring Basis

The Corporation's assets and liabilities measured at fair value on a recurring basis and reported on the consolidated balance sheets were as follows:

|   | June 30, 2010     |                     |                   | Total               |
|---|-------------------|---------------------|-------------------|---------------------|
|   | Level 1           | Level 2             | Level 3           |                     |
|   | (in thousands)    |                     |                   |                     |
| Mortgage loans held for sale                | \$ 0              | \$ 93,504           | \$ 0              | \$ 93,504           |
| Available for sale investment securities:   |                   |                     |                   |                     |
| Equity securities                           | 39,659            | 0                   | 0                 | 39,659              |
| U.S. Government securities                  | 0                 | 1,324               | 0                 | 1,324               |
| U.S. Government sponsored agency securities | 0                 | 12,302              | 0                 | 12,302              |
| State and municipal securities              | 0                 | 359,821             | 0                 | 359,821             |
| Corporate debt securities                   | 0                 | 110,880             | 12,364            | 123,244             |
| Collateralized mortgage obligations         | 0                 | 1,038,725           | 0                 | 1,038,725           |
| Mortgage-backed securities                  | 0                 | 932,939             | 0                 | 932,939             |
| Auction rate securities                     | 0                 | 0                   | 276,539           | 276,539             |
| <b>Total available for sale investments</b> | <b>39,659</b>     | <b>2,455,991</b>    | <b>288,903</b>    | <b>2,784,553</b>    |
| Other financial assets                      | 13,386            | 2,517               | 0                 | 15,903              |
| <b>Total assets</b>                         | <b>\$ 53,045</b>  | <b>\$ 2,552,012</b> | <b>\$ 288,903</b> | <b>\$ 2,893,960</b> |
| <br>  |                   |                     |                   |                     |
| Other financial liabilities                 | \$ 13,386         | \$ 5,299            | \$ 0              | \$ 18,685           |
|   |                   |                     |                   |                     |
|   | December 31, 2009 |                     |                   |                     |
| Mortgage loans held for sale                | \$ 0              | \$ 79,577           | \$ 0              | \$ 79,577           |
| Available for sale investment securities:   |                   |                     |                   |                     |
| Equity securities                           | 41,256            | 0                   | 0                 | 41,256              |
| U.S. Government securities                  | 0                 | 1,325               | 0                 | 1,325               |
| U.S. Government sponsored agency securities | 0                 | 91,956              | 0                 | 91,956              |
| State and municipal securities              | 0                 | 415,773             | 0                 | 415,773             |
| Corporate debt securities                   | 0                 | 104,779             | 11,960            | 116,739             |
| Collateralized mortgage obligations         | 0                 | 1,122,996           | 0                 | 1,122,996           |
| Mortgage-backed securities                  | 0                 | 1,080,024           | 0                 | 1,080,024           |
| Auction rate securities                     | 0                 | 0                   | 289,203           | 289,203             |
| <b>Total available for sale investments</b> | <b>41,256</b>     | <b>2,816,853</b>    | <b>301,163</b>    | <b>3,159,272</b>    |
| Other financial assets                      | 13,882            | 2,353               | 0                 | 16,235              |
| <b>Total assets</b>                         | <b>\$ 55,138</b>  | <b>\$ 2,898,783</b> | <b>\$ 301,163</b> | <b>\$ 3,255,084</b> |
| <br>  |                   |                     |                   |                     |
| Other financial liabilities                 | \$ 13,882         | \$ 1,480            | \$ 0              | \$ 15,362           |

The valuation techniques used to measure fair value for the items in the tables above are as follows:



## Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

Mortgage loans held for sale This category consists of mortgage loans held for sale that the Corporation has elected to measure at fair value. Fair values as of June 30, 2010 and December 31, 2009 were measured as the price that secondary market investors were offering for loans with similar characteristics.

**Table of Contents**

Available for sale investment securities Included within this asset category are both equity and debt securities:

Equity securities Equity securities consist of stocks of financial institutions (\$31.1 million at June 30, 2010 and \$32.3 million at December 31, 2009) and mutual fund and other equity investments (\$8.5 million at June 30, 2010 and \$9.0 million at December 31, 2009). These Level 1 investments are measured at fair value based on quoted prices for identical securities in active markets. Restricted equity securities issued by the Federal Home Loan Bank (FHLB) and Federal Reserve Bank (\$100.3 million at June 30, 2010 and \$99.1 million at December 31, 2009) have been excluded from the above table.

U.S. Government securities/U.S. Government sponsored agency securities/State and municipal securities/Collateralized mortgage obligations/Mortgage-backed securities These debt securities are classified as Level 2 investments. Fair values are determined by a third-party pricing service using both quoted prices for similar assets, when available, and model-based valuation techniques that derive fair value based on market-corroborated data, such as instruments with similar prepayment speeds and default interest rates. The pricing data and market quotes the Corporation obtains from outside sources are reviewed internally for reasonableness.

Corporate debt securities This category consists of subordinated debt issued by financial institutions (\$34.8 million at June 30, 2010 and \$32.7 million at December 31, 2009), single-issuer trust preferred securities issued by financial institutions (\$81.0 million at June 30, 2010 and \$75.8 million at December 31, 2009), pooled trust preferred securities issued by financial institutions (\$4.3 million at June 30, 2010 and \$5.0 million at December 31, 2009) and other corporate debt issued by non-financial institutions (\$3.1 million at June 30, 2010 and \$3.2 million at December 31, 2009).

Classified as Level 2 investments are the subordinated debt, other corporate debt issued by non-financial institutions and \$72.9 million and \$68.8 million of single-issuer trust preferred securities held at June 30, 2010 and December 31, 2009, respectively. These corporate debt securities are measured at fair value by a third-party pricing service using both quoted prices for similar assets, when available, and model-based valuation techniques that derive fair value based on market-corroborated data, such as instruments with similar prepayment speeds and default interest rates. As with the debt securities described above, an active market presently exists for securities similar to these corporate debt security holdings.

Classified as Level 3 assets are the Corporation's investments in pooled trust preferred securities and certain single-issuer trust preferred securities (\$8.1 million at June 30, 2010 and \$7.0 million at December 31, 2009). The fair values of these securities were determined based on quotes provided by third-party brokers who determined fair values based predominantly on internal valuation models which were not indicative prices or binding offers. The Corporation's third-party pricing service cannot derive fair values for these securities primarily due to inactive market transactions for similar investments.

Auction rate securities Due to their illiquidity, ARCs are classified as Level 3 investments and are valued through the use of an expected cash flows model prepared by a third-party valuation expert. The assumptions used in preparing the expected cash flows model include estimates for coupon rates, time to maturity and market rates of return. The expected cash flows model the Corporation obtains from outside sources is reviewed internally for reasonableness.

**Table of Contents**

**Other financial assets** Included within this asset category are: Level 1 assets, consisting of mutual funds that are held in trust for employee deferred compensation plans and measured at fair value based on quoted prices for identical securities in active markets; and Level 2 assets representing the fair value of mortgage banking derivatives in the form of interest rate locks and forward commitments with secondary market investors. The fair value of the Corporation's interest rate locks and forward commitments are determined as the amount that would be required to settle each derivative financial instrument at the balance sheet date. See Note H, Derivative Financial Instruments, for additional information.

**Other financial liabilities** Included within this category are: Level 1 employee deferred compensation liabilities which represent amounts due to employees under the deferred compensation plans described under the heading Other financial assets above and Level 2 mortgage banking derivatives, described under the heading Other financial assets above.

The following tables present the changes in the Corporation's assets and liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) for the three and six months ended June 30, 2010 and 2009:

|   | Three months ended June 30, 2010           |   |                    | Other<br>Financial<br>Liabilities<br>ARC Financial<br>Guarantee (1) |
|---|--|---|--------------------|---|
|   | Available for Sale Investment Securities   |   |                    |   |
|   | Pooled<br>Trust<br>Preferred<br>Securities | Single-issuer<br>Trust<br>Preferred<br>Securities | ARC<br>Investments |   |
|   | (in thousands)                             |   |                    |   |
| Balance, March 31, 2010                       | \$ 4,900                                   | \$ 7,136  | \$ 288,133         | \$ 0  |
| Realized adjustment to fair value (2)         | (2,989)                                    | 0   | 0                  | 0   |
| Unrealized adjustment to fair value (3)       | 2,374                                      | 299   | (2,376)            | 0   |
| Sales   | 0  | 0   | (5,033)            | 0   |
| Redemptions                                   | 0  | 0   | (5,281)            | 0   |
| Transfers to Level 3 from Level 2             | 0  | 650   | 0                  | 0   |
| (Premium amortization)/Discount accretion (4) | (6)  | 0   | 1,096              | 0   |
| Balance, June 30, 2010                        | \$ 4,279                                   | \$ 8,085  | \$ 276,539         | \$ 0  |
|   | Three months ended June 30, 2009           |   |                    |   |
| Balance, March 31, 2009                       | \$ 10,692                                  | \$ 6,294  | \$ 203,578         | \$ (13,934)   |
| Purchases (1)                                 | 0  | 0   | 79,741             | 14,013  |
| Realized adjustment to fair value (2)         | (2,651)                                    | 0   | 0                  | (79)  |
| Unrealized adjustment to fair value (3)       | (3,129)                                    | 712   | 5,812              | 0   |
| Redemptions                                   | 0  | 0   | (628)              | 0   |
| Discount accretion (4)                        | 3  | 0   | 1,072              | 0   |
| Balance, June 30, 2009                        | \$ 4,915                                   | \$ 7,006  | \$ 289,575         | \$ 0  |

**Table of Contents**

|   | Six months ended June 30, 2010           |               |                |   |
|---|--|---------------|----------------|---|
|   | Available for Sale Investment Securities |               |                | Other<br>Financial<br>Liabilities<br>ARC Financial<br>Guarantee (1) |
|   | Pooled                                   | Single-issuer | ARC            |   |
|   | Trust                                    | Trust         |                |   |
| Preferred<br>Securities                       | Preferred<br>Securities                  | Investments   |                |   |
|   | (in thousands)                           |               |                |   |
| Balance, December 31, 2009                    | \$ 4,979                                 | \$ 6,981      | \$ 289,203     | \$ 0  |
| Realized adjustment to fair value (2)         | (7,142)                                  | 0             | 0              | 0   |
| Unrealized adjustment to fair value (3)       | 6,453                                    | 453           | (3,642)        | 0   |
| Sales   | 0  | 0             | (5,033)        | 0   |
| Redemptions                                   | 0  | 0             | (6,382)        | 0   |
| Transfers to Level 3 from Level 2             | 0  | 650           | 0              | 0   |
| (Premium amortization)/Discount accretion (4) | (11)                                     | 1             | 2,393          | 0   |
| <br>Balance, June 30, 2010                    | <br>\$ 4,279                             | <br>\$ 8,085  | <br>\$ 276,539 | <br>\$ 0  |
|   | Six months ended June 30, 2009           |               |                |   |
| Balance, December 31, 2008                    | \$ 15,381                                | \$ 7,544      | \$ 195,900     | \$ (8,653)  |
| Purchases (1)                                 | 0  | 0             | 89,383         | 14,890  |
| Realized adjustment to fair value (2)         | (4,629)                                  | 0             | 0              | (6,237)   |
| Unrealized adjustment to fair value (3)       | (5,840)                                  | (540)         | 3,147          | 0   |
| Redemptions                                   | 0  | 0             | (717)          | 0   |
| Discount accretion (4)                        | 3  | 2             | 1,862          | 0   |
| <br>Balance, June 30, 2009                    | <br>\$ 4,915                             | <br>\$ 7,006  | <br>\$ 289,575 | <br>\$ 0  |

- (1) In 2008, the Corporation offered to purchase illiquid ARCs from customers. The estimated fair value of the guarantee was determined based on the difference between the fair value of the underlying ARCs and their estimated purchase price. During 2009, the Corporation completed the repurchase of all eligible ARCs and, as of December 31, 2009, there were no longer any ARCs still held by customers that the Corporation had agreed to purchase.
- (2) For pooled trust preferred securities, realized adjustments to fair value represent credit related other-than-temporary impairment charges that were recorded as a reduction to investment securities gains on the consolidated statements of income.
- (3) Pooled trust preferred securities, single-issuer trust preferred securities, and ARCs are classified as available for sale investment securities; as such, the unrealized adjustment to fair value was recorded as an unrealized holding gain (loss) and included as a component of available for sale investment securities on the consolidated balance sheet.
- (4) Included as a component of net interest income on the consolidated statements of income.

**Items Measured at Fair Value on a Nonrecurring Basis**

Certain financial assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value measurement in certain circumstances, such as upon their acquisition or when there is evidence of impairment.

The Corporation's assets measured at fair value on a nonrecurring basis and reported on the Corporation's consolidated balance sheets were as follows:

|           | June 30, 2010  |         |            | Total      |
|-----------|----------------|---------|------------|------------|
|           | Level 1        | Level 2 | Level 3    |            |
|           | (in thousands) |         |            |            |
| Net loans | \$ 0           | \$ 344  | \$ 694,700 | \$ 695,044 |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|                                  |      |        |            |            |
|----------------------------------|------|--------|------------|------------|
| Other financial assets           | 0    | 0      | 50,007     | 50,007     |
| Total assets                     | \$ 0 | \$ 344 | \$ 744,707 | \$ 745,051 |
| Reserve for unfunded commitments | \$ 0 | \$ 0   | \$ 8,335   | \$ 8,335   |

**Table of Contents**

|                                  | December 31, 2009 |          |                           | Total      |
|----------------------------------|-------------------|----------|---------------------------|------------|
|                                  | Level 1           | Level 2  | Level 3<br>(in thousands) |            |
| Loans held for sale              | \$ 0              | \$ 5,807 | \$ 0                      | \$ 5,807   |
| Net loans                        | 0                 | 0        | 642,889                   | 642,889    |
| Other financial assets           | 0                 | 0        | 45,807                    | 45,807     |
| Total assets                     | \$ 0              | \$ 5,807 | \$ 688,696                | \$ 694,503 |
| Reserve for unfunded commitments | \$ 0              | \$ 0     | \$ 855                    | \$ 855     |

The valuation techniques used to measure fair value for the items in the tables above are as follows:

**Loans held for sale** This category consists of floating rate residential mortgage construction loans which are measured at the lower of aggregate cost or fair value. Fair value was measured as the prices that secondary market investors were offering for loans with similar characteristics.

**Net loans** This category consists of residential mortgage loans and home equity loans that were previously sold and repurchased from secondary market investors during the first half of 2010 and have been classified as Level 2 assets. Upon repurchase, these loans were written down to the appraised value of their underlying collateral, less estimated selling costs. See Note I, Commitments and Contingencies for additional information.

This category also consists of loans that were considered to be impaired under FASB ASC Section 310-10-35 and have been classified as Level 3 assets. Impaired loans are generally measured at fair value of their underlying collateral. An allowance for loan losses is allocated to an impaired loan if its carrying value exceeds its estimated fair value. The amount shown is the balance of impaired loans, net of the related allowance for loan losses. See Note E, Loans and Allowance for Credit Losses for additional details.

**Other financial assets** This category includes other real estate owned (OREO) (\$25.7 million at June 30, 2010 and \$23.3 million at December 31, 2009) and mortgage servicing rights (MSRs) (\$24.3 million at June 30, 2010 and \$22.5 million at December 31, 2009), both classified as Level 3 assets.

Fair values for OREO were based on estimated selling prices less estimated selling costs for similar assets in active markets.

MSRs are initially recorded at fair value upon the sale of residential mortgage loans, which the Corporation continues to service, to secondary market investors. MSRs are amortized as a reduction to servicing income over the estimated lives of the underlying loans. MSRs are evaluated quarterly for impairment, by comparing the carrying amount to estimated fair value. Fair value is determined at the end of each quarter through a discounted cash flows valuation. Significant inputs to the valuation include expected net servicing income, the discount rate and the expected life of the underlying loans.

**Reserve for unfunded commitments** This liability represents the reserve associated with unused commitments to extend credit on loans which are impaired under FASB ASC Section 310-10-35, and included as Level 3 assets under the heading, Net loans above. The fair value of the reserve for unfunded commitments is determined based on the results of the measurement of impaired loans. As such, this liability is classified as a Level 3 item. See Note E, Loans and Allowance for Credit Losses for additional details.

**Table of Contents**FASB ASC Section 825-10-50 Fair Values of Financial Instruments

The following table details the book values and estimated fair values of the Corporation's financial instruments as of June 30, 2010 and December 31, 2009. A general description of the methods and assumptions used to estimate such fair values is also provided.

Fair values of financial instruments are significantly affected by assumptions used, principally the timing of future cash flows and discount rates. Because assumptions are inherently subjective in nature, the estimated fair values cannot be substantiated by comparison to independent market quotes and, in many cases, the estimated fair values could not necessarily be realized in an immediate sale or settlement of the instrument. Further, certain financial instruments and all non-financial instruments not measured at fair value on the Corporation's consolidated balance sheets are excluded. For financial instruments listed below which are not measured at fair value on the Corporation's consolidated balance sheets, the aggregate fair value amounts presented do not necessarily represent management's estimate of the underlying value of the Corporation.

|  | June 30, 2010 |                      | December 31, 2009 |                      |
|--|---------------|----------------------|-------------------|----------------------|
|  | Book Value    | Estimated Fair Value | Book Value        | Estimated Fair Value |
| (in thousands)                                     |               |                      |                   |                      |
| <b>FINANCIAL ASSETS</b>                            |               |                      |                   |                      |
| Cash and due from banks                            | \$ 268,371    | \$ 268,371           | \$ 284,508        | \$ 284,508           |
| Interest-bearing deposits with other banks         | 433,687       | 433,687              | 16,591            | 16,791               |
| Loans held for sale (1)                            | 93,504        | 93,504               | 85,384            | 85,384               |
| Securities held to maturity                        | 8,054         | 8,154                | 8,700             | 8,797                |
| Securities available for sale (1)                  | 2,884,836     | 2,884,836            | 3,258,386         | 3,258,386            |
| Loans, net of unearned income (1)                  | 11,943,384    | 11,946,332           | 11,972,424        | 11,972,109           |
| Accrued interest receivable                        | 54,763        | 54,763               | 58,515            | 58,515               |
| Other financial assets (1)                         | 130,569       | 130,569              | 128,374           | 128,374              |
| <b>FINANCIAL LIABILITIES</b>                       |               |                      |                   |                      |
| Demand and savings deposits                        | \$ 7,307,678  | \$ 7,307,678         | \$ 6,784,050      | \$ 6,784,050         |
| Time deposits (1)                                  | 5,037,794     | 5,083,856            | 5,313,864         | 5,349,237            |
| Short-term borrowings                              | 458,334       | 458,334              | 868,940           | 868,940              |
| Accrued interest payable                           | 43,292        | 43,292               | 46,596            | 46,596               |
| Other financial liabilities (1)                    | 62,853        | 62,853               | 53,267            | 53,267               |
| Federal Home Loan Bank advances and long-term debt | 1,365,688     | 1,341,623            | 1,540,773         | 1,474,082            |

- (1) Description of fair value determinations for these financial instruments, or certain financial instruments within these categories, measured at fair value on the Corporation's consolidated balance sheets, are detailed under the heading, "FASB ASC Topic 820 Fair Value Measurements" above.

For short-term financial instruments, defined as those with remaining maturities of 90 days or less and excluding those recorded at fair value and reported above under the heading, "FASB ASC Topic 820 Fair Value Measurements," the carrying amount was considered to be a reasonable estimate of fair value. The following instruments are predominantly short-term:

| Assets                      | Liabilities                 |
|-----------------------------|-----------------------------|
| Cash and due from banks     | Demand and savings deposits |
| Interest bearing deposits   | Short-term borrowings       |
| Federal funds sold          | Accrued interest payable    |
| Accrued interest receivable | Other financial liabilities |

For those components of the above-listed financial instruments with remaining maturities greater than 90 days, fair values were determined by discounting contractual cash flows using rates which could be earned for assets with similar remaining maturities and, in the case of liabilities, rates at which the liabilities with similar remaining maturities could be issued as of the balance sheet date.





## **Table of Contents**

The estimated fair values of securities held to maturity as of June 30, 2010 and December 31, 2009 were based on quoted market prices, broker quotes or dealer quotes.

For short-term loans and variable rate loans that reprice within 90 days, the carrying value was considered to be a reasonable estimate of fair value. For other types of loans and time deposits, fair value was estimated by discounting future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

The fair value of FHLB advances and long-term debt was estimated by discounting the remaining contractual cash flows using a rate at which the Corporation could issue debt with a similar remaining maturity as of the balance sheet date. The fair values of commitments to extend credit and standby letters of credit, included within other financial liabilities above, are estimated to equal their carrying amounts.

### **NOTE L New Accounting Standard**

In July 2010, the FASB issued ASC Update No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (ASC Update 2010-20). The goal of ASC Update 2010-20 is to improve transparency in financial reporting by companies that hold financing receivables, which include loans, lease receivables, and other long-term receivables. ASC Update 2010-20 requires companies to provide more information in their disclosures about the credit quality of their financing receivables and the credit reserves held against them. The Corporation's new and existing disclosures related to the credit quality of loans will be disaggregated based on how it develops its allowance for credit losses and how it measures credit exposures.

For publicly traded companies, the expanded disclosure requirements of ASC Update 2010-20 that relate to end of reporting period information are effective for periods ending on or after December 15, 2010, or December 31, 2010 for the Corporation. The expanded disclosure requirements that relate to credit quality activity during a reporting period are effective for periods beginning on or after December 15, 2010, or January 1, 2011 for the Corporation. The adoption of ASC Update 2010-20 will impact the Corporation's disclosures related to its allowance for credit losses; however, this update will not impact how the Corporation measures its allowance for credit losses.

### **NOTE M Subsequent Event**

On July 14, 2010, the Corporation redeemed all 376,500 outstanding shares of its Series A Preferred Stock that it issued to the UST as part of the Troubled Asset Relief Program in December 2008. The Corporation paid \$379.6 million to the UST, consisting of \$376.5 million of principal and \$3.1 million of dividends.

The preferred stock had a carrying value of \$371.0 million at June 30, 2010, as a result of allocating the proceeds received upon issuance to the preferred stock and common stock warrants, also issued to the UST, based on their relative fair value. Upon redemption, the \$5.5 million preferred stock discount will be recorded as a reduction to third quarter net income available to common shareholders.

---

**Table of Contents**

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

Management's Discussion and Analysis of Financial Condition and Results of Operations (Management's Discussion) relates to Fulton Financial Corporation (the Corporation), a financial holding company registered under the Bank Holding Company Act and incorporated under the laws of the Commonwealth of Pennsylvania in 1982, and its wholly owned subsidiaries. Management's discussion should be read in conjunction with the consolidated financial statements and notes presented in this report.

**FORWARD-LOOKING STATEMENTS**

The Corporation has made, and may continue to make, certain forward-looking statements with respect to its financial conditions and results of operations. Many factors could affect future financial results, including without limitation: asset quality and the impact of adverse changes in the economy and in credit or other markets and resulting effects on credit risk and asset values; acquisition and growth strategies; market risk; changes or adverse developments in economic, political, or regulatory conditions; a continuation or worsening of the current disruption in credit and other markets, including the lack of or reduced access to, and the abnormal functioning of, markets for mortgages and other asset-backed securities and for commercial paper and other short-term borrowings; changes in the levels of Federal Deposit Insurance Corporation deposit insurance premiums and assessments; the effect of competition and interest rates on net interest margin and net interest income; investment strategy and income growth; investment securities gains and losses; declines in the value of securities which may result in charges to earnings; changes in rates of deposit and loan growth or a decline in loans originated; balances of risk-sensitive assets to risk-sensitive liabilities; salaries and employee benefits and other expenses; amortization of intangible assets; goodwill impairment; capital and liquidity strategies, and other financial and business matters for future periods. Do not unduly rely on forward-looking statements. Forward-looking statements can be identified by the use of words such as may, should, will, could, estimates, predicts, potential, continue, anticipates, believes, future and intends and similar expressions which are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond the Corporation's control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. The Corporation undertakes no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**RESULTS OF OPERATIONS**

**Summary Financial Results**

The Corporation generates the majority of its revenue through net interest income, or the difference between interest earned on loans and investments and interest paid on deposits and borrowings. Growth in net interest income is dependent upon balance sheet growth and/or maintaining or increasing the net interest margin, which is net interest income (fully taxable-equivalent, or FTE) as a percentage of average interest-earning assets. The Corporation also generates revenue through fees earned on the various services and products offered to its customers and through sales of assets, such as loans, investments or properties. Offsetting these revenue sources are provisions for credit losses on loans, operating expenses and income taxes.

**Table of Contents**

The following table presents a summary of the Corporation's earnings and selected performance ratios:

|  | As of or for the   |           | As of or for the |           |
|--|--------------------|-----------|------------------|-----------|
|  | Three months ended |           | Six months ended |           |
|  | June 30            |           | June 30          |           |
|  | 2010               | 2009      | 2010             | 2009      |
| Net income available to common shareholders (in thousands) | \$ 26,616          | \$ 8,065  | \$ 49,031        | \$ 16,119 |
| Income before income taxes (in thousands)                  | \$ 42,965          | \$ 15,515 | \$ 79,712        | \$ 30,173 |
| Diluted net income per share (1)                           | \$ 0.14            | \$ 0.05   | \$ 0.27          | \$ 0.09   |
| Return on average assets                                   | 0.77%              | 0.32%     | 0.72%            | 0.32%     |
| Return on average common equity (2)                        | 6.06%              | 2.16%     | 5.90%            | 2.17%     |
| Return on average tangible common equity (3)               | 9.10%              | 3.83%     | 9.11%            | 3.85%     |
| Net interest margin (4)                                    | 3.76%              | 3.43%     | 3.77%            | 3.44%     |
| Non-performing assets to total assets                      | 2.06%              | 1.73%     | 2.06%            | 1.73%     |
| Net charge-offs to average loans (annualized)              | 0.97%              | 0.97%     | 0.96%            | 0.99%     |

- (1) Net income available to common shareholders divided by diluted weighted average common shares outstanding.
- (2) Net income available to common shareholders divided by average common shareholders' equity.
- (3) Net income available to common shareholders, adjusted for intangible asset amortization (net of tax), divided by average common shareholders' equity, excluding goodwill and intangible assets.
- (4) Presented on a FTE basis, using a 35% Federal tax rate and statutory interest expense disallowances. See also the Net Interest Income section of Management's Discussion.

The Corporation's income before income taxes for the second quarter of 2010 increased \$27.5 million, or 176.9%, from the same period in 2009. Income before income taxes for the first half of 2010 increased \$49.5 million, or 164.2%, in comparison to the first half of 2009. The increase was primarily due to the following significant items:

**Increases in income before income taxes:**

*Increases in net interest income of \$11.2 million and \$25.6 million, for the three and six months ended June 30, 2010, respectively.* The increases in net interest income were a result of increases in the net interest margin. For the second quarter of 2010, the net interest margin increased 33 basis points, or 9.6%, in comparison to the second quarter of 2009. For the first half of 2010, net interest margin increased 33 basis points, or 9.6%. During 2010, significant declines in funding costs resulted in an improvement in net interest margin.

*Decreases in the provision for loan losses of \$10.0 million and \$20.0 million for the three and six months ended June 30, 2010, respectively.* During the second quarter and first half of 2010, allowance allocation needs for impaired loans slowed in comparison to the same periods in 2009, resulting in a decrease in the provision for loan losses.

*Decreases in Federal Deposit Insurance Corporation (FDIC) insurance expense of \$7.1 million and \$6.4 million for the three and six months ended June 30, 2010, respectively.* During the second quarter of 2009, the Corporation paid a \$7.7 million special FDIC assessment. Partially offsetting the impact of the special assessment was an increase in assessment rates and an increase in the balance of insured deposits in 2010.

*A \$6.2 million decrease in losses associated with the Corporation's guarantee to purchase illiquid student loan auction rate securities, also known as auction rate certificates (ARCs), for the first half of 2010 in comparison to the first half of 2009.* Fulton Financial Advisors (FFA), the investment management and trust division of the Corporation's Fulton Bank, N.A. subsidiary, held ARCs for some of its customers' accounts. FFA had previously sold ARCs to customers as short-term investments with fair values that could be derived based on

periodic auctions under normal market

## Table of Contents

conditions. During the first quarter of 2009, the Corporation recorded a pre-tax charge, as a component of operating risk loss on the consolidated statements of income, of \$6.2 million, which represented contingent losses related to guarantees to purchase ARCs held by customers. As of December 31, 2009, the Corporation had purchased all remaining ARCs held by customers.

### Decrease in income before income taxes:

*Decreases of \$4.3 million and \$9.6 million in gains on sales of mortgage loans for the three and six months ended June 30, 2010, respectively.* During 2009, low interest rates on residential mortgages resulted in a significant level of residential mortgage refinances and gains on sales of these loans. The decrease in gains on sales of mortgage loans in 2010 was a result of lower refinance volumes.

### Common Stock Issuance and Redemption of Preferred Stock Outstanding

In May 2010, the Corporation issued 21.8 million shares of its common stock for total proceeds of \$226.3 million in anticipation of redeeming its outstanding preferred stock issued to the U.S. Department of the Treasury (UST). The proceeds from the common stock issuance were held in other interest-earning assets from the date of issuance through the end of the second quarter, as approval to redeem the preferred stock was not obtained until July 14, 2010. Had the preferred stock been redeemed concurrently with the common stock issuance, the net interest margin for the second quarter of 2010 would have been 3.82%, or 1.6% higher. In addition, preferred stock dividends for the second quarter of 2010 would have been reduced by approximately \$3.1 million, or 1.6 cents per diluted share.

On July 14, 2010, upon receiving formal authorization, the Corporation redeemed its 376,500 shares of its Series A preferred stock with a total payment to the UST of \$379.6 million, consisting of \$376.5 million par value and \$3.1 million of dividends. The preferred stock had a carrying value of \$371.0 million at June 30, 2010, as a result of allocating the proceeds received upon issuance to the preferred stock and common stock warrants, also issued to the UST, based on their relative fair value. Upon redemption, the \$5.5 million preferred stock discount was recorded as a reduction to third quarter net income available to common shareholders.

Subsequent to the redemption of the Corporation's outstanding preferred shares, the UST still holds warrants to purchase up to 5.5 million shares of the Corporation's common stock. The Corporation intends to repurchase the 5.5 million outstanding common stock warrants at a price to be negotiated. As of June 30, 2010, the common stock warrants have a carrying value of \$7.6 million, recorded as a component of shareholders equity. If the common stock warrants are redeemed at a price in excess of their carrying value, the excess will be recorded as a reduction to shareholders' equity and not as a reduction to net income available to common shareholders.

### Quarter Ended June 30, 2010 compared to the Quarter Ended June 30, 2009

#### Net Interest Income

FTE net interest income increased \$11.3 million, or 8.6%, from \$131.8 million in the second quarter of 2009 to \$143.0 million in the second quarter of 2010. This was the net result of a \$10.4 million decrease in FTE interest income and a \$21.6 million decrease in interest expense.

**Table of Contents**

The following table provides a comparative average balance sheet and net interest income analysis for the second quarter of 2010 as compared to the same period in 2009. Interest income and yields are presented on an FTE basis, using a 35% Federal tax rate and statutory interest expense disallowances. The discussion following this table is based on these FTE amounts. All dollar amounts are in thousands.

|   | Three months ended June 30 |              |                |                    |              |                |
|---|----------------------------|--------------|----------------|--------------------|--------------|----------------|
|   | 2010                       |              |                | 2009               |              |                |
|   | Average<br>Balance         | Interest (1) | Yield/<br>Rate | Average<br>Balance | Interest (1) | Yield/<br>Rate |
| <b>ASSETS</b>                                     |                            |              |                |                    |              |                |
| Interest-earning assets:                          |                            |              |                |                    |              |                |
| Loans, net of unearned income (2)                 | \$ 11,959,176              | \$ 159,632   | 5.35%          | \$ 11,960,669      | \$ 163,744   | 5.49%          |
| Taxable investment securities (3)                 | 2,386,695                  | 25,146       | 4.22           | 2,673,136          | 29,422       | 4.40           |
| Tax-exempt investment securities (3)              | 355,186                    | 5,152        | 5.80           | 462,991            | 6,425        | 5.55           |
| Equity securities (3)                             | 140,271                    | 733          | 2.09           | 134,702            | 660          | 1.96           |
| Total investment securities                       | 2,882,152                  | 31,031       | 4.31           | 3,270,829          | 36,507       | 4.47           |
| Loans held for sale                               | 59,412                     | 667          | 4.49           | 139,354            | 1,628        | 4.67           |
| Other interest-earning assets                     | 366,200                    | 231          | 0.25           | 20,897             | 40           | 0.76           |
| Total interest-earning assets                     | 15,266,940                 | 191,561      | 5.03%          | 15,391,749         | 201,919      | 5.26%          |
| Noninterest-earning assets:                       |                            |              |                |                    |              |                |
| Cash and due from banks                           | 261,576                    |              |                | 283,399            |              |                |
| Premises and equipment                            | 203,928                    |              |                | 204,451            |              |                |
| Other assets                                      | 1,102,587                  |              |                | 938,156            |              |                |
| Less: Allowance for loan losses                   | (275,209)                  |              |                | (211,166)          |              |                |
| <i>Total Assets</i>                               | \$ 16,559,822              |              |                | \$ 16,606,589      |              |                |
| <b>LIABILITIES AND EQUITY</b>                     |                            |              |                |                    |              |                |
| Interest-bearing liabilities:                     |                            |              |                |                    |              |                |
| Demand deposits                                   | \$ 2,019,605               | \$ 1,840     | 0.37%          | \$ 1,818,897       | \$ 2,002     | 0.44%          |
| Savings deposits                                  | 3,090,857                  | 5,388        | 0.70           | 2,307,089          | 4,401        | 0.76           |
| Time deposits                                     | 5,120,648                  | 24,591       | 1.93           | 5,625,841          | 41,604       | 2.97           |
| Total interest-bearing deposits                   | 10,231,110                 | 31,819       | 1.25           | 9,751,827          | 48,007       | 1.97           |
| Short-term borrowings                             | 512,583                    | 390          | 0.30           | 1,186,541          | 921          | 0.31           |
| FHLB advances and long-term debt                  | 1,403,410                  | 16,313       | 4.66           | 1,780,120          | 21,225       | 4.78           |
| Total interest-bearing liabilities                | 12,147,103                 | 48,522       | 1.60%          | 12,718,488         | 70,153       | 2.21%          |
| Noninterest-bearing liabilities:                  |                            |              |                |                    |              |                |
| Demand deposits                                   | 2,079,674                  |              |                | 1,812,539          |              |                |
| Other   | 199,778                    |              |                | 206,901            |              |                |
| <i>Total Liabilities</i>                          | 14,426,555                 |              |                | 14,737,928         |              |                |
| Shareholders' equity                              | 2,133,267                  |              |                | 1,868,661          |              |                |
| <i>Total Liabilities and Shareholders' Equity</i> | \$ 16,559,822              |              |                | \$ 16,606,589      |              |                |
| Net interest income/net interest margin (FTE)     |                            | 143,039      | 3.76%          |                    | 131,766      | 3.43%          |
| Tax equivalent adjustment                         |                            | (3,881)      |                |                    | (3,822)      |                |

Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|                     |                   |            |
|---------------------|-------------------|------------|
| Net interest income | <b>\$ 139,158</b> | \$ 127,944 |
|---------------------|-------------------|------------|

- (1) Includes dividends earned on equity securities.
- (2) Includes non-performing loans.
- (3) Balances include amortized historical cost for available for sale securities. The related unrealized holding gains (losses) are included in other assets.

**Table of Contents**

The following table summarizes the changes in FTE interest income and expense due to changes in average balances (volume) and changes in rates:

|                                  | 2010 vs. 2009 |   |             |     |
|----------------------------------|---------------|---|-------------|-----|
|                                  | Volume        | Increase (decrease) due to change in Rate |             |     |
|                                  |               | (in thousands)                            |             | Net |
| <b>Interest income on:</b>       |               |   |             |     |
| Loans, net of unearned income    | \$ (20)       | \$ (4,092)                                | \$ (4,112)  |     |
| Taxable investment securities    | (3,055)       | (1,221)                                   | (4,276)     |     |
| Tax-exempt investment securities | (1,547)       | 274                                       | (1,273)     |     |
| Equity securities                | 28            | 45  | 73          |     |
| Loans held for sale              | (903)         | (58)                                      | (961)       |     |
| Other interest-earning assets    | 234           | (43)                                      | 191         |     |
| <i>Total interest income</i>     | \$ (5,263)    | \$ (5,095)                                | \$ (10,358) |     |
| <b>Interest expense on:</b>      |               |   |             |     |
| Demand deposits                  | \$ 203        | \$ (365)                                  | \$ (162)    |     |
| Savings deposits                 | 1,333         | (346)                                     | 987         |     |
| Time deposits                    | (3,469)       | (13,544)                                  | (17,013)    |     |
| Short-term borrowings            | (487)         | (44)                                      | (531)       |     |
| FHLB advances and long-term debt | (4,391)       | (521)                                     | (4,912)     |     |
| <i>Total interest expense</i>    | \$ (6,811)    | \$ (14,820)                               | \$ (21,631) |     |

Interest income decreased \$10.4 million, or 5.1%. A 23 basis point, or 4.4%, decrease in average yields resulted in a \$5.1 million decrease in interest income. The remaining \$5.3 million decrease was due to a \$124.8 million, or 0.8%, decrease in average interest-earning assets.

Average loans, by type, are summarized in the following table:

|   | Three months ended |               | Increase (decrease) |        |
|---|--------------------|---------------|---------------------|--------|
|   | 2010               | 2009          | \$                  | %      |
| (dollars in thousands)                            |                    |               |                     |        |
| Real estate commercial mortgage                   | \$ 4,319,540       | \$ 4,091,498  | \$ 228,042          | 5.6%   |
| Commercial industrial, financial and agricultural | 3,686,442          | 3,656,294     | 30,148              | 0.8    |
| Real estate home equity                           | 1,638,260          | 1,668,562     | (30,302)            | (1.8)  |
| Real estate residential mortgage                  | 972,129            | 935,983       | 36,146              | 3.9    |
| Real estate construction                          | 909,836            | 1,152,195     | (242,359)           | (21.0) |
| Consumer  | 362,883            | 371,610       | (8,727)             | (2.3)  |
| Leasing and other                                 | 70,086             | 84,527        | (14,441)            | (17.1) |
| <i>Total</i>                                      | \$ 11,959,176      | \$ 11,960,669 | \$ (1,493)          | 0.0%   |

The Corporation experienced growth in its commercial mortgage (\$228.0 million, or 5.6%), residential mortgage (\$36.1 million, or 3.9%) and commercial loan (\$30.1 million, or 0.8%) portfolios.



## Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

Geographically, the growth in commercial mortgages was mainly attributable to the Corporation's Pennsylvania (\$142.9 million, or 6.8%, increase) and Maryland (\$40.1 million, or 11.5%, increase) markets. Commercial loan growth was primarily in the Pennsylvania (\$99.1 million, or 4.2%) and New Jersey (\$22.2 million, or 4.1%) markets, partially offset by declines in the Maryland (\$48.0 million, or 11.7%) and Virginia (\$43.4 million, or 14.2%) markets.

**Table of Contents**

The \$36.1 million, or 3.9%, increase in residential mortgages was primarily due to the Corporation retaining 10 and 15 year fixed rate mortgages in portfolio. These loans were underwritten to the standards required for sale to third-party investors. However, the Corporation elected to retain them in its portfolio due to their relatively attractive yields.

The \$242.4 million, or 21.0%, decrease in construction loans was primarily due to efforts to decrease credit exposure in this portfolio. Geographically, the decline was throughout all of the Corporation's markets, with decreases in Maryland (\$98.9 million, or 32.1%), New Jersey (\$70.4 million, or 30.1%), Virginia (\$59.7 million, or 20.8%) and Pennsylvania (\$11.8 million, or 3.8%). The decrease in home equity loans was mainly due to residential mortgage refinances, driven by low interest rates.

The average yield on loans decreased 14 basis points, or 2.6%, from 5.49% in 2009 to 5.35% in 2010, despite the average prime rate remaining at 3.25% for the second quarter of both 2010 and 2009. The decrease in average yields on loans was attributable to repayments of higher-yielding loans and declining average rates on fixed and adjustable rate loans which, unlike floating rate loans, have a lagged repricing effect.

Average investments decreased \$388.7 million, or 11.9%, due largely to sales of collateralized mortgage obligations and maturities of mortgage-backed securities, the proceeds of which were not fully reinvested into the portfolio, because current rates on many investment options were not attractive. The average yield on investments decreased 16 basis points, or 3.6%, from 4.47% in 2009 to 4.31% in 2010, as investment security purchases were at yields that were lower than the overall portfolio yield.

Other interest-earning assets, consisting of interest-bearing deposits with other banks, increased \$345.3 million, or 1,652.4%. The Corporation invested \$226.3 million of proceeds received from its May 2010 common stock offering in short-term funds, with the intent of redeeming its outstanding preferred stock. Because final approval to redeem the preferred stock did not occur until July 2010, the impact of investing these funds in interest-bearing deposits with other banks for almost two months had a negative impact on net interest margin as the average yield on interest-bearing deposits with other banks was 0.25% for the second quarter of 2010, compared to an average yield for investment securities of 4.31%.

Interest expense decreased \$21.6 million, or 30.8%, to \$48.5 million in the second quarter of 2010 from \$70.2 million in the same period in 2009. Interest expense decreased \$14.8 million as a result of a 61 basis point, or 27.6%, decrease in the average cost of interest-bearing liabilities. Interest expense decreased an additional \$6.8 million as a result of a \$571.4 million, or 4.5%, decline in average interest-bearing liabilities.

The following table summarizes the changes in average deposits, by type:

|                                 | Three months ended                |               | Increase (decrease) |       |
|---------------------------------|-----------------------------------|---------------|---------------------|-------|
|                                 | 2010                              | 2009          | \$                  | %     |
|                                 | June 30<br>(dollars in thousands) |               |                     |       |
| Noninterest-bearing demand      | \$ 2,079,674                      | \$ 1,812,539  | \$ 267,135          | 14.7% |
| Interest-bearing demand         | 2,019,605                         | 1,818,897     | 200,708             | 11.0  |
| Savings                         | 3,090,857                         | 2,307,089     | 783,768             | 34.0  |
| <i>Total demand and savings</i> | <b>7,190,136</b>                  | 5,938,525     | 1,251,611           | 21.1  |
| Time deposits                   | 5,120,648                         | 5,625,841     | (505,193)           | (9.0) |
| <i>Total deposits</i>           | <b>\$ 12,310,784</b>              | \$ 11,564,366 | \$ 746,418          | 6.5%  |

The Corporation experienced an increase in noninterest-bearing and interest-bearing demand and savings accounts of \$1.3 billion, or 21.1%. Increases in demand and savings deposits were consistent with industry trends, as economic conditions have slowed spending and encouraged saving. Also contributing to the growth in demand and savings deposits was the Corporation's promotional efforts with a focus on

**Table of Contents**

building customer relationships. The increase in noninterest-bearing demand accounts was primarily in business accounts, the increase in interest-bearing demand accounts was primarily in personal accounts and partially in municipal accounts, and the increase in savings accounts was in personal, business and municipal accounts. The growth in business accounts was due, in part, to businesses being required to keep higher balances on hand to offset service fees, as well as a migration from the Corporation's cash management products due to low interest rates.

The decrease in time deposits was due to a \$309.8 million, or 5.7%, decrease in customer certificates of deposit and a \$195.4 million, or 94.5%, decrease in brokered certificates of deposit. The decrease in customer certificates of deposits was in accounts with original maturity terms less than one year, partially offset by growth in accounts with original maturity terms greater than one year and jumbo certificates of deposit. The growth in longer-term certificates of deposit was due to the Corporation's continuing focus on building customer relationships, while at the same time extending funding maturities at reasonable rates over a longer time horizon. The decrease in brokered certificates of deposit, was replaced by the significant growth in customer funding.

The average cost of interest-bearing deposits decreased 72 basis points, or 36.5%, from 1.97% in 2009 to 1.25% in 2010 primarily due to the maturities of higher-rate certificates of deposit. The average cost of certificates of deposit decreased 104 basis points, or 35.0%.

As average deposits increased, short-term and long-term borrowings decreased, as summarized in the following table:

|  | Three months ended                |              | Increase (decrease) |         |
|--|-----------------------------------|--------------|---------------------|---------|
|  | 2010                              | 2009         | \$                  | %       |
|  | June 30<br>(dollars in thousands) |              |                     |         |
| <b>Short-term borrowings:</b>            |                                   |              |                     |         |
| Customer repurchase agreements           | \$ 263,533                        | \$ 256,306   | \$ 7,227            | 2.8%    |
| Customer short-term promissory notes     | 207,100                           | 297,743      | (90,643)            | (30.4)  |
| <i>Total short-term customer funding</i> | <b>470,633</b>                    | 554,049      | (83,416)            | (15.1)  |
| Federal funds purchased                  | 41,950                            | 580,020      | (538,070)           | (92.8)  |
| Federal Reserve Bank borrowings          | 0                                 | 48,352       | (48,352)            | N/A     |
| Other short-term borrowings              | 0                                 | 4,120        | (4,120)             | N/A     |
| <i>Total other short-term borrowings</i> | <b>41,950</b>                     | 632,492      | (590,542)           | (93.4)  |
| <i>Total short-term borrowings</i>       | <b>512,583</b>                    | 1,186,541    | (673,958)           | (56.8)  |
| <b>Long-term debt:</b>                   |                                   |              |                     |         |
| FHLB advances                            | 1,020,134                         | 1,397,010    | (376,876)           | (27.0)  |
| Other long-term debt                     | 383,276                           | 383,110      | 166                 | 0       |
| <i>Total long-term debt</i>              | <b>1,403,410</b>                  | 1,780,120    | (376,710)           | (21.2)  |
| <i>Total</i>                             | <b>\$ 1,915,993</b>               | \$ 2,966,661 | \$ (1,050,668)      | (35.4%) |

N/A Not applicable.

The \$83.4 million net decrease in short-term customer funding resulted from customers transferring funds from the cash management program to deposits due to the low interest rate environment. The \$538.1 million decrease in Federal funds purchased was due to increases in non-interest and interest-bearing demand and savings accounts, combined with the decrease in investments and no growth in the loan portfolio, resulting in reduced funding needs for the Corporation. The \$376.9 million decrease in Federal Home Loan Bank (FHLB) advances was due to maturities, which were not replaced with new advances.

**Table of Contents****Provision for Loan Losses and Allowance for Credit Losses**

The following table presents the activity in the allowance for credit losses:

|  | Three months ended<br>June 30 |               |
|--|-------------------------------|---------------|
|  | 2010                          | 2009          |
|  | (dollars in thousands)        |               |
| Loans, net of unearned income outstanding at end of period           | \$ 11,943,384                 | \$ 11,866,818 |
| Daily average balance of loans, net of unearned income               | \$ 11,959,176                 | \$ 11,960,669 |
| <i>Balance of allowance for credit losses at beginning of period</i> | <b>\$ 269,254</b>             | \$ 200,063    |
| Loans charged off:   |                               |               |
| Commercial industrial, agricultural and financial                    | 13,390                        | 6,274         |
| Real estate construction   | 9,299                         | 11,294        |
| Real estate commercial mortgage                                      | 3,915                         | 5,961         |
| Consumer   | 2,438                         | 3,064         |
| Real estate residential mortgage and home equity                     | 1,880                         | 1,830         |
| Leasing and other  | 610                           | 2,099         |
| <i>Total loans charged off</i>                                       | <b>31,532</b>                 | 30,522        |
| Recoveries of loans previously charged off:                          |                               |               |
| Commercial industrial, agricultural and financial                    | 1,157                         | 306           |
| Real estate construction   | 581                           | 214           |
| Real estate commercial mortgage                                      | 157                           | 25            |
| Consumer   | 488                           | 511           |
| Real estate residential mortgage and home equity                     | 3                             | 147           |
| Leasing and other  | 269                           | 210           |
| <i>Total recoveries</i>  | <b>2,655</b>                  | 1,413         |
| Net loans charged off  | 28,877                        | 29,109        |
| Provision for loan losses  | 40,000                        | 50,000        |
| <i>Balance of allowance for credit losses at end of period</i>       | <b>\$ 280,377</b>             | \$ 220,954    |
| <b><u>Components of the Allowance for Credit Losses:</u></b>         |                               |               |
| Allowance for loan losses  | \$ 272,042                    | \$ 214,170    |
| Reserve for unfunded lending commitments                             | 8,335                         | 6,784         |
| Allowance for credit losses  | <b>\$ 280,377</b>             | \$ 220,954    |
| <b><u>Selected Ratios:</u></b>                                       |                               |               |
| Net charge-offs to average loans (annualized)                        | <b>0.97%</b>                  | 0.97%         |
| Allowance for credit losses to loans outstanding                     | <b>2.35%</b>                  | 1.86%         |

The provision for loan losses was \$40.0 million for the second quarter of 2010, a decrease of \$10.0 million, or 20.0%, from the same period in 2009. A slowing in the pace of specific loan loss allocations needed for impaired loans contributed to the decrease in the provision for loan losses. See Note E, Loans and Allowance for Credit Losses in the Notes to Consolidated Financial Statements for additional details related to impaired loans.

## Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

Net charge-offs decreased \$232,000, or 0.8%, to \$28.9 million for the second quarter of 2010 compared to \$29.1 million for the second quarter of 2009. Annualized net charge-offs to average loans were 97 basis points for the second quarter of 2010 and 2009. Decreases in construction loan net charge-offs (\$2.4 million, or 21.3%), commercial mortgage net charge-offs (\$2.2 million, or 36.7%) and leasing and other net charge-offs (\$1.5 million, or 81.9%), were offset by an increase in commercial loan net charge-offs (\$6.3 million, or 105.0%).

**Table of Contents**

Of the \$28.9 million of net charge-offs recorded in the second quarter of 2010, 56.5% were in New Jersey, 31.2% in Pennsylvania and 12.6% in Virginia. During the second quarter of 2010, there were seven individual charge-offs that exceeded \$1.0 million, totaling \$16.5 million, of which \$9.0 million were for businesses that were negatively impacted by the downturn in residential and commercial real estate.

The following table summarizes the Corporation's non-performing assets as of the indicated dates:

|   | June 30<br>2010        | June 30<br>2009 | December 31<br>2009 |
|---|------------------------|-----------------|---------------------|
|   | (dollars in thousands) |                 |                     |
| Non-accrual loans   | \$ 263,227             | \$ 228,132      | \$ 238,360          |
| Loans 90 days past due and accruing   | 53,707                 | 39,135          | 43,359              |
| <i>Total non-performing loans</i>   | <b>316,934</b>         | 267,267         | 281,719             |
| Other real estate owned (OREO)  | 25,681                 | 24,916          | 23,309              |
| <i>Total non-performing assets</i>  | <b>\$ 342,615</b>      | \$ 292,183      | \$ 305,028          |
| Non-accrual loans to total loans  | 2.20%                  | 1.92%           | 1.99%               |
| Non-performing assets to total assets   | 2.06%                  | 1.73%           | 1.83%               |
| Allowance for credit losses to non-performing loans   | 88.47%                 | 82.67%          | 91.42%              |
| Non-performing assets to tangible common shareholders' equity and allowance for credit losses | 21.54%                 | 24.99%          | 24.00%              |

Excluded from non-accrual loans above were \$57.7 million of loans whose terms were modified under a troubled debt restructuring and were current under their modified terms at June 30, 2010. As of June 30, 2010, such troubled debt restructurings included \$32.0 million of residential mortgages, \$14.9 million of commercial mortgages, \$6.2 million of construction loans, \$4.3 million of commercial loans and \$266,000 of consumer loans.

The following table summarizes the Corporation's non-performing loans, by type, as of the indicated dates:

|   | June 30<br>2010   | June 30<br>2009 | December 31<br>2009 |
|---|-------------------|-----------------|---------------------|
|   | (in thousands)    |                 |                     |
| Real estate - commercial mortgage                   | \$ 101,378        | \$ 57,786       | \$ 61,052           |
| Real estate - construction                          | 79,122            | 102,977         | 92,841              |
| Commercial - industrial, agricultural and financial | 77,587            | 58,433          | 69,604              |
| Real estate - residential mortgage and home equity  | 45,639            | 37,231          | 45,748              |
| Consumer  | 13,115            | 9,764           | 12,319              |
| Leasing   | 93                | 1,076           | 155                 |
| <i>Total non-performing loans</i>                   | <b>\$ 316,934</b> | \$ 267,267      | \$ 281,719          |

Non-performing loans increased to \$316.9 million at June 30, 2010, from \$267.3 million at June 30, 2009. The \$49.7 million, or 18.6%, increase in non-performing loans in comparison to June 30, 2009 was primarily due to a \$43.6 million, or 75.4%, increase in non-performing commercial mortgages, a \$19.2 million, or 32.8%, increase in non-performing commercial loans and an \$8.4 million, or 22.6%, increase in non-performing residential mortgage and home equity loans, offset by a \$23.9 million, or 23.2%, decrease in non-performing construction loans.

The \$43.6 million increase in non-performing commercial mortgages was primarily due to increases in the Pennsylvania (\$25.8 million, or 150.3%) and New Jersey (\$15.7 million, or 59.5%) markets. The increase in Pennsylvania was primarily due to two loans, a condominium development and a hotel, included in non-performing assets as of June 30, 2010, which totaled \$14.9 million.



**Table of Contents**

The \$19.2 million increase in non-performing commercial loans was a result of prolonged weak economic conditions continuing to put stress on business customers. Geographically, the increase was due to increases in the Pennsylvania (\$19.6 million, or 99.3%) and Maryland (\$3.5 million, or 87.1%) markets, offset by a 3.5 million, or 20.6%, decrease in Virginia.

The \$8.4 million increase in non-performing residential mortgage and home equity loans was primarily due to increases in the New Jersey (\$4.0 million, or 68.3%), Delaware (\$2.1 million, or 138.9%), Pennsylvania (\$1.6 million, or 17.6%), and Maryland (\$1.5 million, or 40.8%) markets.

The \$23.9 million decrease in non-performing construction loans was due to the \$29.0 million of net charge-offs recorded during the first half of 2010, partially offset by increases to non-performing construction loans, primarily in the Pennsylvania and Maryland markets.

The \$25.7 million of OREO at June 30, 2010 included \$15.1 million of residential properties and \$10.6 million of commercial properties. The residential properties included \$5.8 million of foreclosed repurchased residential mortgage loans, as discussed in Note I, Commitments and Contingencies in the Notes to Consolidated Financial Statements.

The following table summarizes loan delinquency rates, by type, as of June 30:

|   | 2010              |                   |                   | 2009          |              |            |
|---|-------------------|-------------------|-------------------|---------------|--------------|------------|
|   | 30-60<br>Days     | > 90<br>Days      | Total             | 30-60<br>Days | > 90<br>Days | Total      |
| Real estate construction                          | 1.07%             | 8.86%             | 9.93%             | 1.05%         | 9.31%        | 10.36%     |
| Commercial industrial, agricultural and financial | 0.46              | 2.12              | 2.58              | 0.47          | 1.77         | 2.24       |
| Real estate commercial mortgage                   | 0.80              | 2.33              | 3.13              | 0.72          | 1.22         | 1.94       |
| Real estate residential mortgage                  | 3.67              | 4.69              | 8.36              | 5.06          | 4.25         | 9.31       |
| Consumer, home equity, leasing and other          | 0.94              | 0.64              | 1.58              | 0.90          | 0.52         | 1.42       |
| <i>Total</i>                                      | <b>0.98%</b>      | <b>2.65%</b>      | <b>3.63%</b>      | 1.04%         | 2.24%        | 3.28%      |
| <i>Total dollars (in thousands)</i>               | <b>\$ 116,772</b> | <b>\$ 317,372</b> | <b>\$ 434,144</b> | \$ 124,283    | \$ 268,807   | \$ 393,090 |

The increase in delinquency rates since the second quarter of 2009 was primarily due to an increase in greater than 90 days delinquency rates for commercial mortgages and commercial loans, offset by a decline in greater than 90 days delinquency rates for construction loans.

The increases in greater than 90 days delinquencies on commercial mortgages and commercial loans were a by-product of slow consumer demand that continues to place stress on businesses. The decrease in construction loan delinquencies was primarily due to certain delinquent accounts being charged off since June 30, 2009.



**Table of Contents**

The following table presents ending balances of loans outstanding, net of unearned income:

|   | June 30<br>2010      | June 30<br>2009<br>(in thousands) | December 31<br>2009 |
|---|----------------------|-----------------------------------|---------------------|
| Real-estate commercial mortgage                   | <b>\$ 4,330,630</b>  | \$ 4,121,208                      | \$ 4,292,300        |
| Commercial industrial, agricultural and financial | <b>3,664,603</b>     | 3,614,144                         | 3,699,198           |
| Real-estate home equity                           | <b>1,637,171</b>     | 1,653,461                         | 1,644,260           |
| Real-estate residential mortgage                  | <b>985,345</b>       | 925,270                           | 921,741             |
| Real-estate construction                          | <b>893,305</b>       | 1,096,047                         | 978,267             |
| Consumer  | <b>368,631</b>       | 371,492                           | 360,698             |
| Leasing and other                                 | <b>63,699</b>        | 85,196                            | 75,960              |
| <i>Loans, net of unearned income</i>              | <b>\$ 11,943,384</b> | \$ 11,866,818                     | \$ 11,972,424       |

Approximately \$5.2 billion, or 43.7%, of the Corporation's loan portfolio was in commercial mortgage and construction loans at June 30, 2010. The Corporation does not have a concentration of credit risk with any single borrower, industry or geographical location. However, the performance of real estate markets in general has adversely impacted the performance of these loans.

During 2009 and 2008, the Corporation experienced significant increases in non-performing construction loans and commercial mortgages. During the first half of 2010, non-performing construction loans have decreased as the Corporation has reduced its exposure in this sector and charged off certain non-performing construction loans. Non-performing commercial mortgages increased during the first half of 2010, as prolonged weak economic conditions have continued to place stress on the credit quality of the commercial mortgage portfolio.

Commercial loans comprise 30.7% of the total loan portfolio. As with commercial mortgages, the credit quality of these loans has been impacted by generally poor economic conditions as businesses continue to struggle for growth as a result of reduced consumer spending.

Approximately \$2.6 billion, or 22.0%, of the Corporation's loan portfolio was in residential mortgage and home equity loans at June 30, 2010. In recent years, deterioration in residential real estate values in some geographic areas, most notably in portions of Maryland, New Jersey and Virginia, and generally poor economic conditions, have resulted in increases in non-performing loans and negatively impacted the overall credit quality of the portfolio.

Management believes that the allowance for credit losses of \$280.4 million at June 30, 2010 is sufficient to cover losses inherent in both the loan portfolio and the unfunded lending commitments as of that date and is appropriate based on applicable accounting standards.

**Table of Contents****Other Income**

The following table presents the components of other income:

|   | Three months ended                |           | Increase (decrease) |         |
|---|-----------------------------------|-----------|---------------------|---------|
|   | 2010                              | 2009      | \$                  | %       |
|   | June 30<br>(dollars in thousands) |           |                     |         |
| Overdraft fees                                      | \$ 9,618                          | \$ 8,792  | \$ 826              | 9.4%    |
| Cash management fees                                | 2,514                             | 3,090     | (576)               | (18.6)  |
| Other   | 3,350                             | 3,179     | 171                 | 5.4     |
| Service charges on deposit accounts                 | 15,482                            | 15,061    | 421                 | 2.8     |
| Debit card income                                   | 3,369                             | 2,752     | 617                 | 22.4    |
| Merchant fees                                       | 2,123                             | 1,870     | 253                 | 13.5    |
| Foreign currency processing income                  | 1,964                             | 1,676     | 288                 | 17.2    |
| Letter of credit fees                               | 1,463                             | 1,816     | (353)               | (19.4)  |
| Other   | 1,603                             | 1,481     | 122                 | 8.2     |
| Other service charges and fees                      | 10,522                            | 9,595     | 927                 | 9.7     |
| Investment management and trust services            | 8,655                             | 7,876     | 779                 | 9.9     |
| Gains on sales of mortgage loans                    | 3,063                             | 7,395     | (4,332)             | (58.6)  |
| Credit card income                                  | 1,442                             | 1,364     | 78                  | 5.7     |
| Gains on sales of OREO                              | 762                               | 883       | (121)               | (13.7)  |
| Other   | 3,135                             | 3,126     | 9                   | 0.3     |
| <i>Total, excluding investment securities gains</i> | <b>43,061</b>                     | 45,300    | (2,239)             | (4.9)   |
| Investment securities gains                         | 904                               | 77        | 827                 | 1,074.0 |
| <i>Total</i>  | <b>\$ 43,965</b>                  | \$ 45,377 | \$ (1,412)          | (3.1%)  |

The \$2.2 million, or 4.9%, decrease in other income, excluding investment securities gains, resulted from a significant decline in mortgage sale gains, offset by improvements in certain other categories.

The \$826,000, or 9.4%, increase in overdraft fees was due to an increase in volume. The \$172,000, or 5.4%, increase in other service charges on deposit accounts was primarily due to the growth in non-interest and interest bearing demand and savings accounts. The \$576,000, or 18.6%, decrease in cash management fees resulted from customers transferring funds from the cash management program to deposits due to the low interest rate environment.

The \$617,000, or 22.4%, increase in debit card fees was as a result of increasing transaction volumes and the introduction of a new reward points program in 2010. The \$288,000, or 17.2%, increase in foreign currency processing revenue and the \$253,000, or 13.5%, increase in merchant fees were both a result of an increase in transaction volumes. The \$353,000, or 19.4%, decrease in letter of credit fees was due to a decrease in the balance of letters of credit outstanding.

As a result of changes in regulations requiring customers to affirmatively consent to the payment of certain types of overdrafts, the Corporation will likely experience a decrease in overdraft fees in the future. In addition, the recently enacted financial regulatory reform legislation will require debit card fees to be set by the Federal Reserve, which could impact future debit card fee income. The extent to which debit card fees may be impacted is not known at this time.

The \$779,000, or 9.9%, increase in investment management and trust services income was due to an increase in brokerage revenue. The Corporation has expanded its brokerage operations by hiring additional sales staff and transitioning from a transaction-based revenue model to a relationship-based model, which generates fees based on the values of assets under management rather than transaction volume.



**Table of Contents**

Gains on sales of mortgage loans decreased \$4.3 million, or 58.6%, due to a decrease in the volume of loans sold. Total loans sold in the second quarter of 2010 were \$270.9 million, compared to \$650.0 million in the second quarter of 2009, due entirely to a decrease in refinance volumes. For the three months ended June 30, 2010, 33% of loans originated for sale were refinances, compared to 77% for the same period in 2009.

Investment securities gains of \$904,000 for the second quarter of 2010 included \$4.4 million of net gains on the sales of securities, offset by \$3.5 million of other-than-temporary impairment charges. The Corporation recorded \$3.0 million of other-than-temporary impairment charges for pooled trust preferred securities issued by financial institutions and \$509,000 of other-than-temporary impairment charges for certain financial institution stocks. The \$4.4 million of net gains on the sales of securities were primarily due to the sale of collateralized mortgage obligations. The \$77,000 of investment securities gains for the second quarter of 2009 included \$3.5 million of net gains on the sale of securities, primarily mortgage-backed securities, offset by \$3.4 million of other-than-temporary impairment charges. The Corporation recorded \$2.7 million of other-than-temporary impairment charges for pooled trust preferred securities issued by financial institutions and \$728,000 of other-than-temporary impairment charges related to financial institution stocks. See Note D, Investment Securities in the Notes to Consolidated Financial Statements for additional details.

**Other Expenses**

The following table presents the components of other expenses:

|                                | Three months ended     |            | Increase (decrease) |        |
|--------------------------------|------------------------|------------|---------------------|--------|
|                                | 2010                   | 2009       | \$                  | %      |
|                                | (dollars in thousands) |            |                     |        |
| Salaries and employee benefits | \$ 54,654              | \$ 55,799  | \$ (1,145)          | (2.1%) |
| Net occupancy expense          | 10,519                 | 10,240     | 279                 | 2.7    |
| FDIC insurance expense         | 5,136                  | 12,206     | (7,070)             | (57.9) |
| Professional fees              | 3,035                  | 2,088      | 947                 | 45.4   |
| Equipment expense              | 2,663                  | 3,300      | (637)               | (19.3) |
| Data processing                | 2,364                  | 2,907      | (543)               | (18.7) |
| Marketing                      | 2,271                  | 1,724      | 547                 | 31.7   |
| Telecommunications             | 2,086                  | 2,181      | (95)                | (4.4)  |
| Postage                        | 1,455                  | 1,204      | 251                 | 20.8   |
| Supplies                       | 1,369                  | 1,500      | (131)               | (8.7)  |
| Intangible amortization        | 1,341                  | 1,434      | (93)                | (6.5)  |
| OREO expense                   | 1,337                  | 1,867      | (530)               | (28.4) |
| Other                          | 11,928                 | 11,356     | 572                 | 5.0    |
| <i>Total</i>                   | <b>\$ 100,158</b>      | \$ 107,806 | \$ (7,648)          | (7.1%) |

Salaries and employee benefits decreased \$1.1 million, or 2.1%, with salaries decreasing \$1.0 million, or 2.3%, and employee benefits decreasing \$116,000, or 1.1%. The decrease in salaries was primarily due to a decrease in average full-time equivalent employees from 3,630 in the second quarter of 2009 to 3,520 in the second quarter of 2010, largely from the consolidation of The Columbia Bank's back office functions in 2009.

The \$7.1 million, or 57.9%, decrease in FDIC insurance expense was a result of a \$7.7 million special assessment recorded in the second quarter of 2009, partially offset by an increase in assessment rates and growth in insured deposits. The \$947,000, or 45.4%, increase in professional fees was primarily due to an increase in legal fees related to collection and workout efforts for non-performing loans. The \$637,000, or 19.3%, decrease in equipment expense was largely due to a vendor rebate received in the second quarter of 2010. The \$543,000, or 18.7%, decrease in data processing expense was primarily due to the conversion of The Columbia Bank's back office systems in the third quarter of 2009. The \$547,000, or 31.7%, increase in marketing expenses was due to the timing of promotional campaigns.

**Table of Contents**

The \$530,000, or 28.4%, decrease in OREO expense was primarily due to an \$864,000 decrease in loss provisions, offset by increases in losses on sales of OREO and in carrying costs, both a result of a larger number of properties owned.

**Income Taxes**

Income tax expense for the second quarter of 2010 was \$11.3 million, an \$8.9 million, or 369.3%, increase from \$2.4 million in 2009. The increase was primarily due to the increase in income before income taxes.

The Corporation's effective tax rate was 26.3% in 2010, as compared to 15.5% in 2009. The effective rate is generally lower than the Federal statutory rate of 35% due to investments in tax-free municipal securities and Federal tax credits earned from investments in low and moderate-income housing partnerships. The effective rate for the second quarter of 2010 is higher than the same period in 2009 due to non-taxable income and tax credits having a smaller impact on the effective tax rate due to the higher level of income before income taxes.

**Six Months Ended June 30, 2010 compared to the Six Months Ended June 30, 2009**

**Net Interest Income**

FTE net interest income increased \$25.6 million, or 9.8%, from \$259.9 million in the first half of 2009 to \$285.5 million in the first half of 2010. This was the net result of a \$15.4 million decrease in FTE interest income and a \$41.0 million decrease in interest expense.

**Table of Contents**

The following table provides a comparative average balance sheet and net interest income analysis for the first half of 2010 as compared to the same period in 2009. Interest income and yields are presented on an FTE basis, using a 35% Federal tax rate and statutory interest expense disallowances. The discussion following this table is based on these FTE amounts. All dollar amounts are in thousands.

|   | Six months ended June 30 |              |                |                      |              |                |
|---|--------------------------|--------------|----------------|----------------------|--------------|----------------|
|   | 2010                     |              |                | 2009                 |              |                |
|   | Average<br>Balance       | Interest (1) | Yield/<br>Rate | Average<br>Balance   | Interest (1) | Yield/<br>Rate |
| <b>ASSETS</b>                                     |                          |              |                |                      |              |                |
| Interest-earning assets:                          |                          |              |                |                      |              |                |
| Loans, net of unearned income (2)                 | \$ 11,965,446            | \$ 319,056   | 5.37%          | \$ 12,000,755        | \$ 327,497   | 5.50%          |
| Taxable investment securities (3)                 | 2,524,149                | 53,295       | 4.23           | 2,444,159            | 56,272       | 4.61           |
| Tax-exempt investment securities (3)              | 371,488                  | 10,683       | 5.75           | 483,016              | 13,312       | 5.51           |
| Equity securities (3)                             | 141,079                  | 1,542        | 2.19           | 135,998              | 1,434        | 2.12           |
| Total investment securities                       | 3,036,716                | 65,520       | 4.32           | 3,063,173            | 71,018       | 4.64           |
| Loans held for sale                               | 51,220                   | 1,223        | 4.77           | 122,007              | 2,889        | 4.74           |
| Other interest-earning assets                     | 189,479                  | 256          | 0.27           | 18,927               | 89           | 0.95           |
| Total interest-earning assets                     | 15,242,861               | 386,055      | 5.10%          | 15,204,862           | 401,493      | 5.32%          |
| Noninterest-earning assets:                       |                          |              |                |                      |              |                |
| Cash and due from banks                           | 262,357                  |              |                | 300,568              |              |                |
| Premises and equipment                            | 203,757                  |              |                | 203,667              |              |                |
| Other assets                                      | 1,094,653                |              |                | 931,494              |              |                |
| Less: Allowance for loan losses                   | (274,322)                |              |                | (199,241)            |              |                |
| <i>Total Assets</i>                               | <b>\$ 16,529,306</b>     |              |                | <b>\$ 16,441,350</b> |              |                |
| <b>LIABILITIES AND EQUITY</b>                     |                          |              |                |                      |              |                |
| Interest-bearing liabilities:                     |                          |              |                |                      |              |                |
| Demand deposits                                   | \$ 2,000,734             | \$ 3,680     | 0.37%          | \$ 1,786,629         | \$ 3,777     | 0.43%          |
| Savings deposits                                  | 2,969,814                | 10,589       | 0.72           | 2,183,243            | 8,754        | 0.81           |
| Time deposits                                     | 5,161,583                | 51,288       | 2.00           | 5,529,794            | 85,371       | 3.11           |
| Total interest-bearing deposits                   | 10,132,131               | 65,557       | 1.30           | 9,499,666            | 97,902       | 2.08           |
| Short-term borrowings                             | 691,289                  | 939          | 0.27           | 1,350,889            | 2,358        | 0.35           |
| FHLB advances and long-term debt                  | 1,443,600                | 34,105       | 4.75           | 1,783,787            | 41,344       | 4.67           |
| Total interest-bearing liabilities                | 12,267,020               | 100,601      | 1.65%          | 12,634,342           | 141,604      | 2.26%          |
| Noninterest-bearing liabilities:                  |                          |              |                |                      |              |                |
| Demand deposits                                   | 2,026,705                |              |                | 1,735,525            |              |                |
| Other   | 190,207                  |              |                | 204,190              |              |                |
| <i>Total Liabilities</i>                          | <b>14,483,932</b>        |              |                | <b>14,574,057</b>    |              |                |
| Shareholders' equity                              | 2,045,374                |              |                | 1,867,293            |              |                |
| <i>Total Liabilities and Shareholders' Equity</i> | <b>\$ 16,529,306</b>     |              |                | <b>\$ 16,441,350</b> |              |                |
| Net interest income/net interest margin (FTE)     |                          | 285,454      | 3.77%          |                      | 259,889      | 3.44%          |
| Tax equivalent adjustment                         |                          | (7,787)      |                |                      | (7,829)      |                |
| Net interest income                               |                          | \$ 277,667   |                |                      | \$ 252,060   |                |

- (1) Includes dividends earned on equity securities.
- (2) Includes non-performing loans.
- (3) Balances include amortized historical cost for available for sale securities. The related unrealized holding gains (losses) are included in other assets.

**Table of Contents**

The following table summarizes the changes in FTE interest income and expense for the first half of 2010 due to changes in average balances (volume) and changes in rates:

|                                  | 2010 vs. 2009 |   |             |
|----------------------------------|---------------|---|-------------|
|                                  | Volume        | Increase (decrease) due to change in Rate<br>(in thousands) | Net         |
| <b>Interest income on:</b>       |               |   |             |
| Loans, net of unearned income    | \$ (898)      | \$ (7,543)  | \$ (8,441)  |
| Taxable investment securities    | 1,790         | (4,767)   | (2,977)     |
| Tax-exempt investment securities | (3,181)       | 552   | (2,629)     |
| Equity securities                | 55            | 53  | 108         |
| Loans held for sale              | (1,684)       | 18  | (1,666)     |
| Other interest-earning assets    | 272           | (105)   | 167         |
| <i>Total interest income</i>     | \$ (3,646)    | \$ (11,792)   | \$ (15,438) |
| <b>Interest expense on:</b>      |               |   |             |
| Demand deposits                  | \$ 425        | \$ (522)  | \$ (97)     |
| Savings deposits                 | 2,887         | (1,052)   | 1,835       |
| Time deposits                    | (5,366)       | (28,717)  | (34,083)    |
| Short-term borrowings            | (976)         | (443)   | (1,419)     |
| FHLB advances and long-term debt | (7,943)       | 704   | (7,239)     |
| <i>Total interest expense</i>    | \$ (10,973)   | \$ (30,030)   | \$ (41,003) |

Interest income decreased \$15.4 million, or 3.8%. A 22 basis point, or 4.1%, decrease in average yields resulted in an \$11.8 million decrease in interest income. Despite a \$38.0 million, or 0.2%, increase in total interest earning assets, the change in the composition of interest-earning assets caused a \$3.6 million decrease in interest income, when calculated by individual earning asset category as the total increase in balances was in lower-yielding other interest-earning assets, offset by a decrease in higher-yielding average loans, investments and loans held for sale.

In May 2010, the \$226.3 million of proceeds from the Corporation's common stock offering were invested in lower yielding interest-bearing deposits with other banks while the Corporation awaited final approval to redeem its outstanding preferred stock.

Average loans, by type, are summarized in the following table:

|   | Six months ended |              | Increase (decrease)    |        |
|---|------------------|--------------|------------------------|--------|
|   | 2010             | June 30 2009 | \$                     | %      |
|   |                  |              | (dollars in thousands) |        |
| Real estate commercial mortgage                   | \$ 4,312,942     | \$ 4,070,291 | \$ 242,651             | 6.0%   |
| Commercial industrial, financial and agricultural | 3,686,425        | 3,656,133    | 30,292                 | 0.8    |
| Real estate home equity                           | 1,639,579        | 1,683,497    | (43,918)               | (2.6)  |
| Real estate residential mortgage                  | 956,478          | 946,710      | 9,768                  | 1.0    |
| Real estate construction                          | 935,861          | 1,190,803    | (254,942)              | (21.4) |
| Consumer  | 362,549          | 366,293      | (3,744)                | (1.0)  |
| Leasing and other                                 | 71,612           | 87,028       | (15,416)               | (17.7) |



Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

|              |                      |               |             |        |
|--------------|----------------------|---------------|-------------|--------|
| <i>Total</i> | <b>\$ 11,965,446</b> | \$ 12,000,755 | \$ (35,309) | (0.3%) |
|--------------|----------------------|---------------|-------------|--------|

The Corporation experienced growth in both its commercial mortgage (\$242.7 million, or 6.0%) and commercial loan (\$30.3 million, or 0.8%) portfolios. Geographically, the growth in commercial

**Table of Contents**

mortgages was mainly attributable to the Corporation's Pennsylvania (\$159.4 million, or 7.6%, increase) and Maryland (\$45.4 million, or 13.3%, increase) markets. Commercial loan growth was in the Pennsylvania (\$92.5 million, or 3.9%) and New Jersey (\$20.3 million, or 3.7%) markets, partially offset by declines in the Maryland (\$48.7 million, or 11.8%) and Virginia (\$34.4 million, or 11.2%) markets.

The \$254.9 million, or 21.4%, decrease in construction loans was primarily due to efforts to decrease credit exposure in this portfolio. Geographically, the decline was throughout all of the Corporation's markets, with decreases in Maryland (\$97.1 million, or 30.1%), New Jersey (\$67.4 million, or 28.5%), Virginia (\$59.5 million, or 20.3%) and Pennsylvania (\$29.0 million, or 9.0%). The \$43.9 million, or 2.6%, decrease in home equity loans was due to higher residential mortgage refinances resulting from relatively low interest rates during 2009.

The average yield on loans decreased 13 basis points, or 2.4%, from 5.50% in 2009 to 5.37% in 2010, despite the average prime rate remaining at 3.25% for the first half of both 2010 and 2009. The decrease in average yields on loans was attributable to repayments of higher-yielding loans and declining average rates on fixed and adjustable rate loans which, unlike floating rate loans, have a lagged repricing effect.

Average investments decreased \$26.5 million, or 0.9%, as sales and maturities of collateralized mortgage obligations and mortgage-backed securities were not fully reinvested in the portfolio. The decrease was not as pronounced as the second quarter of 2010 in comparison to 2009 mainly due to the timing of securities sales. The average yield on investments decreased 32 basis points, or 6.9%, from 4.64% in 2009 to 4.32% in 2010, as the reinvestment of cash flows and incremental purchases of taxable investment securities were at yields that were lower than the overall portfolio yield.

Other interest-earning assets, consisting of interest-bearing deposits with other banks, increased \$170.6 million, or 901.1%. As noted above, the Corporation invested \$226.3 million of proceeds received in connection with its May 2010 common stock offering in short-term funds, with the intent of redeeming its outstanding preferred stock.

Interest expense decreased \$41.0 million, or 29.0%, to \$100.6 million in the first half of 2010 from \$141.6 million in the same period in 2009. Interest expense decreased \$30.0 million as a result of a 61 basis point, or 27.0%, decrease in the average cost of interest-bearing liabilities. Interest expense decreased an additional \$11.0 million as a result of a \$367.3 million, or 2.9%, decline in average interest-bearing liabilities.

The following table summarizes the changes in average deposits, by type:

|                                 | Six months ended       |               | Increase (decrease) |       |
|---------------------------------|------------------------|---------------|---------------------|-------|
|                                 | 2010                   | 2009          | \$                  | %     |
|                                 | June 30                |               |                     |       |
|                                 | (dollars in thousands) |               |                     |       |
| Noninterest-bearing demand      | \$ 2,026,705           | \$ 1,735,525  | \$ 291,180          | 16.8% |
| Interest-bearing demand         | 2,000,734              | 1,786,629     | 214,105             | 12.0  |
| Savings                         | 2,969,814              | 2,183,243     | 786,571             | 36.0  |
| <i>Total demand and savings</i> | <b>6,997,253</b>       | 5,705,397     | 1,291,856           | 22.6  |
| Time deposits                   | 5,161,583              | 5,529,794     | (368,211)           | (6.7) |
| <i>Total deposits</i>           | <b>\$ 12,158,836</b>   | \$ 11,235,191 | \$ 923,645          | 8.2%  |

Noninterest-bearing and interest-bearing demand and savings accounts increased \$1.3 billion, or 22.6%. The increase in noninterest-bearing demand accounts was primarily in business accounts, the increase in interest-bearing demand accounts was primarily in personal and municipal accounts, and the increase in savings accounts was in personal, business and municipal accounts.



**Table of Contents****Provision for Loan Losses and Allowance for Credit Losses**

The following table presents the activity in the allowance for credit losses:

|  | Six months ended<br>June 30 |                   |
|--|-----------------------------|-------------------|
|  | 2010                        | 2009              |
|  | (dollars in thousands)      |                   |
| Loans, net of unearned income outstanding at end of period           | \$ 11,943,384               | \$ 11,866,818     |
| Daily average balance of loans, net of unearned income               | \$ 11,965,446               | \$ 12,000,755     |
| <i>Balance of allowance for credit losses at beginning of period</i> | <i>\$ 257,553</i>           | <i>\$ 180,137</i> |
| Loans charged off:   |                             |                   |
| Commercial industrial, agricultural and financial                    | 16,371                      | 16,896            |
| Real estate construction   | 29,852                      | 23,536            |
| Real estate commercial mortgage                                      | 6,259                       | 9,921             |
| Consumer   | 4,516                       | 5,140             |
| Real estate residential mortgage and home equity                     | 3,271                       | 3,767             |
| Leasing and other  | 1,255                       | 3,045             |
| <i>Total loans charged off</i>                                       | <i>61,524</i>               | <i>62,305</i>     |
| Recoveries of loans previously charged off:                          |                             |                   |
| Commercial industrial, agricultural and financial                    | 1,593                       | 1,210             |
| Real estate construction   | 896                         | 326               |
| Real estate commercial mortgage                                      | 285                         | 35                |
| Consumer   | 1,040                       | 940               |
| Real estate residential mortgage and home equity                     | 4                           | 148               |
| Leasing and other  | 530                         | 463               |
| <i>Total recoveries</i>  | <i>4,348</i>                | <i>3,122</i>      |
| Net loans charged off  | 57,176                      | 59,183            |
| Provision for loan losses  | 80,000                      | 100,000           |
| <i>Balance of allowance for credit losses at end of period</i>       | <i>\$ 280,377</i>           | <i>\$ 220,954</i> |
| Net charge-offs to average loans (annualized)                        | 0.96%                       | 0.99%             |

The provision for loan losses was \$80.0 million for the first half of 2010, a decrease of \$20.0 million, or 20.0%, over the same period in 2009. A slight decrease in net charge-offs and a slowing in the pace of specific loan loss allocations needed for impaired loans contributed to the decrease in the provision for loan losses.

Net charge-offs decreased \$2.0 million, or 3.4%, to \$57.2 million for the first half of 2010 compared to \$59.2 million for the first half of 2009. Annualized net charge-offs to average loans decreased 3 basis points, or 3.0%, to 96 basis points for the first half of 2010. The \$2.0 million decrease in net charge-offs was primarily due to decreases in commercial mortgage net charge-offs (\$3.9 million, or 39.6%), leasing and other net charge-offs (\$1.9 million, or 71.9%), commercial loan net charge-offs (\$908,000, or 5.8%), and consumer loan net charge-offs (\$724,000, or 17.2%), partially offset by an increase in construction loan net charge-offs (\$5.7 million, or 24.8%).

Of the \$57.2 million of net charge-offs recorded in the first half of 2010, 38.0% were in New Jersey, 24.9% in Pennsylvania, 22.3% in Virginia and 14.0% in Maryland. During the first half of 2010, there were 13 individual charge-offs which exceeded \$1.0 million, totaling \$33.4 million, of which \$25.9 were for businesses that were negatively impacted by the downturn in residential and commercial real estate.



**Table of Contents****Other Income**

The following table presents the components of other income:

|  | Six months ended<br>June 30 |           | Increase (decrease) |         |
|--|-----------------------------|-----------|---------------------|---------|
|  | 2010                        | 2009      | \$                  | %       |
|  | (dollars in thousands)      |           |                     |         |
| Overdraft fees   | \$ 18,502                   | \$ 17,234 | \$ 1,268            | 7.4%    |
| Cash management fees   | 4,791                       | 6,293     | (1,502)             | (23.9)  |
| Other  | 6,456                       | 6,428     | 28                  | 0.4     |
| Service charges on deposit accounts                          | 29,749                      | 29,955    | (206)               | (0.7)   |
| Debit card income  | 6,322                       | 5,192     | 1,130               | 21.8    |
| Merchant fees  | 3,947                       | 3,496     | 451                 | 12.9    |
| Foreign currency processing income                           | 3,902                       | 2,959     | 943                 | 31.9    |
| Letter of credit fees  | 2,702                       | 3,350     | (648)               | (19.3)  |
| Other  | 3,021                       | 2,952     | 69                  | 2.3     |
| Other service charges and fees                               | 19,894                      | 17,949    | 1,945               | 10.8    |
| Investment management and trust services                     | 16,743                      | 15,779    | 964                 | 6.1     |
| Gains on sales of mortgage loans                             | 6,427                       | 15,986    | (9,559)             | (59.8)  |
| Credit card income   | 2,893                       | 2,551     | 342                 | 13.4    |
| Gains on sales of OREO                                       | 1,226                       | 1,044     | 182                 | 17.4    |
| Other  | 5,819                       | 6,031     | (212)               | (3.5)   |
| <i>Total, excluding investment securities gains (losses)</i> | <b>82,751</b>               | 89,295    | (6,544)             | (7.3)   |
| Investment securities gains (losses)                         | (1,319)                     | 2,996     | (4,315)             | N/M     |
| <i>Total</i>   | <b>\$ 81,432</b>            | \$ 92,291 | \$ (10,859)         | (11.8%) |

N/A Not meaningful.

The \$1.3 million, or 7.4%, increase in overdraft fees was due to an increase in volume. The \$1.5 million, or 23.9%, decrease in cash management fees resulted from customers transferring funds from the cash management program to deposits due to the low interest rate environment.

The \$1.1, or 21.8%, increase in debit card fees was due to an increase in transaction volumes and due to the introduction of a new rewards point program in 2010. The \$943,000, or 31.9%, increase in foreign currency processing income was due to an increase in volume. Merchant fees grew \$451,000, or 12.9%, also due to transaction volume growth. The \$648,000, or 19.3%, decline in letter of credit fees was due to a decrease in the balance of letters of credit outstanding.

The \$964,000, or 6.1%, increase in investment management and trust services income was due to a \$1.4 million, or 30.1%, increase in brokerage revenue, offset by a \$430,000, or 3.9%, decrease in trust commissions. The Corporation has expanded its brokerage operations by adding to its sales staff and transitioning from a transaction-based revenue model to a relationship-based model, which generates fees based on the values of assets under management rather than transaction volume.

Gains on sales of mortgage loans decreased \$9.6 million, or 59.8%, due to a decrease in the volume of loans sold. Total loans sold in the first half of 2010 were \$504.7 million, compared to \$1.2 billion in the first half of 2009. The \$693.2 million, or 57.9%, decrease in volume was mainly due to lower refinance activity in 2010. For the first half of 2010, 42% of loans originated for sale were refinances, compared to 80% for the same period in 2009.

## Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

The \$342,000, or 13.4%, increase in credit card income was due to an increase in the volume of transactions on credit cards previously originated, which generate fees under a joint marketing agreement with an independent third-party.

**Table of Contents**

Investment securities losses of \$1.3 million for the first half of 2010 included \$7.2 million of net gains on the sales of securities, primarily collateralized mortgage obligations, offset by \$8.5 million of other-than-temporary impairment charges. The Corporation recorded \$7.1 million of other-than-temporary impairment charges for pooled trust preferred securities issued by financial institutions and \$1.3 million of other-than-temporary impairment charges for certain financial institution stocks. The \$3.0 million of investment securities gains for the first half of 2009 resulted from \$9.4 million of net gains on the sales of securities, primarily collateralized mortgage obligations, partially offset by \$4.6 million of other-than-temporary impairment charges for debt securities issued by financial institutions, \$1.7 million of other-than-temporary impairment charges for certain financial institution stocks and \$106,000 of other-than-temporary impairment charges for other equity securities. See Note D, Investment Securities in the Notes to Consolidated Financial Statements for additional details.

**Other Expenses**

The following table presents the components of other expenses:

|                                | Six months ended       |                   | Increase (decrease) |               |
|--------------------------------|------------------------|-------------------|---------------------|---------------|
|                                | 2010                   | June 30<br>2009   | \$                  | %             |
|                                | (dollars in thousands) |                   |                     |               |
| Salaries and employee benefits | \$ 106,999             | \$ 111,103        | \$ (4,104)          | (3.7%)        |
| Net occupancy expense          | 22,169                 | 21,263            | 906                 | 4.3           |
| FDIC insurance expense         | 10,090                 | 16,494            | (6,404)             | (38.8)        |
| Equipment expense              | 5,754                  | 6,379             | (625)               | (9.8)         |
| Professional fees              | 5,581                  | 4,316             | 1,265               | 29.3          |
| Data processing                | 4,988                  | 5,979             | (991)               | (16.6)        |
| Telecommunications             | 4,356                  | 4,344             | 12                  | 0.3           |
| Marketing                      | 4,101                  | 4,295             | (194)               | (4.5)         |
| OREO expense                   | 2,998                  | 3,183             | (185)               | (5.8)         |
| Postage                        | 2,760                  | 2,588             | 172                 | 6.6           |
| Supplies                       | 2,698                  | 2,781             | (83)                | (3.0)         |
| Intangible amortization        | 2,655                  | 2,897             | (242)               | (8.4)         |
| Operating risk loss            | 1,151                  | 6,345             | (5,194)             | (81.9)        |
| Other                          | 23,087                 | 22,211            | 876                 | 3.9           |
| <b>Total</b>                   | <b>\$ 199,387</b>      | <b>\$ 214,178</b> | <b>\$ (14,791)</b>  | <b>(6.9%)</b> |

Salaries and employee benefits decreased \$4.1 million, or 3.7%, with salaries decreasing \$2.7 million, or 3.0%, and employee benefits decreasing \$1.4 million, or 6.5%. The decrease in salaries was primarily due to the reversal of excess incentive compensation accruals in the first quarter of 2010, in addition to a decrease in average full-time equivalent employees from 3,635 in the first half of 2009 to 3,525 in the first half of 2010, largely due to the consolidation of The Columbia Bank's back office functions in 2009.

The \$1.4 million decrease in employee benefits was primarily due to an \$852,000 decrease in healthcare costs as claims decreased as a result of higher deductibles in 2010 and \$774,000 of severance expense recorded in the first half of 2009 related to the consolidation of The Columbia Bank's back office functions.

The \$906,000, or 4.3%, increase in net occupancy expense was primarily due to higher maintenance expense, primarily snow removal and utilities costs. The \$6.4 million, or 38.8%, decrease in FDIC insurance expense was due to a \$7.7 million special assessment incurred in the first half of 2009, partially offset by an increase in assessment rates and growth in insured deposits in the first half of 2010. The \$1.3 million, or 29.3%, increase in professional fees was due to an increase in legal fees related to collection and workout efforts for non-performing loans and an increase in regulatory fees. The \$625,000, or 9.8%, decrease in equipment expense was largely due to an increased vendor rebate received in 2010 and a decrease in depreciation expense. The \$991,000, or 16.6%, decrease in data processing expense was primarily due to the conversion of The Columbia Bank's back office systems in the third quarter of 2009.



**Table of Contents**

The \$5.2 million, or 81.9%, decrease in operating risk loss was a result of a \$6.2 million charge recorded in the first quarter of 2009 related to the Corporation's commitment to purchase illiquid ARCs from customer accounts. The Corporation did not record any charges related to this guarantee in 2010 as all remaining customer ARCs were purchased during 2009. Partially offsetting this increase was the effect of \$600,000 of credits, recorded in the first half of 2009, related to a reduction in the Corporation's accrual for potential repurchases of previously sold residential mortgage and home equity loans. See Note I, Commitments and Contingencies in the Notes to Consolidated Financial Statements for additional details.

The \$876,000, or 3.9%, increase in other expenses was primarily due to an \$872,000 increase in student loan lender expense and a \$730,000 increase in costs associated with the repossession of foreclosed assets. These increases were partially offset by a \$364,000 decrease in outside services and a \$252,000 decrease in travel, meals and entertainment expenses, all as a result of efforts by the Corporation to reduce discretionary spending.

**Income Taxes**

Income tax expense for the first half of 2010 was \$20.6 million, a \$16.6 million, or 416.7%, increase from \$4.0 million in 2009. The increase was primarily due to the increase in income before income taxes.

The Corporation's effective tax rate was 25.8% in 2010, as compared to 13.2% in 2009. The effective rate is generally lower than the Federal statutory rate of 35% due to investments in tax-free municipal securities and Federal tax credits earned from investments in low and moderate-income housing partnerships. The effective rate for the first half of 2010 is higher than the same period in 2009 due to non-taxable income and tax credits having a smaller impact on the effective tax rate due to the higher level of income before income taxes.

**FINANCIAL CONDITION**

Total assets decreased \$8.8 million, or 0.1%, to \$16.6 billion at June 30, 2010.

Interest-bearing deposits with other banks increased \$417.1 million as the proceeds from the Corporation's common stock offering in May 2010 were invested in short-term assets while the Corporation awaited final approval to redeem its outstanding preferred stock.

Investment securities decreased \$374.2 million, or 11.5%. During 2010, proceeds from the sales and maturities of collateralized mortgage obligations and mortgage-backed securities were not fully reinvested in the investment portfolio due to few attractive investment options in the current rate environment.

The Corporation experienced a \$29.0 million, or 0.2%, decrease in loans, net of unearned income. Construction loans decreased \$85.0 million, or 8.7%, due to paydowns on existing loans and \$29.0 million of net charge-offs recorded in the first half of 2010. Commercial loans decreased \$34.6 million, or 0.9%, due to a lack of demand resulting from continued weak economic conditions. Offsetting these decreases was a \$63.6 million, or 6.9%, increase in residential mortgages and a \$38.3 million, or 0.9%, increase in commercial mortgages. Residential mortgages increased as certain 10 and 15 year mortgages, originated in the first half of 2010, were held in portfolio rather than being sold in the secondary market.

Deposits increased \$247.6 million, or 2.0%, due to an increase in demand and savings deposits of \$523.6 million, or 7.8%, partially offset by a decrease in time deposits of \$276.0 million, or 5.2%. The increase in demand and savings accounts was in personal and municipal accounts. The decrease in time deposits was due to a decrease in customer demand for time deposits.

**Table of Contents**

Short-term borrowings decreased \$410.6 million, or 47.3%, mainly in Federal funds purchased, which decreased \$368.5 million, or 97.5%. The decrease in short-term borrowings largely resulted from the Corporation's overall liquidity position, which was enhanced by the increase in deposits, the decrease in investments and weak loan demand. Long-term borrowings decreased \$175.1 million, or 11.4%, as a result of FHLB advance maturities.

Other liabilities increased \$38.0 million, or 26.2%, primarily due to a \$14.5 million increase in equity commitments payable on new low and moderate-income housing partnership investments, a \$7.5 million increase in the reserve for unfunded loan commitments and a \$5.9 million increase in payables related to the purchase of investment securities that had not settled as of June 30, 2010.

**Capital Resources**

Total shareholders' equity increased \$294.7 million, or 15.2%, during the first half of 2010. The increase was due to the \$226.3 million of net proceeds received in connection with the Corporation's common stock offering in May 2010, \$59.2 million of net income and a \$28.2 million increase in net holding gains on investment securities, offset by \$21.2 million in dividends on common and preferred shares outstanding.

The Corporation and its subsidiary banks are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain actions by regulators that could have a material effect on the Corporation's consolidated financial statements. The regulations require that banks maintain minimum amounts and ratios of total and Tier I capital (as defined in the regulations) to risk weighted assets (as defined), and Tier I capital to average assets (as defined). As of June 30, 2010, the Corporation and each of its bank subsidiaries met the minimum requirements. In addition, each of the Corporation's bank subsidiaries' capital ratios exceeded the amounts required to be considered "well capitalized" as defined in the regulations.

The following table summarizes the Corporation's capital ratios in comparison to regulatory requirements, where applicable:

|  | June 30<br>2010 | December 31<br>2009 | Regulatory<br>Minimum<br>Capital<br>Adequacy |
|--|-----------------|---------------------|--|
| Total Capital (to Risk-Weighted Assets)            | 16.8%           | 14.7%               | 8.0%   |
| Tier I Capital (to Risk-Weighted Assets)           | 14.3%           | 11.9%               | 4.0%   |
| Tier I Capital (to Average Assets)                 | 11.3%           | 9.7%                | 3.0%   |
| Tangible common equity to tangible assets (1)      | 8.2%            | 6.3%                | N/A  |
| Tangible common equity to risk weighted assets (2) | 10.4%           | 7.8%                | N/A  |

(1) Ending common shareholders' equity, excluding goodwill and intangible assets, divided by ending assets, excluding goodwill and intangible assets.

(2) Ending common shareholders' equity, excluding goodwill and intangible assets, divided by risk-weighted assets.

In December 2008, the Corporation voluntarily participated in the UST's Capital Purchase Program by issuing \$376.5 million of fixed rate cumulative perpetual preferred stock, and warrants to purchase 5.5 million of the Corporation's common stock, to the UST. The preferred stock paid a compounding cumulative dividend at a rate of 5.0% for the first five years and 9.0% thereafter.

On May 5, 2010, the Corporation issued 21.8 million shares of its common stock, in an underwritten public offering, for total proceeds of \$226.3 million, net of underwriting discounts and commissions. The Corporation intended to use the net proceeds from this offering, together with other funds, to redeem all of the Series A Preferred Stock that it issued to the UST. On July 14, 2010, the Corporation redeemed all 376,500 outstanding shares of its Series A Preferred Stock that it issued to the UST.

**Table of Contents**

As of June 30, 2010, the preferred stock is included in regulatory capital. Pro-forma regulatory capital ratios, excluding this amount, would be as follows:

|  | June 30<br>2010 | December 31<br>2009 | Regulatory<br>Minimum<br>Capital<br>Adequacy |
|--|-----------------|---------------------|--|
| Total Capital (to Risk-Weighted Assets)  | 13.8%           | 11.8%               | 8.0%   |
| Tier I Capital (to Risk-Weighted Assets) | 11.3%           | 9.0%                | 4.0%   |
| Tier I Capital (to Average Assets)       | 8.9%            | 7.3%                | 3.0%   |

**Liquidity**

The Corporation must maintain a sufficient level of liquid assets to meet the cash needs of its customers, who, as depositors, may want to withdraw funds or who, as borrowers, need credit availability. Liquidity is provided on a continuous basis through scheduled and unscheduled principal and interest payments on outstanding loans and investments and through the availability of deposits and borrowings. The Corporation also maintains secondary sources that provide liquidity on a secured and unsecured basis to meet short-term needs. Liquidity must also be managed at the Fulton Financial Corporation parent company level. For safety and soundness reasons, banking regulations limit the amount of cash that can be transferred from subsidiary banks to the parent company in the form of loans and dividends. Generally, these limitations are based on the subsidiary banks' regulatory capital levels and their net income. Management continues to monitor the liquidity and capital needs of the parent company and will implement appropriate strategies, as necessary, to remain adequately capitalized and to meet its cash needs.

The Corporation's sources and uses of cash were discussed in general terms in the net interest income section of Management's Discussion. The consolidated statements of cash flows provide additional information. The Corporation's operating activities during the first half of 2010 generated \$150.5 million of cash, mainly due to net income, as adjusted for non-cash expenses, most notably the provision for loan losses. Cash flows used in investing activities were \$37.5 million, due mainly to purchases of short-term investments with funds provided by the May 2010 common stock issuance. This amount was substantially offset by proceeds from the sales and maturities of available for sale securities in excess of investment purchases. Net cash outflows from financing activities were \$129.1 million as a result of repayments of short-term borrowings and long-term debt exceeding cash inflows from deposit increases and the common stock offering.

## Table of Contents

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the exposure to economic loss that arises from changes in the values of certain financial instruments. The types of market risk exposures generally faced by financial institutions include interest rate risk, equity market price risk, debt security market price risk, foreign currency risk and commodity price risk. Due to the nature of its operations, only equity market price risk, debt security market price risk and interest rate risk are significant to the Corporation.

#### Equity Market Price Risk

Equity market price risk is the risk that changes in the values of equity investments could have a material impact on the financial position or results of operations of the Corporation. The Corporation's equity investments consisted of \$100.3 million of Federal Home Loan Bank (FHLB) and Federal Reserve Bank stock, \$31.1 million of stocks of publicly traded financial institutions, and \$8.5 million of money market mutual funds and other equity investments. The equity investments most susceptible to equity market price risk are the financial institutions stocks, which had a cost basis of approximately \$30.9 million and fair value of \$31.1 million at June 30, 2010. Gross unrealized gains in this portfolio were \$3.2 million, and gross unrealized losses were \$3.0 million.

The Corporation has evaluated whether any unrealized losses on individual equity investments constituted other-than-temporary impairment, which would require a write-down through a charge to earnings. Based on the results of such evaluations, the Corporation recorded write-downs of \$509,000 and \$1.3 million for specific financial institution stocks that were deemed to exhibit other-than-temporary impairment in value during the three and six months ended June 30, 2010, respectively. Additional impairment charges may be necessary in the future depending upon the performance of the equity markets in general and the performance of the individual investments held by the Corporation. See Note D, Investment Securities in the Notes to Consolidated Financial Statements for additional details.

Management continuously monitors the fair value of its equity investments and evaluates current market conditions and operating results of the issuers. Periodic sale and purchase decisions are made based on this monitoring process. None of the Corporation's equity securities are classified as trading. Future cash flows from these investments are not provided in the table on page 56 as such investments do not have maturity dates.

Another source of equity market price risk is the Corporation's investment in FHLB stock, which the Corporation is required to own in order to borrow funds from the FHLB. FHLBs obtain funding primarily through the issuance of consolidated obligations of the Federal Home Loan Bank system. The U.S. government does not guarantee these obligations, and each of the FHLB banks is, generally, jointly and severally liable for repayment of each other's debt. The FHLB system has experienced financial stress, and some of the regional banks within the FHLB system have suspended or reduced their dividends, or eliminated the ability of members to redeem capital stock. The Corporation's FHLB stock and its ability to obtain FHLB funds could be adversely impacted if the financial health of the FHLB system worsens.

In addition to its equity portfolio, the Corporation's investment management and trust services income may be impacted by fluctuations in the securities markets. A portion of this revenue is based on the value of the underlying investment portfolios. If the values of those investment portfolios decrease, whether due to factors influencing U.S. securities markets in general or otherwise, the Corporation's revenue would be negatively impacted. In addition, the Corporation's ability to sell its brokerage services in the future will be dependent, in part, upon consumers level of confidence in the outlook for rising securities prices.

**Table of Contents****Debt Security Market Price Risk**

Debt security market price risk is the risk that changes in the values of debt securities could have a material impact on the financial position or results of operations of the Corporation. The Corporation's debt security investments consist primarily of mortgage-backed securities and collateralized mortgage obligations whose principal payments are guaranteed by U.S. government sponsored agencies, state and municipal securities, U.S. government sponsored and U.S. government debt securities, auction rate certificates and corporate debt securities. The Corporation's investments in auction rate certificates and corporate debt securities are susceptible to market price risk.

**Auction Rate Certificates**

The Corporation's debt securities include investments in student loan auction rate securities, also known as auction rate certificates (ARCs) with a cost basis of \$282.8 million and fair value of \$276.5 million, or 1.7% of total assets, at June 30, 2010.

ARCs are long-term securities structured to allow their sale in periodic auctions, resulting in both the treatment of ARCs as short-term instruments in normal market conditions and fair values that could be derived based on periodic auction prices. However, beginning in 2008, market auctions for these securities began to fail due to an insufficient number of buyers, resulting in an illiquid market. This illiquidity has resulted in recent market prices that represent forced liquidations or distressed sales and do not provide an accurate basis for fair value. Therefore, at June 30, 2010, the fair values of the ARCs were derived using significant unobservable inputs based on an expected cash flow model which produced fair values that were materially different from those that would be expected from settlement of these investments in the illiquid market that presently exists. The expected cash flow model produced fair values which assumed a return to market liquidity sometime within the next three years.

The credit quality of the underlying debt associated with ARCs is also a factor in the determination of their estimated fair value. As of June 30, 2010, approximately \$231 million, or 84%, of the ARCs were rated above investment grade, with approximately \$175 million, or 63%, AAA rated by at least one ratings agency. Approximately \$29 million, or 11%, of ARCs were rated below investment grade by at least one ratings agency. Of this amount, approximately \$17 million, or 57%, of the student loans underlying the ARCs have principal payments which are guaranteed by the Federal government. In total, approximately \$245 million, or 88%, of the student loans underlying the ARCs have principal payments which are guaranteed by the Federal government. At June 30, 2010, all ARCs were current and making scheduled interest payments. At June 30, 2010, the risk of changes in the estimated fair values of ARCs due to deterioration in the credit quality of their underlying debt instruments was not significant.

**Corporate Debt Securities**

The Corporation holds corporate debt securities in the form of pooled trust preferred securities, single-issuer trust preferred securities and subordinated debt issued by financial institutions, as presented in the following table:

|  | <b>June 30, 2010</b>      |                                 |
|--|---------------------------|---------------------------------|
|  | <b>Amortized<br/>cost</b> | <b>Estimated fair<br/>value</b> |
|  | <b>(in thousands)</b>     |                                 |
| Single-issuer trust preferred securities                         | \$ 95,524                 | \$ 81,012                       |
| Subordinated debt  | 34,941                    | 34,835                          |
| Pooled trust preferred securities                                | 13,513                    | 4,279                           |
| Total corporate debt securities issued by financial institutions | \$ 143,978                | \$ 120,126                      |

## Table of Contents

The fair values for pooled trust preferred securities and certain single-issuer trust preferred securities were based on quotes provided by third-party brokers who determined fair values based predominantly on internal valuation models which were not indicative prices or binding offers.

The Corporation's investments in single-issuer trust preferred securities had an unrealized loss of \$14.5 million as of June 30, 2010. The Corporation did not record any other-than-temporary impairment charges for single-issuer trust preferred securities during the three and six months ended June 30, 2010 or 2009. The Corporation holds 11 single-issuer trust preferred securities that were rated below investment grade by at least one ratings agency, with an amortized cost of \$37.1 million and an estimated fair value of \$32.2 million as of June 30, 2010. The majority of the single-issuer trust preferred securities rated below investment grade were rated BB or Baa. Single-issuer trust preferred securities with an amortized cost of \$13.7 million and an estimated fair value of \$10.6 million as of June 30, 2010, were not rated by any ratings agency.

During the three and six months ended June 30, 2010, the Corporation recorded \$3.0 and \$7.1 million of other-than-temporary impairment losses for pooled trust preferred securities, respectively, based on an expected cash flows model. The Corporation holds ten pooled trust preferred securities. Nine of these securities, with an amortized cost of \$12.6 million and an estimated fair value of \$3.7 million, were rated below investment grade by at least one ratings agency, with ratings ranging from C to Ca. For each of the nine pooled trust preferred securities rated below investment grade, the class of securities held by the Corporation is below the most senior tranche, with the Corporation's interests being subordinate to other investors in the pool. The Corporation determines the fair value of pooled trust preferred securities based on quotes provided by third-party brokers.

The amortized cost of pooled trust preferred securities is the purchase price of the securities, net of cumulative credit related other-than-temporary impairment charges, determined using an expected cash flows model. The most significant input to the expected cash flows model was the expected payment deferral rate for each pooled trust preferred security. The Corporation evaluates the financial metrics, such as capital ratios and non-performing asset ratios, of the individual financial institution issuers that comprise each pooled trust preferred security to estimate its expected deferral rate. The actual weighted average cumulative defaults and deferrals as a percentage of original collateral were approximately 30% as of June 30, 2010. The discounted cash flow modeling for pooled trust preferred securities held by the Corporation as of June 30, 2010 assumed an additional 12% expected deferral rate.

Additional impairment charges for debt securities may be necessary in the future depending upon the performance of the individual investments held by the Corporation.

See Note D, Investment Securities in the Notes to Consolidated Financial Statements for further discussion related to the Corporation's other-than-temporary impairment evaluations for debt securities and Note K, Fair Value Measurements in the Notes to Consolidated Financial Statements for further discussion related to debt securities' fair values.

## Interest Rate Risk

Interest rate risk creates exposure in two primary areas. First, changes in rates have an impact on the Corporation's liquidity position and could affect its ability to meet obligations and continue to grow. Second, movements in interest rates can create fluctuations in the Corporation's net income and changes in the economic value of its equity.

The Corporation employs various management techniques to minimize its exposure to interest rate risk. An Asset/Liability Management Committee (ALCO), consisting of key financial and senior management personnel, meets on a periodic basis. The ALCO is responsible for reviewing the interest rate sensitivity position of the Corporation, approving asset and liability management policies, and overseeing the formulation and implementation of strategies regarding balance sheet positions and earnings.

**Table of Contents**

The following table provides information about the Corporation's interest rate sensitive financial instruments. The table presents expected cash flows and weighted average rates for each significant interest rate sensitive financial instrument, by expected maturity period. None of the Corporation's financial instruments are classified as trading. All dollar amounts are in thousands.

|                                      | Expected Maturity Period |              |              |              |              |              | Total         | Estimated Fair Value |
|--------------------------------------|--------------------------|--------------|--------------|--------------|--------------|--------------|---------------|----------------------|
|                                      | Year 1                   | Year 2       | Year 3       | Year 4       | Year 5       | Beyond       |               |                      |
| <b>Fixed rate loans</b>              |                          |              |              |              |              |              |               |                      |
| (1)                                  | \$ 1,063,909             | \$ 507,652   | \$ 438,121   | \$ 331,475   | \$ 264,687   | \$ 632,336   | \$ 3,238,180  | \$ 3,273,905         |
| <i>Average rate</i>                  | 4.60%                    | 6.42%        | 6.35%        | 6.31%        | 6.41%        | 5.87%        | 5.69%         |                      |
| <b>Floating rate loans</b>           |                          |              |              |              |              |              |               |                      |
| (1) (2)                              | 2,102,287                | 1,129,629    | 908,096      | 825,266      | 1,725,595    | 2,007,741    | 8,698,614     | 8,665,838            |
| <i>Average rate</i>                  | 4.80%                    | 5.09%        | 5.08%        | 4.94%        | 4.45%        | 5.59%        | 4.99%         |                      |
| <b>Fixed rate investments</b>        |                          |              |              |              |              |              |               |                      |
| (3)                                  | 513,693                  | 478,200      | 310,622      | 225,399      | 152,249      | 651,201      | 2,331,364     | 2,420,193            |
| <i>Average rate</i>                  | 4.54%                    | 4.62%        | 4.71%        | 4.67%        | 4.64%        | 4.23%        | 4.51%         |                      |
| <b>Floating rate investments</b>     |                          |              |              |              |              |              |               |                      |
| (3)                                  | 0                        | 500          | 282,765      | 93           | 197          | 71,231       | 354,786       | 332,756              |
| <i>Average rate</i>                  | 0%                       | 4.09%        | 2.68%        | 1.18%        | 1.65%        | 2.44%        | 2.64%         |                      |
| <b>Other interest-earning assets</b> |                          |              |              |              |              |              |               |                      |
|                                      | 527,191                  | 0            | 0            | 0            | 0            | 0            | 527,191       | 527,191              |
| <i>Average rate</i>                  | 1.10%                    | 0%           | 0%           | 0%           | 0%           | 0%           | 1.10%         |                      |
| <b>Total</b>                         | \$ 4,207,080             | \$ 2,115,981 | \$ 1,939,604 | \$ 1,382,233 | \$ 2,142,728 | \$ 3,362,509 | \$ 15,150,135 | \$ 15,219,883        |
| <i>Average rate</i>                  | 4.25%                    | 5.30%        | 4.96%        | 5.22%        | 4.71%        | 5.31%        | 4.88%         |                      |
| <b>Fixed rate deposits</b>           |                          |              |              |              |              |              |               |                      |
| (4)                                  | \$ 2,960,769             | \$ 759,953   | \$ 501,024   | \$ 139,974   | \$ 73,938    | \$ 12,853    | \$ 4,448,511  | \$ 4,494,573         |
| <i>Average rate</i>                  | 1.65%                    | 2.16%        | 3.04%        | 3.30%        | 2.84%        | 2.61%        | 1.97%         |                      |
| <b>Floating rate deposits</b>        |                          |              |              |              |              |              |               |                      |
| (5)                                  | 3,341,019                | 189,843      | 187,625      | 178,852      | 180,855      | 1,671,614    | 5,749,808     | 5,749,808            |
| <i>Average rate</i>                  | 0.76%                    | 0.51%        | 0.51%        | 0.48%        | 0.49%        | 0.34%        | 0.60%         |                      |
| <b>Fixed rate borrowings</b>         |                          |              |              |              |              |              |               |                      |
| (6)                                  | 346,831                  | 102,827      | 5,837        | 5,880        | 151,052      | 732,965      | 1,345,392     | 1,336,267            |
| <i>Average rate</i>                  | 4.23%                    | 4.01%        | 2.89%        | 5.52%        | 4.57%        | 4.92%        | 4.63%         |                      |
| <b>Floating rate borrowings</b>      |                          |              |              |              |              |              |               |                      |
| (7)                                  | 458,630                  | 0            | 0            | 0            | 0            | 20,000       | 478,630       | 463,690              |
| <i>Average rate</i>                  | 0.27%                    | 0%           | 0%           | 0%           | 0%           | 2.86%        | 0.38%         |                      |
| <b>Total</b>                         | \$ 7,107,249             | \$ 1,052,623 | \$ 694,486   | \$ 324,706   | \$ 405,845   | \$ 2,437,432 | \$ 12,022,341 | \$ 12,044,338        |
| <i>Average rate</i>                  | 1.27%                    | 2.04%        | 2.36%        | 1.79%        | 2.44%        | 1.75%        | 1.55%         |                      |

- (1) Amounts are based on contractual payments and maturities, adjusted for expected prepayments. Excludes overdraft deposit balances.
- (2) Line of credit amounts are based on historical cash flow assumptions, with an average life of approximately 5 years.
- (3) Amounts are based on contractual maturities; adjusted for expected prepayments on mortgage-backed securities and collateralized mortgage obligations and expected calls on agency and municipal securities.
- (4) Amounts are based on contractual maturities of time deposits.
- (5) Estimated based on history of deposit flows.
- (6) Amounts are based on contractual maturities of debt instruments, adjusted for possible calls. Amounts also include junior subordinated deferrable interest debentures.
- (7) Amounts include Federal Funds purchased, short-term promissory notes and securities sold under agreements to repurchase, which mature in less than 90 days, in addition to junior subordinated deferrable interest debentures.

## Edgar Filing: FULTON FINANCIAL CORP - Form 10-Q

The preceding table and discussion addressed the liquidity implications of interest rate risk and focused on expected cash flows from financial instruments. Expected maturities, however, do not necessarily reflect the net interest impact of interest rate changes. Certain financial instruments, such as adjustable rate loans, have repricing periods that differ from expected cash flows periods. Fair value adjustments related to acquisitions are not included in the preceding table.

Included within the \$8.7 billion of floating rate loans above are \$3.7 billion of loans, or 42.5% of the total, that float with the prime interest rate, \$1.2 billion, or 13.3%, of loans that float with other interest rates, primarily LIBOR, and \$3.8 billion, or 44.2%, of adjustable rate loans. The \$3.8 billion of adjustable rate loans include loans that are fixed rate instruments for a certain period of time, and then convert to floating rates.



**Table of Contents**

The following table presents the percentage of adjustable rate loans, at June 30, 2010, stratified by the period until their next repricing:

|                         | <b>Percent of Total<br/>Adjustable Rate<br/>Loans</b> |
|-------------------------|---|
| One year                | 30.7%   |
| Two years               | 20.1  |
| Three years             | 20.5  |
| Four years              | 14.6  |
| Five years              | 10.1  |
| Greater than five years | 4.0   |

The Corporation uses three complementary methods to measure and manage interest rate risk. They are static gap analysis, simulation of earnings, and estimates of economic value of equity. Using these measurements in tandem provides a reasonably comprehensive summary of the magnitude of interest rate risk in the Corporation, level of risk as time evolves, and exposure to changes in interest rate relationships.

Static gap provides a measurement of repricing risk in the Corporation's balance sheet as of a point in time. This measurement is accomplished through stratification of the Corporation's assets and liabilities into repricing periods. The sum of assets and liabilities in each of these periods are compared for mismatches within that maturity segment. Core deposits having no contractual maturities are placed into repricing periods based upon historical balance performance. Repricing for mortgage loans, mortgage-backed securities and collateralized mortgage obligations includes the effect of expected cash flows. Estimated prepayment effects are applied to these balances based upon industry projections for prepayment speeds. The Corporation's policy limits the cumulative six-month ratio of rate sensitive assets to rate sensitive liabilities (RSA/RSL) to a range of 0.85 to 1.15. As of June 30, 2010, the cumulative six-month ratio of RSA/RSL was 1.10.

Simulation of net interest income and net income is performed for the next twelve-month period. A variety of interest rate scenarios are used to measure the effects of sudden and gradual movements upward and downward in the yield curve. These results are compared to the results obtained in a flat or unchanged interest rate scenario. Simulation of earnings is used primarily to measure the Corporation's short-term earnings exposure to rate movements. The Corporation's policy limits the potential exposure of net interest income to 10% of the base case net interest income for a 100 basis point shock in interest rates, 15% for a 200 basis point shock and 20% for a 300 basis point shock. A shock is an immediate upward or downward movement of interest rates across the yield curve. The shocks do not take into account changes in customer behavior that could result in changes to mix and/or volumes in the balance sheet nor do they account for competitive pricing over the forward 12-month period.

The following table summarizes the expected impact of interest rate shocks on net interest income (due to the current level of interest rates, the 200 and 300 basis point downward shock scenario is not shown):

| <b>Rate Shock</b> | <b>Annual change<br/>in net interest<br/>income</b> | <b>% Change</b> |
|-------------------|---|-----------------|
| +300 bp           | + \$ 61.8 million                                   | + 10.6%         |
| +200 bp           | + \$ 38.1 million                                   | + 6.6%          |
| +100 bp           | + \$15.4 million                                    | + 2.7%          |
| - 100 bp (1)      | - \$ 1.6 million                                    | - 0.3%          |

- (1) Because certain current short-term interest rates are at or below 1.00%, the 100 basis point downward shock assumes that corresponding short-term interest rates approach an implied floor that, in effect, reflects a decrease of less than the full 100 basis points downward shock.

**Table of Contents**

Economic value of equity estimates the discounted present value of asset cash flows and liability cash flows. Discount rates are based upon market prices for like assets and liabilities. Upward and downward shocks of interest rates are used to determine the comparative effect of such interest rate movements relative to the unchanged environment. This measurement tool is used primarily to evaluate the longer-term repricing risks and options in the Corporation's balance sheet. A policy limit of 10% of economic equity may be at risk for every 100 basis point shock movement in interest rates. As of June 30, 2010, the Corporation was within policy limits for every 100 basis point shock movement in interest rates.

**Table of Contents**

**Item 4. Controls and Procedures**

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this quarterly report, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Corporation reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in the Corporation's internal control over financial reporting during the fiscal quarter covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## **Table of Contents**

### **PART II OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

Not applicable.

#### **Item 1A. Risk Factors**

Information responsive to this item as of June 30, 2010 appears under the heading, "Risk Factors" within the Corporation's Form 10-K for the year ended December 31, 2009, except for the following additional risk factors.

##### ***Increases in FDIC insurance premiums may adversely affect the Corporation's earnings.***

In response to the impact of economic conditions since 2008 on banks generally and on the FDIC deposit insurance fund, the FDIC changed its risk-based assessment system and increased base assessment rates. In addition, on November 12, 2009, the FDIC adopted a rule requiring banks to prepay three years' worth of premiums to replenish the depleted insurance fund. A change in the risk categories applicable to the Corporation's bank subsidiaries, further adjustments to base assessment rates and any special assessments could have a material adverse effect on the Corporation's earnings, financial condition and results of operation and may adversely affect the market price of the Corporation's common stock.

##### ***Recently enacted financial reform legislation may have a significant impact on the Corporation's business and results of operations.***

On July 21, 2010, the President of the United States signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). Among other things, the Act creates the Financial Stability Oversight Council, with oversight authority for monitoring and regulating systemic risk, and the Bureau of Consumer Financial Protection, which will have broad regulatory and enforcement powers over consumer financial products and services. The Act also changes the responsibilities of the current federal banking regulators, imposes additional corporate governance and disclosure requirements in areas such as executive compensation and proxy access, and limits or prohibits proprietary trading and hedge fund and private equity activities of banks. The scope of the Act impacts many aspects of the financial services industry, and it requires the development and adoption of many implementing regulations over the next several months and years. The effects of the Act on the financial services industry will depend, in large part, upon the extent to which regulators exercise the authority granted to them under the Act and the approaches taken in implementing regulations. The Corporation, as well as the broader financial services industry, has begun to assess the potential impact of the Act on its business and operations, but at this early stage, the likely impact cannot be ascertained with any degree of certainty. However, it would appear that the Corporation is likely to be impacted by the Act in the areas of corporate governance, deposit insurance assessments, capital requirements, risk management, stress testing, and regulation under consumer protection laws.

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

Not applicable.

#### **Item 3. Defaults Upon Senior Securities and Use of Proceeds**

Not applicable.

#### **Item 4. Reserved**

**Item 5. Other Information**

Not applicable.

**Table of Contents**

**Item 6. Exhibits**

See Exhibit Index for a list of the exhibits required by Item 601 of Regulation S-K and filed as part of this report.

**Table of Contents**

**FULTON FINANCIAL CORPORATION AND SUBSIDIARIES**

**SIGNATURES**

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

FULTON FINANCIAL CORPORATION

Date: August 9, 2010

/s/ R. Scott Smith, Jr.  
R. Scott Smith, Jr.  
Chairman and Chief Executive Officer

Date: August 9, 2010

/s/ Charles J. Nugent  
Charles J. Nugent  
Senior Executive Vice President and  
Chief Financial Officer

**Table of Contents**

**EXHIBIT INDEX**

**Exhibits Required Pursuant**

**to Item 601 of Regulation S-K**

- 3.1 Articles of Incorporation, as amended and restated, of Fulton Financial Corporation as amended Incorporated by reference to Exhibit 3.1 of the Fulton Financial Corporation Form S-4 Registration Statement filed on October 7, 2005.
- 3.2 Bylaws of Fulton Financial Corporation as amended Incorporated by reference to Exhibit 3.1 of the Fulton Financial Corporation Current Report on Form 8-K dated September 18, 2008.
- 3.3 Certificate of Designations of Fixed Rate Cumulative Preferred Stock, Series A of Fulton Financial Corporation Incorporated by reference to Exhibit 3.1 of the Fulton Financial Corporation Current Report on Form 8-K dated December 23, 2008.
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 Interactive data file containing the following financial statements formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets at June 30, 2010 and December 31, 2009; (ii) the Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2009; (iii) the Consolidated Statements of Shareholders' Equity and Comprehensive Income for the six months ended June 30, 2010 and 2009; (iv) the Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009; and, (v) the Notes to Consolidated Financial Statements, tagged as blocks of text. As provided in Rule 406T of Regulation S-T, this interactive data file shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, and shall not be deemed filed or part of any registration statement or prospectus for purposes of Section 11 or 12 under the Securities Act of 1933, or otherwise subject to liability under those sections.