Huntsman CORP
Form 8-K
May 06, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 8-K

CURRENT REPORT

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

Date of Report (Date of earliest event reported): **May 2, 2013**

Huntsman Corporation

(Exact name of registrant as specified in its charter)

Delaware	**001-32427**	**42-1648585**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

500 Huntsman Way	
Salt Lake City, Utah	**84108**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code:

(801) 584-5700

Not applicable

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligations of the registrant under any of the following provisions (see General Instruction A.2. below):

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 5.07 Submission of Matters to a Vote of Security Holders

(a) The 2013 Annual Meeting of Stockholders of Huntsman Corporation (the Company) was held on May 2, 2013 (the Annual Meeting).

(b) The Company s stockholders voted on the following four proposals (described in detail in the Company s definitive proxy statement filed with the Securities and Exchange Commission on March 20, 2013) at the Annual Meeting and cast their votes as follows:

Proposal No. 1 The four nominees named below were elected to serve as Class III directors of the board of directors, to serve until the 2016 Annual Meeting, and the voting results were as follows:

Class II Directors	**For**	**Withheld**	**Broker Non-Votes**
Nolan D. Archibald	161,987,632	34,349,811	28,285,404
M. Anthony Burns	188,248,275	8,089,168	28,285,404
Gov. Jon M. Huntsman, Jr.	158,920,381	37,417,062	28,285,404
Sir Robert J. Margetts	187,742,772	8,594,671	28,285,404

Proposal No. 2 The non-binding advisory vote to approve the compensation of the Company s named executive officers was approved as set forth below.

For	**Against**	**Abstain**	**Broker Non-Votes**
155,438,148	30,141,728	10,757,567	28,285,404

Proposal No. 3 The appointment of Deloitte & Touche LLP as the independent registered public accounting firm for the year ending December 31, 2013 was ratified, and the voting results were as follows.

For	**Against**	**Abstain**
216,732,386	6,905,881	984,580

Proposal No. 4 The vote on a proposal submitted by a stockholder urging that the board of directors take steps necessary to elect each director annually was approved as follows.

For	**Against**	**Abstain**	**Broker Non-Votes**
115,894,809	71,359,842	9,082,792	28,285,404

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 hereunto duly authorized.

HUNTSMAN CORPORATION

/s/ TROY M. KELLER
Assistant Secretary

Dated: May 6, 2013

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mily:Times New Roman" SIZE="2"> 319,384 3.9 336,604 4.1

Student loans held for sale

18,771 0.2

Other

17,310 0.2 28,234 0.4 64,732 0.8

Total consumer and other

325,122 4.1 347,618 4.3 420,107 5.1

Unearned discounts

(20,348) (0.3) (20,287) (0.3) (21,302) (0.3)

Total loans

$8,025,080 100.0% $8,117,020 100.0% $8,189,591 100.0%

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

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

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation s commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Corporation s exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans

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based on collateral, geography and risk grade criteria. As a general rule, the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Corporation also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At March 31, 2011, approximately 62% of the outstanding principal balance of the Corporation s commercial real estate loans were secured by owner-occupied properties.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Note 4 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets were as follows:

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

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

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

	$ 13,215

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Note 5 - Deposits

Deposits were as follows:

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

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

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

Note 6 - Commitments and Contingencies

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

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

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

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

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

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

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

Note 7 - Regulatory Matters

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

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

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

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

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

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

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

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

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

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

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Note 8 - Derivative Financial Instruments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Note 9 - Earnings Per Common Share

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

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

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

Note 10 - Stock-Based Compensation

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

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

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

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

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

Total	$ 3,737	$ 3,648

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

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

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Note 11 - Defined Benefit Plans

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

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

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

Note 12 - Income Taxes

Income tax expense was as follows:

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

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

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

Note 13 - Comprehensive Income

Comprehensive income was as follows:

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

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

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Note 14 - Operating Segments

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

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

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

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

Summarized operating results by segment were as follows:

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

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Note 15 - Fair Value Measurements

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

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

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

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

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

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

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
March 31, 2011				
Securities available for sale:				
U.S. Treasury	$ 983,918	$	$	$ 983,918
Residential mortgage-backed securities		2,563,498		2,563,498
States and political subdivisions		2,075,979		2,075,979
Other		38,816		38,816
Trading account securities:				
U.S. Treasury	15,705			15,705
States and political subdivisions		5,041		5,041
Derivative assets:				

Interest rate swaps, caps and floors		37,647	982	38,629
Commodity and foreign exchange derivatives	5	28,202		28,207
Derivative liabilities:				
Interest rate swaps, caps and floors		54,753		54,753
Commodity and foreign exchange derivatives		27,934		27,934

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	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
December 31, 2010				
Securities available for sale:				
U.S. Treasury	$ 987,031	$	$	$ 987,031
Residential mortgage-backed securities		2,091,330		2,091,330
States and political subdivisions		2,040,300		2,040,300
Other		38,809		38,809
Trading account securities:				
U.S. Treasury	14,986			14,986
States and political subdivisions		115		115
Derivative assets:				
Interest rate swaps, caps and floors		43,633	1,090	44,723
Commodity and foreign exchange derivatives		14,177		14,177
Derivative liabilities:				
Interest rate swaps, caps and floors		63,299		63,299
Commodity and foreign exchange derivatives	19	14,082		14,101

The following table reconciles the beginning and ending balances of derivative assets measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2011	2010
Balance, beginning of period	$ 1,090	$ 945
Cash settlements	(112)	(116)
Realized gains (losses) included in other non-interest income	(35)	223
Realized gains (losses) included in other non-interest expense	39	(19)
Balance, end of period	$ 982	$ 1,033

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets measured at fair value on a non-recurring basis during the three months ended March 31, 2011 and 2010 include certain impaired loans reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. The following table presents impaired loans that were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses based upon the fair value of the underlying collateral during the three months ended March 31, 2011 and 2010.

	Three Months Ended March 31, 2011		Three Months Ended March 31, 2010	
	Level 2	Level 3	Level 2	Level 3
Carrying value of impaired loans	$ 11,787	$ 2,633	$ 9,712	$ 16,071
Specific valuation allowance allocations	(3,205)	(752)	(1,194)	(5,872)
Fair value	$ 8,582	$ 1,881	$ 8,518	$ 10,199

Non-Financial Assets and Non-Financial Liabilities: The Corporation has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Non-financial assets measured at fair value on a non-recurring basis during the three months ended March 31, 2011 and 2010 include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for possible loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in other non-interest expense. The fair value of a foreclosed asset is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. During the reported periods, all fair value measurements for foreclosed assets utilized Level 2 inputs.

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The following table presents foreclosed assets that were remeasured and reported at fair value:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Foreclosed assets remeasured at initial recognition:		
Carrying value of foreclosed assets prior to remeasurement	$ 8,804	$ 6,494
Charge-offs recognized in the allowance for possible loan losses	(1,370)	(1,098)
Fair value	$ 7,434	$ 5,396
Foreclosed assets remeasured subsequent to initial recognition:		
Carrying value of foreclosed assets prior to remeasurement	$ 936	$ 2,184
Write-downs included in other non-interest expense	(241)	(631)
Fair value	$ 695	$ 1,553

FASB ASC Topic 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. A detailed description of the valuation methodologies used in estimating the fair value of financial instruments is set forth in the 2010 Form 10-K.

The estimated fair values of financial instruments were as follows:

	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 2,698,671	$ 2,698,671	$ 2,820,977	$ 2,820,977
Securities	6,023,991	6,034,468	5,456,200	5,468,799
Loans, net	7,900,759	7,951,779	7,990,704	8,038,760
Cash surrender value of life insurance policies	130,910	130,910	129,922	129,922
Non-hedging commercial loan/lease interest rate swaps, caps and floors	38,629	38,629	44,723	44,723
Commodity and foreign exchange derivatives	28,207	28,207	14,177	14,177
Accrued interest receivable	48,896	48,896	72,328	72,328
Financial liabilities:				
Deposits	14,709,559	14,710,508	14,479,342	14,480,725
Federal funds purchased and repurchase agreements	553,571	553,571	475,673	475,673
Junior subordinated deferrable interest debentures	123,712	123,712	123,712	123,712
Subordinated notes payable and other borrowings	250,040	251,946	250,045	256,172
Interest rate swap on junior subordinated deferrable interest debentures designated as a hedge of cash flows	8,742	8,742	9,895	9,895
Commercial loan/lease interest rate swaps designated as hedges of fair value	7,090	7,090	8,350	8,350
Non-hedging commercial loan/lease interest rate swaps, caps and floors	38,921	38,921	45,054	45,054
Commodity and foreign exchange derivatives	27,934	27,934	14,101	14,101
Accrued interest payable	5,191	5,191	9,991	9,991

Under ASC Topic 825, entities may choose to measure eligible financial instruments at fair value at specified election dates. The fair value measurement option (i) may be applied instrument by instrument, with certain exceptions, (ii) is generally irrevocable and (iii) is applied only to entire instruments and not to portions of instruments. Unrealized gains and losses on items for which the fair value measurement option has been elected must be reported in earnings at each subsequent reporting date. During the reported periods, the Corporation had no financial instruments measured at fair value under the fair value measurement option.

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Note 16 - Accounting Standards Updates

ASU No. 2010-20, Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users evaluation of (i) the nature of credit risk inherent in the entity s portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 became effective for the Corporation s financial statements as of December 31, 2010, as it relates to disclosures required as of the end of a reporting period. Disclosures that relate to activity during a reporting period became effective for the Corporation s financial statements beginning on January 1, 2011. ASU 2011-01, Receivables (Topic 310) - Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20, temporarily deferred the effective date for disclosures related to troubled debt restructurings to coincide with the effective date of the then proposed ASU 2011-02, Receivables (Topic 310) - A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring, which is further discussed below.

ASU No. 2010-28, Intangibles - Goodwill and Other (Topic 350) - When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. ASU 2010-28 modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. ASU 2010-28 became effective for the Corporation on January 1, 2011 and did not have a significant impact on the Corporation s financial statements.

ASU No. 2011-02, Receivables (Topic 310) - A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 will be effective for the Corporation on July 1, 2011, and applies retrospectively to restructurings occurring on or after January 1, 2011. Adoption of ASU 2011-02 is not expected have a significant impact on the Corporation s financial statements.

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

Financial Review

Cullen/Frost Bankers, Inc.

The following discussion should be read in conjunction with the Corporation s consolidated financial statements, and notes thereto, for the year ended December 31, 2010, included in the 2010 Form 10-K. Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results for the year ending December 31, 2011 or any future period.

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

Forward-Looking Statements and Factors that Could Affect Future Results

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

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

Local, regional, national and international economic conditions and the impact they may have on the Corporation and its customers and the Corporation s assessment of that impact.

Volatility and disruption in national and international financial markets.

Government intervention in the U.S. financial system.

Changes in the mix of loan geographies, sectors and types or the level of non-performing assets and charge-offs.

Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.

The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve.

Inflation, interest rate, securities market and monetary fluctuations.

The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Corporation and its subsidiaries must comply.

The soundness of other financial institutions.

Political instability.

Impairment of the Corporation s goodwill or other intangible assets.

Acts of God or of war or terrorism.

The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

Changes in consumer spending, borrowings and savings habits.

Changes in the financial performance and/or condition of the Corporation s borrowers.

Technological changes.

Acquisitions and integration of acquired businesses.

The ability to increase market share and control expenses.

The Corporation s ability to attract and retain qualified employees.

Changes in the competitive environment in the Corporation s markets and among banking organizations and other financial service providers.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters.

Changes in the reliability of the Corporation s vendors, internal control systems or information systems.

Changes in the Corporation s liquidity position.

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Changes in the Corporation s organization, compensation and benefit plans.

The costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews.

Greater than expected costs or difficulties related to the integration of new products and lines of business.

The Corporation s success at managing the risks involved in the foregoing items.

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

Application of Critical Accounting Policies and Accounting Estimates

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

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

For additional information regarding critical accounting policies, refer to Note 1 - Summary of Significant Accounting Policies in the notes to consolidated financial statements and the sections captioned Application of Critical Accounting Policies and Allowance for Possible Loan Losses in Management s Discussion and Analysis of Financial Condition and Results of Operations included in the 2010 Form 10-K. There have been no significant changes in the Corporation s application of critical accounting policies related to the allowance for possible loan losses since December 31, 2010.

Overview

A discussion of the Corporation s results of operations is presented below. Certain reclassifications have been made to make prior periods comparable. Taxable-equivalent adjustments are the result of increasing income from tax-free loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 35% federal income tax rate, thus making tax-exempt asset yields comparable to taxable asset yields.

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Results of Operations

Net income totaled $51.9 million, or $0.85 diluted per common share, for the three months ended March 31, 2011 compared to $47.8 million, or $0.79 diluted per common share, for the three months ended March 31, 2010 and $53.1 million, or $0.87 diluted per common share, for the three months ended December 31, 2010.

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

	Three Months Ended		
	March 31, 2011	December 31, 2010	March 31, 2010
Taxable-equivalent net interest income	$ 156,638	$ 155,221	$ 150,343
Taxable-equivalent adjustment	14,879	13,658	12,759
Net interest income	141,759	141,563	137,584
Provision for possible loan losses	9,450	11,290	13,571
Net interest income after provision for possible loan losses	132,309	130,273	124,013
Non-interest income	72,333	70,278	71,393
Non-interest expense	140,061	133,741	134,594
Income before income taxes	64,581	66,810	60,812
Income taxes	12,653	13,759	12,994
Net income	$ 51,928	$ 53,051	$ 47,818
Earnings per common share - basic	$ 0.85	$ 0.87	$ 0.79
Earnings per common share - diluted	0.85	0.87	0.79
Dividends per common share	0.45	0.45	0.43
Return on average assets	1.19%	1.18%	1.17%
Return on average equity	10.11	9.96	10.07
Average shareholder s equity to average total assets	11.78	11.84	11.65

Net income for the three months ended March 31, 2011 increased $4.1 million, or 8.6%, compared to the same period in 2010. The increase was primarily the result of a $4.2 million increase in net interest income, a $4.1 million decrease in the provision for possible loan losses, a $940 thousand increase in non-interest income and a $341 thousand decrease in income tax expense partly offset by a $5.5 million increase in non-interest expense.

Net income for the first quarter of 2011 decreased $1.1 million, or 2.1%, from the fourth quarter of 2010. The decrease was primarily the result of a $6.3 million increase in non-interest expense partly offset by a $2.1 million increase in non-interest income, a $1.8 million decrease in the provision for possible loan losses, a $1.1 million decrease in income tax expense and a $196 thousand increase in net interest income.

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

Net Interest Income

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Corporation s largest source of revenue, representing 66.2% of total revenue during the first three months of 2011. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Corporation s loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, remained at 3.25% for the entire year in 2010 and through the first quarter of 2011. The Corporation s loan portfolio is also impacted, to a lesser extent, by changes in the London Interbank Offered Rate (LIBOR). At March 31, 2011, the one-month and three-month U.S. dollar LIBOR rates were 0.24% and 0.31%, respectively, while at March 31, 2010, the one-month and three-month U.S. dollar LIBOR rates were 0.25% and 0.29%, respectively. The intended federal funds rate, which is the cost of immediately available overnight funds, remained at zero to 0.25% for the entire year in 2010 and through the first quarter of 2011.

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The Corporation s balance sheet has historically been asset sensitive, meaning that earning assets generally reprice more quickly than interest-bearing liabilities. Therefore, the Corporation s net interest margin was likely to increase in sustained periods of rising interest rates and decrease in sustained periods of declining interest rates. During the fourth quarter of 2007, in an effort to make the Corporation s balance sheet less sensitive to changes in interest rates, the Corporation entered into various interest rate swaps which effectively converted certain variable-rate loans into fixed-rate instruments for a period of time. During the fourth quarter of 2008, the Corporation also entered into an interest rate swap which effectively converted variable-rate debt into fixed-rate debt for a period of time. As a result of these actions, the Corporation s balance sheet was more interest-rate neutral and changes in interest rates had a less significant impact on the Corporation s net interest margin than would have otherwise been the case. During the fourth quarter of 2009, a portion of the interest rate swaps on variable-rate loans were terminated, while the remaining interest rate swaps on variable-rate loans were terminated during the fourth quarter of 2010. These actions increased the asset sensitivity of the Corporation s balance sheet. See Note 8 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report for additional information related to these interest rate swaps.

The Corporation is primarily funded by core deposits, with non-interest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Corporation s net interest income and net interest margin in a rising interest rate environment. As discussed in the section captioned Supervision and Regulation included in Item 1. Business, of the 2010 Form 10-K, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the ultimate impact of this legislation on the Corporation has not yet been determined, the Corporation expects interest costs associated with demand deposits to increase and the Corporation s balance sheet could become more liability sensitive. See Item 3. Quantitative and Qualitative Disclosures About Market Risk elsewhere in this report. Further analysis of the components of the Corporation s net interest margin is presented below.

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

	First Quarter 2011 vs. Fourth Quarter 2010	First Quarter 2011 vs. First Quarter 2010
Due to changes in average volume	$ (250)	$ 12,185
Due to changes in average interest rates	5,041	(5,890)
Due to difference in the number of days in each of the comparable periods	(3,374)	
Total change	$ 1,417	$ 6,295

Taxable-equivalent net interest income for the three months ended March 31, 2011 increased $6.3 million, or 4.2%, compared to the same period in 2010. The increase primarily resulted from an increase in the average volume of interest-earning assets partly offset by a decrease in the net interest margin. The average volume of interest-earning assets for the first quarter of 2011 increased $1.2 billion compared to the same period in 2010. Over the same time frame, the net interest margin decreased 16 basis points from 4.19% in 2010 to 4.03% in 2011. The decrease in the net interest margin was partly due to an increase in the relative proportion of interest-earning assets invested in lower-yielding interest-bearing deposits during 2011 compared to 2010 while the relative proportion of average interest-earning assets invested in higher-yielding loans decreased. The net interest margin was also negatively impacted by a decrease in the average yield on securities, as further discussed below. The average yield on interest-earning assets decreased 25 basis points from 4.59% in the first quarter of 2010 to 4.34% in the first quarter of 2011 while the average cost of funds decreased 14 basis points from 0.61% in the first quarter of 2010 to 0.47% in the first quarter of 2011. The average yield on interest-earning assets is primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of interest-earning assets. As stated above, market interest rates have remained at historically low levels during the reported periods. The effect of lower average market interest rates on the average yield on average interest-earning assets was partly limited by the aforementioned interest rate swaps on variable-rate loans.

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Taxable-equivalent net interest income for the first quarter of 2011 increased $1.4 million, or 0.9%, from the fourth quarter of 2010. Taxable-equivalent net interest income for the first quarter of 2011 was impacted by a decrease in the number of days compared to the fourth quarter of 2010. Taxable-equivalent net interest income for the fourth quarter of 2010 included 92 days compared to 90 days for the first quarter of 2011. The additional days added approximately $3.4 million to taxable-equivalent net interest income during the fourth quarter of 2010. Excluding the impact of the additional days during the fourth quarter of 2010 results in an effective increase in taxable-equivalent net interest income of approximately $4.8 million during the first quarter of 2011, which was primarily related to a increase in the average yield on interest-earning assets. The average yield on interest-earning assets increased 9 basis points from 4.25% in the fourth quarter of 2010 to 4.34% in the first quarter of 2011 primarily due to an decrease in the relative proportion of interest-earning assets invested in lower-yielding interest-bearing deposits during first quarter of 2011 compared to the fourth quarter of 2010. The average volume of funds invested in interest-bearing deposits decreased $557.8 million from $2.4 billion during the fourth quarter of 2010 to $1.9 billion during first quarter of 2011. Taxable-equivalent net interest income in for the first quarter of 2011 was also favorably impacted by a 3 basis point decrease in the average cost of funds from 0.50% in the fourth quarter of 2010 to 0.47% in the first quarter of 2011. As a result of the aforementioned increase in the average yield on interest-earning assets and concurrent decrease in the average cost of funds, the net interest margin increased 10 basis points from 3.93% in the fourth quarter of 2010 to 4.03% in the first quarter of 2011.

The average volume of loans during the first quarter of 2011 decreased $189.3 million compared to the first quarter of 2010 and increased $48.1 million compared to the fourth quarter of 2010. Loans made up approximately 51.1% of average interest-earning assets during the first quarter of 2011 compared to 56.4% during the first quarter of 2010 and 50.4% during the fourth quarter of 2010. The average yield on loans was 5.01% during the first quarter of 2011 compared to 5.09% during both the first and fourth quarters of 2010. Loans generally have significantly higher yields compared to securities, interest-bearing deposits and federal funds sold and resell agreements and, as such, have a more positive effect on the net interest margin.

The average volume of securities increased $978.8 million and $378.4 million during the first quarter of 2011 compared to the first and fourth quarters of 2010, respectively. Securities made up approximately 37.0% of average interest-earning assets during the first quarter of 2011 compared to 33.3% during the first quarter of 2010 and 34.3% during the fourth quarter of 2010. The average yield on securities was 4.73% in the first quarter of 2011 compared to 5.13% in the first quarter of 2010 and 4.83% in the fourth quarter of 2010. The decrease in the average yield on securities was partly due to a decrease in the yield on taxable securities as proceeds from principal repayments were reinvested at lower market rates. The decrease in the average yield on securities was also partly related to a decrease in the relative proportion of higher-yielding, tax-exempt municipal securities in the first quarter of 2011 compared to the prior periods. The relative proportion of higher-yielding, tax-exempt municipal securities totaled 35.3% of average securities during the first quarter of 2011 compared to 38.1% during in the first quarter of 2010 and 36.4% during the fourth quarter of 2010. The average yield on taxable securities was 3.39% in the first quarter of 2011 compared to 3.98% in first quarter of 2010 and 3.58% in the fourth quarter of 2010, while the average taxable-equivalent yield on tax-exempt securities was 7.15% in the first quarter of 2011 compared to 7.04% in first quarter of 2010 and 7.02% in the fourth quarter of 2010.

Average federal funds sold, resell agreements and interest-bearing deposits during the first quarter of 2011 increased $368.1 million compared to the first quarter of 2010 and decreased $556.6 million compared to the fourth quarter of 2010. Federal funds sold, resell agreements and interest-bearing deposits made up approximately 11.9% of average interest-earning assets during the first quarter of 2011 compared to 10.3% during the first quarter of 2010 and 15.3% during the fourth quarter of 2010. The combined average yield on federal funds sold, resell agreements and interest-bearing deposits was 0.26% during the first quarter of 2011 compared to 0.23% during the first quarter of 2010 and 0.27% during the fourth quarter of 2010. The increase in average federal funds sold, resell agreements and interest-bearing deposits compared to the first quarter of 2010 was primarily due to growth in average deposits. The decrease in average federal funds sold, resell agreements and interest-bearing deposits compared to the fourth quarter of 2010 was due to the reinvestment of funds into higher-yielding securities and a decrease in average deposits.

Average deposits increased $978.7 million during the first quarter of 2011 compared to the first quarter of 2010 and decreased $166.1 million compared to the fourth quarter of 2010. Average interest-bearing deposits for the first quarter of 2011 increased $415.4 million and decreased $42.8 million compared to the first and fourth quarters of 2010, respectively, while average non-interest-bearing deposits increased $563.4 million and decreased $123.3 million compared to the first and fourth quarters of 2010, respectively. The ratio of average interest-bearing deposits to total average deposits was 63.7% during the first quarter of 2011 compared to 65.3% during the first quarter of 2010 and 63.3% during the fourth quarter of 2010. The average cost of deposits is primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of interest-bearing deposits. The average cost of interest-bearing deposits and total deposits was 0.26% and 0.17% during the first quarter of 2011 compared to 0.39% and 0.26% during the first quarter of 2010 and 0.29% and 0.18% during the fourth quarter of 2010. The decrease in the average cost of interest-bearing deposits during the comparable periods was primarily the result of decreases in interest rates offered on certain deposit products due to decreases in average market interest rates and decreases in renewal interest rates on maturing certificates of deposit given the current low interest rate environment. Additionally, during first quarter of 2011 compared to the same period in 2010, the relative proportion of higher-cost certificates of deposit to total average interest-bearing deposits decreased from 14.9% during the first quarter of 2010 to 12.6% during the first quarter of 2011.

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The Corporation s net interest spread, which represents the difference between the average rate earned on earning assets and the average rate paid on interest-bearing liabilities, was 3.87% during the first quarter of 2011 compared to 3.98% and 3.75% during the first and fourth quarters of 2010, respectively. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

The Corporation s hedging policies permit the use of various derivative financial instruments, including interest rate swaps, swaptions, caps and floors, to manage exposure to changes in interest rates. Details of the Corporation s derivatives and hedging activities are set forth in Note 8 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report. Information regarding the impact of fluctuations in interest rates on the Corporation s derivative financial instruments is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

Provision for Possible Loan Losses

The provision for possible loan losses is determined by management as the amount to be added to the allowance for possible loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management s best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for possible loan losses totaled $9.5 million for the first quarter of 2011 compared to $11.3 million for the fourth quarter of 2010 and $13.6 million for the first quarter of 2010. See the section captioned Allowance for Possible Loan Losses elsewhere in this discussion for further analysis of the provision for possible loan losses.

Non-Interest Income

The components of non-interest income were as follows:

	Three Months Ended		
	March 31, 2011	**December 31, 2010**	**March 31, 2010**
Trust fees	$ 18,220	$ 17,399	$ 16,963
Service charges on deposit accounts	23,368	24,082	24,809
Insurance commissions and fees	10,494	6,777	11,138
Other charges, commissions and fees	8,759	7,796	6,919
Net gain on securities transactions	5		5
Other	11,487	14,224	11,559
Total	$ 72,333	$ 70,278	$ 71,393

Total non-interest income for the three months ended March 31, 2011 increased $940 thousand, or 1.3%, compared to the same period in 2010 and $2.1 million, or 2.9%, compared to the fourth quarter of 2010. Changes in the components of non-interest income are discussed below.

Trust Fees. Trust fee income for the three months ended March 31, 2011 increased $1.3 million, or 7.4%, compared to the same period in 2010. Investment fees are the most significant component of trust fees, making up approximately 75% of total trust fees for the first three months of 2011. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees.

The $1.3 million increase in trust fee income during the three months ended March 31, 2011 compared to the same period in 2010 was primarily the result of an increase in investment fees (up $635 thousand), securities lending income (up $276 thousand), real estate fees (up $122 thousand) and custody fees (up $118 thousand). The increase in investment fees was primarily due to the general appreciation in the market values of assets in trust accounts on which these fees are generally based. Equity valuations during the first quarter of 2011 were higher on average compared to the first quarter of 2010.

Trust fee income for the first quarter of 2011 increased $821 thousand, or 4.7%, from the fourth quarter of 2010. The increase was primarily due to increases in investment fees (up $549 thousand), estate fees (up $229 thousand) and real estate fees (up $127 thousand) partly offset by a decrease in oil and gas trust management fees (down $158 thousand).

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At March 31, 2011, trust assets, including both managed assets and custody assets, were primarily composed of fixed income securities (42.9% of trust assets), equity securities (42.4% of trust assets) and cash equivalents (9.1% of trust assets). The estimated fair value of trust assets was $25.5 billion (including managed assets of $10.1 billion and custody assets of $15.4 billion) at March 31, 2011, compared to $24.9 billion (including managed assets of $9.9 billion and custody assets of $15.0 billion) at December 31, 2010 and $22.6 billion (including managed assets of $10.0 billion and custody assets of $12.6 billion) at March 31, 2010.

Service Charges on Deposit Accounts. Service charges on deposit accounts for the three months ended March 31, 2011 decreased $1.4 million, or 5.8%, compared to the same period in 2010. The decrease was due to decreases in overdraft/insufficient funds charges on both consumer and commercial accounts (down $1.0 million) and a decrease in service charges on commercial accounts (down $783 thousand), which was partly related to a decrease in service volumes for billable services. The decrease in overdraft/insufficient funds charges on consumer accounts during the first quarter of 2011 was partly related to a new rule issued by the Federal Reserve that became effective in the third quarter of 2010, as further discussed below. The decreases in the aforementioned categories of service charges on deposit accounts were partly offset by an increase in point of sale income (up $573 thousand). The increase in point of sale income from PIN-based debit card transactions was related to an increase in the volume of transactions as well as a higher interchange pricing structure during the first quarter of 2011 compared to the first quarter of 2010.

Service charges on deposit accounts for the first quarter of 2011 decreased $714 thousand, or 3.0%, compared to the fourth quarter of 2010. The decrease was primarily due to a decrease in overdraft/insufficient funds charges on both consumer and commercial accounts (down $822 thousand) and point of sale income (down $123 thousand) partly offset by an increase in. service charges on commercial accounts (up $259 thousand).

Overdraft/insufficient funds charges totaled $8.6 million ($6.6 million consumer and $2.0 million commercial) during the first quarter of 2011 compared to $9.6 million ($7.5 million consumer and $2.1 million commercial) during the first quarter of 2010 and $9.4 million ($7.3 million consumer and $2.1 million commercial) during the fourth quarter of 2010. Overdraft/insufficient funds charges were partly impacted by changes in posting policies and a new rule issued by the Federal Reserve that became effective in the third quarter of 2010. The new rule prohibits financial institutions from charging consumers fees for paying overdrafts on automated teller machine and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. Consumers must be provided a notice that explains the financial institution s overdraft services, including the fees associated with the service, and the consumer s choices.

Point of sale income from PIN-based debit card transactions totaled $1.7 million and $1.2 million during the three months ended March 31, 2011 and 2010, respectively. As discussed in the section captioned Supervision and Regulation included in Item 1. Business, of the 2010 Form 10-K, the Dodd-Frank Act amended the Electronic Fund Transfer Act (EFTA) to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers, such as Frost Bank. In December 2010, the Federal Reserve proposed a new regulation that, among other things, establishes standards for determining whether an interchange fee received or charged by an issuer with respect to an electronic debit transaction is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. These new standards would take effect on July 21, 2011 and would apply to issuers, such as the Corporation, that, together with their affiliates, have assets of $10 billion or more. The Federal Reserve had requested comment on two alternative interchange fee standards that would apply to all covered issuers. One alternative would be based on each issuer s costs, with a safe harbor (initially set at 7 cents per transaction) and a cap (initially set at 12 cents per transaction); and the other a stand-alone cap (initially set at 12 cents per transaction). Under both alternatives, circumvention or evasion of the interchange fee limitations would be prohibited. Because of the uncertainty as to the final outcome of the Federal Reserve s rulemaking process, the Corporation cannot provide any assurance as to the ultimate impact of this proposal on the amount of point of sale income from PIN-based debit card transactions reported in future periods; however, based on the current proposal the Corporation s revenues from these transactions would likely be approximately one fourth of current levels. Also see the discussion regarding income from Visa check card usage below under Other Non-Interest Income.

Insurance Commissions and Fees. Insurance commissions and fees for the three months ended March 31, 2011 decreased $644 thousand, or 5.8%, compared to the same period in 2010. The decrease is related to a decrease in commission income (down $619 thousand). The decrease in commission income was partly due to normal variation in the market demand for insurance products.

Insurance commissions and fees include contingent commissions totaling $2.6 million during both the three months ended March 31, 2011 and 2010. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers related to the loss performance of insurance policies previously placed. Such commissions are seasonal in nature and are generally received during the first quarter of each year. These commissions totaled $2.2 million and $2.3 million during the three months ended March 31, 2011 and 2010. Contingent commissions also include amounts received from various benefit plan insurance companies related to the volume of business generated and/or the subsequent retention of such business. These commissions totaled $387 thousand and $248 thousand during the three months ended March 31, 2011 and 2010.

Insurance commissions and fees for the first quarter of 2011 increased $3.7 million, or 54.8%, compared to the fourth quarter of 2010. The increase was primarily due to the seasonal increase in contingent commissions (up $2.4 million) received from various insurance carriers related to the performance of insurance policies previously placed. Commission income for the first quarter of 2011 increased $1.3 million compared to the fourth quarter of 2010 primarily due to normal variation in the timing of renewals and the market demand for insurance products.

Other Charges, Commissions and Fees. Other charges, commissions and fees for the three months ended March 31, 2011 increased $1.8 million, or 26.6%, compared to the same period in 2010. The increase was primarily related to increases in investment banking fees related to corporate advisory services (up $693 thousand), mutual fund management fees (up $340 thousand), income related to sale of annuities (up $247 thousand) and unused balance fees on loan commitments (up $193 thousand). Investment banking fees related to corporate advisory services are transaction based and can vary significantly from quarter to quarter. These increases were partly offset by a decrease in receivables factoring income (down $178 thousand).

Other charges, commissions and fees for the first quarter of 2011 increased $963 thousand, or 12.4%, compared to the fourth quarter of 2010. The increase was primarily due to increases in investment banking fees related to corporate advisory services (up $636 thousand), income related to the sale of annuities (up $167 thousand) and mutual fund management fees (up $154 thousand). These increases were partly offset by a decrease in receivables factoring income (down $108 thousand).

Net Gain/Loss on Securities Transactions. During the first quarter of 2011, the Corporation sold available-for-sale securities with an amortized cost totaling $5.5 billion and realized a net gain of $5 thousand on those sales. During the first quarter of 2010, the Corporation sold available-for-sale securities with an amortized cost totaling $7.0 billion and realized a net gain of $5 thousand on those sales. These securities were purchased during the first quarters of each respective year and subsequently sold primarily in connection with certain tax planning strategies.

Other Non-Interest Income. Other non-interest income for the three months ended March 31, 2011 did not significantly fluctuate compared to the same period in 2010. Components of other non-interest income with significant increases included income from check card activity (up $634 thousand), mineral interest income related to bonus, rental and shut-in payments and oil and gas royalties received from severed mineral interests on property owned by Main Plaza Corporation, a wholly owned non-banking subsidiary of the Corporation (up $227 thousand) and gains on the sale of assets/foreclosed assets (up $189 thousand). Components of other non-interest income with significant decreases included sundry income from various miscellaneous items (down $404 thousand), income from securities trading and customer derivative activities (down $240 thousand), lease rental income (down $178 thousand) and gains on the sale of student loans (down $174 thousand). The decrease in income from securities trading and customer derivative activities was primarily related to decreases customer interest rate swap transaction fees and securities trading gains partly offset by an increase in customer commodity swap transaction fees. The decrease in gains on the sale of student loans resulted as the Corporation sold its remaining student loans in 2010 and no longer operates this line of business.

Other non-interest income for the first quarter of 2011 decreased $2.7 million, or 19.2%, compared to the fourth quarter of 2010. The decrease was primarily related to decreases in sundry income from various miscellaneous items (down $1.7 million), income from municipal bond underwriting discounts/fees (down $619 thousand) and mineral interest income (down $185 thousand). These decreases were partly offset by increases in gains on the sale of assets/foreclosed assets (up $213 thousand). During the fourth quarter of 2010, sundry income from various miscellaneous items included $885 thousand in income recognized from the collection of loan interest and other charges written-off in prior years and $386 thousand related to an annual revenue share payment from the PULSE automated teller machine network, among other things.

The Corporation had income from Visa check card usage totaling $5.5 million and $4.9 million during the first quarters of 2011 and 2010. The Dodd-Frank Act amended the EFTA to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers, such as Frost Bank. As more fully discussed above relative to point of sale income from PIN-based debit card transactions under Service Charges on Deposit Accounts, in December 2010, the Federal Reserve proposed a new regulation which, if enacted, will significantly impact the level of interchange fees that may be charged. Because of the uncertainty as to the final outcome of the Federal Reserve s rulemaking process, the Corporation cannot provide any assurance as to the ultimate impact of this proposal on the amount of income from Visa check card usage reported in future periods; however, based on the current proposal the Corporation s revenues from Visa check card usage would likely be approximately one fourth of current levels.

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Non-Interest Expense

The components of non-interest expense were as follows:

	Three Months Ended		
	March 31, 2011	December 31, 2010	March 31, 2010
Salaries and wages	$ 62,430	$ 60,744	$ 60,275
Employee benefits	15,311	12,458	14,521
Net occupancy	11,652	11,197	11,135
Furniture and equipment	12,281	12,335	11,489
Deposit insurance	4,760	4,918	5,443
Intangible amortization	1,120	1,217	1,333
Other	32,507	30,872	30,398
Total	$ 140,061	$ 133,741	$ 134,594

Total non-interest expense for the three months ended March 31, 2011 increased $5.5 million, or 4.1%, and $6.3 million, or 4.7%, compared to the first and fourth quarters of 2010, respectively. Changes in the components of non-interest expense are discussed below.

Salaries and Wages. Salaries and wages for the three months ended March 31, 2011 increased $2.2 million, or 3.6%, compared to the same period in 2010 and $1.7 million, or 2.8%, compared to the fourth quarter of 2010. The increase from the first quarter of 2010 was primarily related to normal annual merit and market increases and an increase in incentive compensation. The increase from the fourth quarter of 2010 was primarily related normal annual merit increases and an increase in incentive compensation partly offset by a decrease in stock-based compensation expense.

Employee Benefits. Employee benefits for the three months ended March 31, 2011 increased $790 thousand, or 5.4%, compared to the same period in 2010. The increase was primarily related to increases in expenses related to the Corporation s 401(k) and profit sharing plans (up $468 thousand) and an increase in payroll taxes (up $439 thousand).

Employee benefits for the first quarter of 2011 increased $2.9 million, or 22.9%, compared to the fourth quarter of 2010 primarily due to increases in payroll taxes (up $2.3 million) and expenses related to the Corporation s 401(k) and profit sharing plans (up $494 thousand). The Corporation generally experiences a decline in payroll taxes during the fourth quarter of each year as certain employees reach maximum taxable salary levels earlier in the year and higher levels of payroll taxes and 401(k) plan matching contributions during the first quarter each year due to annual incentive compensation payments.

Combined expense related to the defined benefit retirement and restoration plans was not significant during the reported periods. The Corporation s defined benefit retirement and restoration plans were frozen effective as of December 31, 2001 and were replaced by a profit sharing plan. Management believes these actions helped to reduce the volatility in retirement plan expense. However, the Corporation still has funding obligations related to the defined benefit and restoration plans and could recognize retirement expense related to these plans in future years, which would be dependent on the return earned on plan assets, the level of interest rates and employee turnover.

Net Occupancy. Net occupancy expense for the three months ended March 31, 2011 increased $517 thousand, or 4.6%, compared to the same period in 2010. The increase was primarily related to a decrease in rental income (down $250 thousand) as well as increases in service contracts expense (up $185 thousand), lease expense (up $118 thousand), building depreciation (up $104 thousand) and repairs expense (up $102 thousand). Offsetting the increase in net occupancy expense related to the aforementioned items was a decrease in utilities expense (down $155 thousand). Net occupancy expense for the first quarter of 2011 increased $455 thousand, or 4.1%, compared to the fourth quarter of 2010. The increase was primarily related to an increase in property taxes (up $422 thousand) and increases in service contracts expense (up $112 thousand). These items were partly offset by a decrease in building maintenance expense (down $177 thousand).

Furniture and Equipment. Furniture and equipment expense for the three months ended March 31, 2011 increased $792 thousand, or 6.9%, compared to the same period in 2010. The increase was primarily related to increases in software maintenance (up $580 thousand) and software amortization (up $326 thousand) partly offset by a decrease in service contract expenses (down $249 thousand). The increase in software amortization and maintenance was primarily related to new applications placed into service in 2010. Furniture and equipment expense for the first quarter of 2011 did not significantly fluctuate compared to the fourth quarter of 2010 as an increase in software maintenance expense (up $259 thousand) was offset by decreases related to depreciation on furniture and fixtures (down $139 thousand) and software amortization (down $128 thousand).

Deposit Insurance. Deposit insurance expense totaled $4.8 million for the three months ended March 31, 2011, compared to $5.4 million for the three months ended March 31, 2010 and $4.9 million for the three months ended December 31, 2010. The decrease in deposit insurance expense during the first quarter of 2011 compared to the same period in 2010 was primarily related to the Corporation opting out of the Transaction Account Guarantee component of the Temporary Liquidity Guarantee Program effective July 1, 2010. The decrease in deposit insurance expense during the first quarter of 2011 compared to the fourth quarter of 2010 was primarily due to a decrease in average deposits. Average deposits for the first quarter of 2011 increased $978.7 million compared to the first quarter of 2010 and decreased $166.1 million compared to the fourth quarter of 2010.

In November 2009, the FDIC issued a rule that required all insured depository institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. As of March 31, 2011, $39.2 million in pre-paid deposit insurance is included in accrued interest receivable and other assets in the accompanying consolidated balance sheet.

In November 2010, the FDIC issued a final rule to implement provisions of the Dodd-Frank Act that provide for temporary unlimited coverage for non-interest-bearing transaction accounts. The separate coverage for non-interest-bearing transaction accounts became effective on December 31, 2010 and terminates on December 31, 2012.

In February 2011, the FDIC issued a final rule to change the deposit insurance assessment base from total domestic deposits to average total assets minus average tangible equity, as required by the Dodd-Frank Act, effective April 1, 2011. The FDIC also issued a final rule that revised the deposit insurance assessment system effective April 1, 2011 for large institutions by creating a two scorecard system, one for most large institutions, including Frost Bank, that have more than $10 billion in assets and another for highly complex institutions that have over $50 billion in assets and are fully owned by a parent with over $500 billion in assets. Each scorecard will have a performance score and a loss-severity score that will be combined to produce a total score, which will be translated into an initial assessment rate. In calculating these scores, the FDIC will continue to utilize CAMELS ratings, will introduce certain new financial measures to assess an institution s ability to withstand asset-related stress and funding-related stress, and will eliminate the use of risk categories and long-term debt issuer ratings. The FDIC will have the ability to make discretionary adjustments to the total score, up or down, by a maximum of 15 points, based upon significant risk factors that are not adequately captured in the scorecard. The total score will be constrained to be between 30 and 90 and will then translate to an initial base assessment rate on a non-linear, sharply-increasing scale.

For large institutions, including Frost Bank, the initial base assessment rate will range from 5 to 35 basis points on an annualized basis (basis points representing cents per $100). After the effect of potential base-rate adjustments, the total base assessment rate could range from 2.5 to 45 basis points on an annualized basis. The potential adjustments to an institution s initial base assessment rate include (i) a potential decrease of up to 5 basis points for certain long-term unsecured debt (unsecured debt adjustment) and (except for well-capitalized institutions with a CAMELS rating of 1 or 2) (ii) a potential increase of up to 10 basis points for brokered deposits in excess of 10% of domestic deposits (brokered deposit adjustment). As the DIF reserve ratio grows, the rate schedule will be adjusted downward. Additionally, the rule includes a new adjustment for depository institution debt whereby an institution will pay an additional premium equal to 50 basis points on every dollar (above 3% of an institution s Tier 1 capital) of long-term, unsecured debt held that was issued by another insured depository institution (excluding debt guaranteed under the TLGP). Based upon Frost Bank s current balance sheet, the Corporation expects that the quarterly deposit insurance premium under the new assessment system will be approximately half of the amount that would have otherwise been the case under the current assessment system.

Intangible Amortization. Intangible amortization is primarily related to core deposit intangibles and, to a lesser extent, intangibles related to customer relationships and non-compete agreements. Intangible amortization for the three months ended March 31, 2011 decreased $213 thousand, or 16.0%, compared to the same period in 2010 and $97 thousand, or 8.0%, compared to the fourth quarter of 2010. The decreases in amortization expense are primarily the result of the completion of amortization of certain intangible assets and a reduction in the annual amortization rate of certain intangible assets as the Corporation uses an accelerated amortization approach which results in higher amortization rates during the earlier years of the useful lives of intangible assets.

Other Non-Interest Expense. Other non-interest expense for the three months ended March 31, 2011 increased $2.1 million, or 6.9%, compared to the same period in 2010. Components of other non-interest expense with significant increases included losses on the sale/write-down of assets (up $891 thousand), advertising/promotions expense (up $834 thousand), sundry losses from various miscellaneous items (up $591 thousand), Visa check card expense (up $431 thousand), web-site maintenance expense (up $423 thousand) and sub-advisor investment management fees related to Frost Investment Advisors, LLC, (up $263 thousand). The increase in losses on the sale/write-down of assets was primarily related to a $900 thousand write-down of a branch facility that is in the process of being sold. The increase in advertising/promotions expense is primarily related to a new, expanded marketing campaign that began during the first quarter of 2011. The Corporation expects advertising/promotions expense throughout 2011 to be significantly higher than in 2010 as a result of this campaign. The increases in the aforementioned items were partly offset by decreases in losses on the sale/write-down of foreclosed assets (down $1.3 million), Federal Reserve service charges (down $377 thousand) and professional services expense (down $356 thousand).

Other non-interest expense for the first quarter of 2011 increased $1.6 million, or 5.3%, compared to the fourth quarter of 2010. Components of other non-interest expense with significant increases included losses on the sale/write-down of assets (up $903 thousand), Visa check card expense (up $434 thousand), business development expense (up $260 thousand), advertising/promotions expense (up $242 thousand) and web-site maintenance expense (up $236 thousand). These increases were partly offset by decreases in professional services expense (down $1.2 million), losses on the sale/write-down of foreclosed assets (down $614 thousand) and travel expense (down $308 thousand).

Results of Segment Operations

The Corporation s operations are managed along two operating segments: Banking and the Financial Management Group (FMG). A description of each business and the methodologies used to measure financial performance is described in Note 14 - Operating Segments in the accompanying notes to consolidated financial statements included elsewhere in this report. Net income (loss) by operating segment is presented below:

	Three Months Ended		
	March 31, 2011	**December 31, 2010**	**March 31, 2010**
Banking	$ 51,853	$ 53,727	$ 48,763
Financial Management Group	1,670	2,036	1,303
Non-Banks	(1,595)	(2,712)	(2,248)
Consolidated net income	$ 51,928	$ 53,051	$ 47,818

Banking

Net income for the three months ended March 31, 2011 increased $3.1 million, or 6.3%, compared to the same period in 2010. The increase was primarily the result of a $4.0 million increase in net interest income, a $4.1 million decrease in the provision for possible loan losses and a $513 thousand decrease in income tax expense partly offset by a $4.3 million increase in non-interest expense and a $1.2 million decrease in non-interest income.

Net interest income for the three months ended March 31, 2011 increased $4.0 million, or 2.9%, compared to the same period in 2010. The increase primarily resulted from an increase in the average volume of interest-earning assets partly offset by a decrease in the net interest margin. See the analysis of net interest income included in the section captioned Net Interest Income included elsewhere in this discussion.

The provision for possible loan losses for the three months ended March 31, 2011 totaled $9.5 million compared to $13.6 million for the same period in 2010. See the analysis of the provision for possible loan losses included in the section captioned Allowance for Possible Loan Losses included elsewhere in this discussion.

Non-interest income for the three months ended March 31, 2011 decreased $1.2 million, or 2.5%, compared to the same period in 2010. The decrease was primarily due to decreases in service charges on deposit accounts, insurance commissions and fees and other non-interest income partly offset by an increase in other charges, commissions and fees. See the analysis of these categories of non-interest income included in the section captioned Non-Interest Income included elsewhere in this discussion.

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Non-interest expense for the three months ended March 31, 2011 increased $4.3 million, or 3.8%, compared to the same period in 2010. The increase was primarily related to increases in salaries and wages, other non-interest expense, employee benefits, furniture and equipment expense and net occupancy partly offset by a decrease in deposit insurance expense and intangible amortization. The increase in salaries and wages was primarily related to normal annual merit increases and an increase in incentive compensation. The increase in employee benefits expense was primarily related to increases in expenses related to the Corporation s 401(k) and profit sharing plans and an increase in payroll taxes. The increase in net occupancy was due to a decrease in rental income as well as increases in service contracts expense and repairs expense. The increase in furniture and equipment expense was due to increases in software maintenance and software amortization partly offset by a decrease in service contract expenses. The decrease in deposit insurance was primarily related to the Corporation opting out of the Transaction Account Guarantee component of the Temporary Liquidity Guarantee Program effective July 1, 2010. See the analysis of these items included in the section captioned Non-Interest Expense included elsewhere in this discussion.

Frost Insurance Agency, which is included in the Banking operating segment, had gross commission revenues of $10.6 million during the three months ended March 31, 2011 and $11.3 million during the three months ended March 31, 2010. The decrease during the three months ended March 31, 2011 is primarily related to a decrease in commission income (down $619 thousand) and, to a lesser extent, a decrease in contingent commissions (down $25 thousand). See the analysis of insurance commissions and fees included in the section captioned Non-Interest Income included elsewhere in this discussion.

Financial Management Group (FMG)

Net income for the three months ended March 31, 2011 increased $367 thousand, or 28.2%, compared to the same period in 2010. The increase was primarily due to a $2.0 million increase in non-interest income partly offset by a $1.5 million increase in non-interest expense and a $201 thousand increase in income tax expense.

Non-interest income for the three months ended March 31, 2011 increased $2.0 million, or 9.5%, compared to the same period in 2010. The increase was primarily due to an increase in trust fees (up $1.3 million) and in other charges, commissions and fees (up $775 thousand).

Trust fee income is the most significant income component for FMG. Investment fees are the most significant component of trust fees, making up approximately 75 % of total trust fees for the first three months of 2011. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees. The increase in trust fee income during the three months ended March 31, 2011 compared to the same period in 2010 was primarily the result of an increase in investment fees, securities lending income, real estate fees and custody fees. See the analysis of trust fees included in the section captioned Non-Interest Income included elsewhere in this discussion.

The increase in other charges, commissions and fees during the first quarter of 2011 compared to 2010 was primarily due to increases in mutual fund management fees and income related to sale of annuities and mutual funds.

Non-interest expense for the three months ended March 31, 2011 increased $1.5 million, or 7.2%, compared to the same period in 2010 primarily due to increases in other non-interest expense (up $1.5 million). The increase in other non-interest expense was partly related to an increase in sub-advisor investment management fees related to Frost Investment Advisors, LLC, an increase in sundry losses from various miscellaneous items and increases in various overhead cost allocations, among other things.

Non-Banks

The net loss for the Non-Banks operating segment for the three months ended March 31, 2011 decreased $653 thousand, or 29.1%, compared to the same period in 2010. The decrease was primarily due to a $334 thousand decrease in non-interest expense, a $188 thousand increase in non-interest income and a $102 thousand decrease in net interest expense.

Income Taxes

The Corporation recognized income tax expense of $12.7 million, for an effective rate of 19.6%, for the three months ended March 31, 2011 compared to $13.0 million, for an effective rate of 21.4%, for the three months ended March 31, 2010. The effective income tax rates differed from the U.S. statutory rate of 35% during the comparable periods primarily due to the effect of tax-exempt income from loans, securities and life insurance policies. The decrease in the effective tax rate during 2011 was primarily the result of an increase in holdings of tax-exempt municipal securities.

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Average Balance Sheet

Average assets totaled $17.7 billion for the three months ended March 31, 2011 representing an increase of $1.1 billion, or 6.9 %, compared to average assets for the same period in 2010. The increase was primarily reflected in earning assets, which increased $1.2 billion, or 7.9%, during the first quarter of 2011 compared to the first quarter of 2010. The increase in earning assets was primarily due to a $978.8 million increase in average securities and a $368.1 million increase in average interest-bearing deposits and federal funds sold and resale agreements partly offset by a $189.3 million decrease in average loans. The growth in average interest-earning assets was primarily funded by an increase in deposits. Total deposits averaged $14.5 billion for the first three months of 2011, increasing $978.7 million, or 7.3%, compared to the same period in 2010. Average interest-bearing accounts totaled 63.7% and 65.3% of average total deposits during the first three months of 2011 and 2010, respectively.

Loans

Loans were as follows as of the dates indicated:

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

Loans decreased $91.9 million, or 1.1%, compared to December 31, 2010. The majority of the Corporation s loan portfolio is comprised of commercial and industrial loans and real estate loans. Commercial and industrial loans made up 46.4% and 46.7% of total loans at March 31, 2011 and December 31, 2010, respectively while real estate loans made up 49.8% and 49.3% of total loans, respectively, at those dates. Real estate loans include both commercial and consumer balances.

Commercial and industrial loans decreased $65.4 million, or 1.7%, during the first quarter of 2011. The Corporation s commercial and industrial loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Corporation s loan policy guidelines. The commercial and industrial loan portfolio also includes the commercial lease and asset-based lending portfolios as well as purchased shared national credits (SNC s) which are discussed in more detail below.

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Purchased shared national credits are participations purchased from upstream financial organizations and tend to be larger in size than the Corporation s originated portfolio. The Corporation s purchased SNC portfolio totaled $477.9 million at March 31, 2011, increasing $17.9 million, or 3.9%, from $460.0 million at December 31, 2010. At March 31, 2011, 65.4% of outstanding purchased SNCs was related to the energy industry. The remaining purchased SNCs were diversified throughout various other industries, with no other single industry exceeding 10% of the total purchased SNC portfolio. Additionally, almost all of the outstanding balance of purchased SNCs was included in the commercial and industrial portfolio, with the remainder included in the real estate categories. SNC participations are originated in the normal course of business to meet the needs of the Corporation s customers. As a matter of policy, the Corporation generally only participates in SNCs for companies headquartered in or which have significant operations within the Corporation s market areas. In addition, the Corporation must have direct access to the company s management, an existing banking relationship or the expectation of broadening the relationship with other banking products and services within the following 12 to 24 months. SNCs are reviewed at least quarterly for credit quality and business development successes.

Real estate loans decreased $4.0 million, or 0.1%, during the first quarter of 2011. Real estate loans include both commercial and consumer balances. Commercial real estate loans totaled $3.2 billion at March 31, 2011 and represented 80.4% of total real estate loans. The majority of this portfolio consists of commercial real estate mortgages, which includes both permanent and intermediate term loans. The Corporation s primary focus for its commercial real estate portfolio has been growth in loans secured by owner-occupied properties. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Consequently, these loans must undergo the analysis and underwriting process of a commercial and industrial loan, as well as that of a real estate loan.

The consumer loan portfolio, including all consumer real estate, decreased $25.5 million, or 2.3%, from December 31, 2010. As the following table illustrates, the consumer loan portfolio has three distinct segments, including consumer real estate, consumer installment and student loans held for sale.

	March 31, 2011	December 31, 2010	March 31, 2010
Consumer real estate:			
Home equity loans	$ 274,952	$ 275,806	$ 279,012
Home equity lines of credit	187,573	186,465	169,393
1-4 family residential mortgages	53,587	57,877	66,368
Construction	23,504	23,565	26,876
Other	244,752	254,551	274,164
Total consumer real estate	784,368	798,264	815,813
Consumer installment	307,812	319,384	336,604
Student loans held for sale			18,771
Total consumer loans	$ 1,092,180	$ 1,117,648	$ 1,171,188

Consumer real estate loans, decreased $13.9 million, or 1.7%, from December 31, 2010. Combined, home equity loans and lines of credit made up 59.0% and 57.9% of the consumer real estate loan total at March 31, 2011 and December 31, 2010, respectively. The Corporation offers home equity loans up to 80% of the estimated value of the personal residence of the borrower, less the value of existing mortgages and home improvement loans. In general, the Corporation no longer originates 1-4 family mortgage loans, however, from time to time, the Corporation may invest in such loans to meet the needs of its customers.

The consumer installment loan portfolio primarily consists of automobile loans, unsecured revolving credit products, personal loans secured by cash and cash equivalents, and other similar types of credit facilities.

The Corporation discontinued the origination of student loans for resale, aside from previously outstanding commitments, during 2008 and sold all remaining student loans during 2010. Student loans were primarily originated for resale on the secondary market and classified as held for sale though included in total loans in the consolidated balance sheet. Student loans were generally sold on a non-recourse basis after the deferment period ended; however, from time to time, the Corporation sold such loans prior to the end of the deferment period.

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Non-Performing Assets

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

	March 31, 2011	December 31, 2010	March 31, 2010
Non-accrual loans:			
Commercial and industrial	$ 58,681	$ 60,408	$ 73,512
Commercial Real estate	60,808	73,512	66,541
Consumer real estate	3,741	2,758	3,813
Consumer and other	581	462	751
Total non-accrual loans	123,811	137,140	144,617
Foreclosed assets:			
Real estate	30,442	27,339	26,456
Other	450	471	480
Total foreclosed assets	30,892	27,810	26,936
Total non-performing assets	$ 154,703	$ 164,950	$ 171,553
Ratio of non-performing assets to:			
Total loans and foreclosed assets	1.92%	2.03%	2.09%
Total assets	0.86	0.94	1.02
Accruing past due loans:			
30 to 89 days past due	$ 64,600	$ 55,045	$ 87,687
90 or more days past due	24,499	26,922	34,413
Total accruing loans past due	$ 89,099	$ 81,967	$ 122,100
Ratio of accruing past due loans to total loans:			
30 to 89 days past due	0.80%	0.68%	1.07%
90 or more days past due	0.31	0.33	0.42
Total accruing loans past due	1.11%	1.01%	1.49%

Non-performing assets include non-accrual loans and foreclosed assets. Non-performing assets at March 31, 2011 decreased $10.2 million from December 31, 2010. In general, the level of non-performing assets during the comparable periods is reflective of weaker economic conditions which began in the latter part of 2008, although the Corporation has experienced decreases in the levels of classified assets in recent quarters. Non-accrual commercial loans included two credit relationships in excess of $5 million totaling $18.0 million at March 31, 2011 and three credit relationships in excess of $5 million totaling $25.8 million at December 31, 2010. Non-accrual real estate loans primarily consist of land development, 1-4 family residential construction credit relationships and loans secured by office buildings and religious facilities. Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectibility of the principal and/or interest to be in question, as well as when required by regulatory requirements. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured.

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

Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor s potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. At March 31, 2011 and December 31, 2010, the Corporation had $29.4 million and $33.8 million in loans of this type which are not included in either of the non-accrual or 90 days past due loan categories. At March 31, 2011, potential problem loans consisted of seven credit relationships. Of the total outstanding balance at March 31, 2011, 31.1% related to a customer in the credit collections industry, 18.1% related to a customer that provides transportation services and 17.6% related to a customer that operates a hotel. Weakness in these companies operating performance has caused the Corporation to heighten the attention given to these credits.

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Allowance for Possible Loan Losses

The allowance for possible loan losses is a reserve established through a provision for possible loan losses charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Corporation s allowance for possible loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, Receivables and allowance allocations calculated in accordance with ASC Topic 450, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation s process for determining the appropriate level of the allowance for possible loan losses is designed to account for credit deterioration as it occurs. The provision for possible loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, classified and criticized loans and net charge-offs or recoveries, among other factors. The provision for possible loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for possible loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools. See Note 3 - Loans in the accompanying notes to consolidated financial statements included elsewhere in this report for further details regarding the Corporation s methodology for estimating the appropriate level of the allowance for possible loan losses.

The table below provides, as of the dates indicated, an allocation of the allowance for possible loan losses by loan type; however, allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories:

	March 31, 2011	December 31, 2010	March 31, 2010
Commercial and industrial	$ 52,800	$ 57,789	$ 63,576
Commercial real estate	24,551	28,534	30,259
Consumer real estate	3,485	3,223	2,430
Consumer and other	12,941	11,974	19,689
Unallocated	30,544	24,796	9,415
Total	$ 124,321	$ 126,316	$ 125,369

As of March 31, 2011, the reserve allocated to commercial and industrial loans and commercial real estate loans decreased compared to December 31, 2010 due, in part, to decreases in the levels of classified loans as well as decreases in the historical loss allocation factors applied to non-classified loans offset by the effect of an increase in the environmental adjustment factor. The base historical loss allocation for each category of loans is the product of the volume of loans within each level of risk classification and the historical loss allocation factor for that particular level of risk classification, adjusted, as necessary to reflect the impact of current conditions. The base historical loss allocation is then adjusted upwards utilizing an environmental adjustment factor that is based upon a more qualitative analysis of risk. Prior to the first quarter of 2011, the historical loss allocation factors for non-classified loans determined based upon actual historical loss experience were adjusted upwards given the continued higher levels of charge-offs relative to historical average and the prevailing uncertain economic conditions. During the first quarter of 2011, the amounts of these upward adjustments were partly reduced in light of the decreasing trend in classified loans and an improvement in the outlook related to credit quality. Notwithstanding the foregoing, the increase in the unallocated portion of the allowance for possible loan losses at March 31, 2011 compared to December 31, 2010, is reflective of continued economic uncertainty resulting from weakness in certain business sectors, high unemployment and relatively low consumer spending activity.

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

	Three Months Ended		
	March 31, 2011	December 31, 2010	March 31, 2010
Balance at beginning of period	$ 126,316	$ 126,157	$ 125,309
Provision for possible loan losses	9,450	11,290	13,571
Charge-offs:			
Commercial and industrial	(7,597)	(9,082)	(9,175)
Commercial real estate	(3,877)	(543)	(3,413)
Consumer real estate	(820)	(948)	(375)
Consumer and other	(2,302)	(3,145)	(2,843)
Total charge-offs	(14,596)	(13,718)	(15,806)
Recoveries:			
Commercial and industrial	767	580	540
Commercial real estate	556	45	48
Consumer real estate	290	265	12
Consumer and other	1,538	1,697	1,695
Total recoveries	3,151	2,587	2,295
Net charge-offs	(11,445)	(11,131)	(13,511)
Balance at end of period	$ 124,321	$ 126,316	$ 125,369
Ratio of allowance for possible loan losses to:			
Total loans	1.55%	1.56%	1.53%
Non-accrual loans	100.41	92.11	86.69
Ratio of annualized net charge-offs to average total loans	0.57	0.55	0.66

The provision for possible loan losses decreased by $4.1 million, or 30.4%, during the first quarter of 2011 compared to the first quarter of 2010 and decreased $1.8 million, or 16.3%, compared to the fourth quarter of 2010. The decrease in the provision for possible loan losses during the first quarter of 2011 is reflective of the decreasing trend in classified loans and, in comparison to the first quarter of 2010, a decrease in net charge-offs. Net charge-offs during the first quarter of 2011 decreased $2.1 million compared to the first quarter of 2010 and increased $314 thousand compared to the fourth quarter of 2010. Net charge-offs as a percentage of average loans (on an annualized basis) totaled 0.57% during the first quarter of 2011 decreasing 9 basis points compared to 0.66% during the first quarter of 2010 and increasing 2 basis points compared 0.55% during the fourth quarter of 2010. The ratio of the allowance for possible loan losses to total loans decreased 1 basis point from 1.56% at December 31, 2010 to 1.55% at March 31, 2011. Management believes the level of the allowance for possible loan losses continues to remain adequate. Should any of the factors considered by management in evaluating the adequacy of the allowance for possible loan losses change, the Corporation s estimate of probable loan losses could also change, which could affect the level of future provisions for possible loan losses.

Capital and Liquidity

Capital. Shareholders equity totaled $2.1 billion at both March 31, 2011 and December 31, 2010 and $1.9 billion at March 31, 2010. In addition to net income of $51.9 million, other changes in shareholders equity during the first three months of 2011 included $27.6 million of dividends paid, $5.8 million in proceeds from stock option exercises and the related tax benefits of $89 thousand, $3.7 million related to stock-based compensation and other comprehensive income, net of tax, of $568 thousand. Additionally, the Corporation issued $1.4 million in newly issued common stock directly to the Corporation s 401(k) plan in connection with matching contributions.

The accumulated other comprehensive income/loss component of shareholders equity totaled a net, after-tax, unrealized gain of $154.8 million at March 31, 2011 compared to a net, after-tax, unrealized gain of $154.3 million at December 31, 2010. During the first quarter of 2011, the after-tax effect of the change in the net unrealized gain/loss on securities available for sale was for the most part offset by the change in the accumulated net gain/loss on effective cash flow hedges. Under regulatory requirements, amounts reported as accumulated other comprehensive income/loss related to securities available for sale, effective cash flow hedges and defined benefit post-retirement benefit plans do not increase or reduce regulatory capital and are not included in the calculation of risk-based capital and leverage ratios. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items. See Note 7 - Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report.

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The Corporation paid quarterly dividends of $0.45 per common share during the first quarter of 2011 and the fourth quarter of 2010 and a quarterly dividend of $0.43 per common share in the first quarter of 2010. This equates to a dividend payout ratio of 53.1%, 51.8% and 54.2% for each of these periods, respectively.

From time to time, the Corporation s board of directors has authorized stock repurchase plans. Stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. No shares were repurchased under stock repurchase plans during any of the reported periods. See Part II, Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds, included elsewhere in this report, for details of stock repurchases during the quarter.

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

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

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

Since Cullen/Frost is a holding company and does not conduct operations, its primary sources of liquidity are dividends upstreamed from Frost Bank and borrowings from outside sources. Banking regulations may limit the amount of dividends that may be paid by Frost Bank. See Note 7 - Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report regarding such dividends. At March 31, 2011, Cullen/Frost had liquid assets, including cash and resell agreements, totaling $163.0 million, which included $8.0 million in cash collateral on deposit with other financial institution counterparties to interest rate swap transactions.

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

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

Accounting Standards Updates

See Note 16 - Accounting Standards Updates in the accompanying notes to consolidated financial statements included elsewhere in this report for details of recently issued accounting pronouncements and their expected impact on the Corporation s financial statements.

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

(Dollars in thousands - taxable-equivalent basis)

	March 31, 2011			December 31, 2010		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:						
Interest-bearing deposits	$ 1,867,858	$ 1,171	0.25%	$ 2,425,664	$ 1,619	0.26%
Federal funds sold and resell agreements	16,517	16	0.39	15,301	15	0.39
Securities:						
Taxable	3,789,497	31,185	3.39	3,482,517	29,877	3.58
Tax-exempt	2,067,194	36,246	7.15	1,995,820	33,252	7.02
Total securities	5,856,691	67,431	4.73	5,478,337	63,129	4.83
Loans, net of unearned discounts	8,081,356	99,854	5.01	8,033,289	103,071	5.09
Total Earning Assets and Average Rate Earned	15,822,422	168,472	4.34	15,952,591	167,834	4.25
Cash and due from banks	652,399			617,588		
Allowance for possible loan losses	(127,328)			(126,292)		
Premises and equipment, net	316,036			316,772		
Accrued interest and other assets	1,014,253			1,094,661		
Total Assets	$ 17,677,782			$ 17,855,320		
Liabilities:						
Non-interest-bearing demand deposits:						
Commercial and individual	$ 4,679,602			$ 4,849,037		
Correspondent banks	336,218			331,129		
Public funds	231,651			190,594		
Total non-interest-bearing demand deposits	5,247,471			5,370,760		
Interest-bearing deposits:						
Private accounts						
Savings and interest checking	2,437,774	585	0.10	2,385,777	658	0.11
Money market deposit accounts	5,159,976	3,753	0.29	5,270,276	4,158	0.31
Time accounts	1,164,835	1,409	0.49	1,189,282	1,667	0.56
Public funds	458,489	204	0.18	418,586	218	0.21
Total interest-bearing deposits	9,221,074	5,951	0.26	9,263,921	6,701	0.29
Total deposits	14,468,545			14,634,681		
Federal funds purchased and repurchase agreements	521,731	131	0.10	438,832	147	0.13
Junior subordinated deferrable interest debentures	123,712	1,672	5.41	123,712	1,685	5.45
Subordinated notes payable and other notes	250,000	4,079	6.53	250,000	4,079	6.53
Federal Home Loan Bank advances	42	1	6.00	46	1	6.00
Total Interest-Bearing Funds and Average Rate Paid	10,116,559	11,834	0.47	10,076,511	12,613	0.50
Accrued interest and other liabilities	230,951			294,100		
Total Liabilities	15,594,981			15,741,371		

Shareholders Equity	2,082,801		2,113,949	
Total Liabilities and Shareholders Equity	$ 17,677,782		$ 17,855,320	
Net interest income		$ 156,638		$ 155,221
Net interest spread		3.87%		3.75%
Net interest income to total average earning assets		4.03%		3.93%

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

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

(Dollars in thousands - taxable-equivalent basis)

	September 30, 2010			June 30, 2010		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:						
Interest-bearing deposits	$ 2,127,686	$ 1,438	0.27%	$ 1,785,527	$ 989	0.22%
Federal funds sold and resell agreements	33,805	28	0.33	23,046	21	0.36
Securities:						
Taxable	3,432,481	30,968	3.77	3,202,840	31,482	4.08
Tax-exempt	1,937,932	32,340	7.08	1,917,660	32,201	7.04
Total securities	5,370,413	63,308	4.95	5,120,500	63,683	5.18
Loans, net of unearned discounts	8,058,097	104,200	5.13	8,141,908	103,779	5.11
Total Earning Assets and Average Rate Earned	15,590,001	168,974	4.39	15,070,981	168,472	4.54
Cash and due from banks	562,861			500,930		
Allowance for possible loan losses	(127,308)			(126,526)		
Premises and equipment, net	317,833			321,652		
Accrued interest and other assets	1,127,085			1,104,977		
Total Assets	$ 17,470,472			$ 16,872,014		
Liabilities:						
Non-interest-bearing demand deposits:						
Commercial and individual	$ 4,660,006			$ 4,445,554		
Correspondent banks	293,283			304,782		
Public funds	172,165			155,816		
Total non-interest-bearing demand deposits	5,125,454			4,906,152		
Interest-bearing deposits:						
Private accounts						
Savings and interest checking	2,270,935	787	0.14	2,253,942	811	0.14
Money market deposit accounts	5,269,509	4,426	0.33	4,956,757	4,303	0.35
Time accounts	1,229,182	1,904	0.61	1,278,948	2,030	0.64
Public funds	396,143	217	0.22	421,161	233	0.22
Total interest-bearing deposits	9,165,769	7,334	0.32	8,910,808	7,377	0.33
Total deposits	14,291,223			13,816,960		
Federal funds purchased and repurchase agreements	449,284	116	0.10	450,234	116	0.10
Junior subordinated deferrable interest debentures	124,519	1,741	5.59	136,084	1,783	5.24
Subordinated notes payable and other notes	250,000	4,080	6.53	250,000	4,079	6.53
Federal Home Loan Bank advances	51	1	7.84	3,841	63	6.59
Total Interest-Bearing Funds and Average Rate Paid	9,989,623	13,272	0.53	9,750,967	13,418	0.55
Accrued interest and other liabilities	275,759			226,379		
Total Liabilities	15,390,836			14,883,498		

Shareholders Equity	2,079,636		1,988,516	
Total Liabilities and Shareholders Equity	$ 17,470,472		$ 16,872,014	
Net interest income		$ 155,702		$ 155,054
Net interest spread		3.86%		3.99%
Net interest income to total average earning assets		4.04%		4.18%

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

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

(Dollars in thousands - taxable-equivalent basis)

	March 31, 2010		
	Average Balance	Interest Income/ Expense	Yield/ Cost
Assets:			
Interest-bearing deposits	$ 1,506,029	$ 855	0.23%
Federal funds sold and resell agreements	10,232	10	0.40
Securities:			
Taxable	3,021,446	29,075	3.98
Tax-exempt	1,856,494	31,234	7.04
Total securities	4,877,940	60,309	5.13
Loans, net of unearned discounts	8,270,653	103,746	5.09
Total Earning Assets and Average Rate Earned	14,664,854	164,920	4.59
Cash and due from banks	552,779		
Allowance for possible loan losses	(126,844)		
Premises and equipment, net	323,965		
Accrued interest and other assets	1,115,007		
Total Assets	$ 16,529,761		
Liabilities:			
Non-interest-bearing demand deposits:			
Commercial and individual	$ 4,221,470		
Correspondent banks	313,198		
Public funds	149,424		
Total non-interest-bearing demand deposits	4,684,092		
Interest-bearing deposits:			
Private accounts			
Savings and interest checking	2,199,302	810	0.15
Money market deposit accounts	4,820,741	4,905	0.41
Time accounts	1,308,488	2,583	0.80
Public funds	477,192	263	0.22
Total interest-bearing deposits	8,805,723	8,561	0.39
Total deposits	13,489,815		
Federal funds purchased and repurchase agreements	495,031	58	0.05
Junior subordinated deferrable interest debentures	136,084	1,773	5.21
Subordinated notes payable and other notes	250,000	4,080	6.53
Federal Home Loan Bank advances	6,560	105	6.49
Total Interest-Bearing Funds and Average Rate Paid	9,693,398	14,577	0.61
Accrued interest and other liabilities	226,206		
Total Liabilities	14,603,696		
Shareholders Equity	1,926,065		

Total Liabilities and Shareholders Equity	$ 16,529,761	
Net interest income		$ 150,343
Net interest spread		3.98%
Net interest income to total average earning assets		4.19%

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

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Refer to the discussion of market risks included in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in the 2010 Form 10-K. There has been no significant change in the types of market risks faced by the Corporation since December 31, 2010.

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

As of March 31, 2011, the model simulations projected that 100 and 200 basis point increases in interest rates would result in negative variances in net interest income of 0.5% and 0.6%, respectively, relative to the base case over the next 12 months, while a decrease in interest rates of 25 basis points would result in a negative variance in net interest income of 0.4% relative to the base case over the next 12 months. The March 31, 2011 model simulations were impacted by the expectation that the Corporation will begin to pay interest on demand deposits in the third quarter of 2011, as further discussed below. As of March 31, 2010, the model simulations projected that 100 and 200 basis point increases in interest rates would result in positive variances in net interest income of 1.4% and 3.1%, respectively, relative to the base case over the next 12 months, while a decrease in interest rates of 25 basis points would not have a meaningful impact on net interest income relative to the base case over the next 12 months. The likelihood of a decrease in interest rates beyond 25 basis points as of March 31, 2011 and 2010 was considered remote given prevailing interest rate levels.

The Corporation experienced significant growth in deposits in 2011 compared to 2010. The deposit growth funded a significant increase in fixed-rate securities and short-term interest-bearing deposits. Though short-term interest-bearing deposits are generally immediately impacted by changes in interest rates, the increase in fixed-rate securities coupled with the expectation that the Corporation will, in the third quarter of 2011, begin paying interest on demand deposits that were previously non-interest-bearing as a result of recent legislation, as further discussed below, the model simulations indicate that the Corporation s balance sheet will become slightly liability sensitive relative to the base case over the next 12 months.

As mentioned above, financial regulatory reform legislation entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the ultimate impact of this legislation on the Corporation has not yet been determined, the Corporation expects interest costs associated with demand deposits to increase. Furthermore, the Corporation s balance sheet is currently expected to become slightly liability sensitive. Because the interest rate that will ultimately be paid on these demand deposits depends upon a variety of factors, some of which are beyond the Corporation s control, the Corporation assumed an aggressive pricing structure for the purposes of the model simulations discussed above. Should the actual interest rate paid on demand deposits be less than the rate assumed in the model simulations, or should the interest rate paid for such deposits become an administered rate with less direct correlation to movements in general market interest rates, the Corporation s balance sheet could be less liability sensitive, or more asset sensitive, than the model simulations currently indicate.

As of March 31, 2011, the effects of a 200 basis point increase and a 25 basis point decrease in interest rates on the Corporation s derivative holdings would not result in a significant variance in the Corporation s net interest income.

The effects of hypothetical fluctuations in interest rates on the Corporation s securities classified as trading under ASC Topic 320, Investments - Debt and Equity Securities, are not significant, and, as such, separate quantitative disclosure is not presented.

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Item 4. Controls and Procedures

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

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Part II. Other Information

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There has been no material change in the risk factors previously disclosed under Item 1A. of the Corporation s 2010 Form 10-K.

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

The following table provides information with respect to purchases made by or on behalf of the Corporation or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Corporation s common stock during the three months ended March 31, 2011.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares That May Yet Be Purchased Under the Plan at the End of the Period
January 1, 2011 to January 31, 2011		$		
February 1, 2011 to February 28, 2011				
March 1, 2011 to March 31, 2011	3,464(1)			
Total	3,464	$		

(1) Represents repurchases made in connection with the vesting of certain share awards.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description
31.1	Rule 13a-14(a) Certification of the Corporation s Chief Executive Officer
31.2	Rule 13a-14(a) Certification of the Corporation s Chief Financial Officer
32.1+	Section 1350 Certification of the Corporation s Chief Executive Officer
32.2+	Section 1350 Certification of the Corporation s Chief Financial Officer
101++	Interactive Data File

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

++ As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934

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Signatures

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

Cullen/Frost Bankers, Inc.
(Registrant)

Date: April 27, 2011

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

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