CULLEN FROST BANKERS INC
Form 10-Q
October 26, 2011
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United States

Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended: September 30, 2011

Or

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission file number: 001-13221

Cullen/Frost Bankers, Inc.

(Exact name of registrant as specified in its charter)

Texas **(State or other jurisdiction of incorporation or organization)**	**74-1751768** **(I.R.S. Employer Identification No.)**
100 W. Houston Street, San Antonio, Texas **(Address of principal executive offices)**	**78205** **(Zip code)**

(210) 220-4011

(Registrant s telephone number, including area code)

N/A

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

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

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

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

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

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

As of October 20, 2011, there were 61,245,244 shares of the registrant s Common Stock, $.01 par value, outstanding.

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Cullen/Frost Bankers, Inc.

Quarterly Report on Form 10-Q

September 30, 2011

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Part I. Financial Information

Item 1. Financial Statements (Unaudited)

Cullen/Frost Bankers, Inc.

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest income:				
Loans, including fees	$ 99,737	$ 102,874	$ 298,036	$ 307,898
Securities:				
Taxable	30,089	30,968	92,942	91,525
Tax-exempt	23,127	20,380	69,029	60,399
Interest-bearing deposits	1,811	1,438	4,454	3,282
Federal funds sold and resell agreements	15	28	44	59
Total interest income	154,779	155,688	464,505	463,163
Interest expense:				
Deposits	5,306	7,334	17,203	23,272
Federal funds purchased and repurchase agreements	63	116	277	290
Junior subordinated deferrable interest debentures	1,710	1,741	5,073	5,297
Other long-term borrowings	2,339	4,081	10,499	12,408
Total interest expense	9,418	13,272	33,052	41,267
Net interest income	145,361	142,416	431,453	421,896
Provision for loan losses	9,010	10,100	27,445	32,321
Net interest income after provision for loan losses	136,351	132,316	404,008	389,575
Non-interest income:				
Trust fees	18,405	17,029	55,601	51,029
Service charges on deposit accounts	24,306	24,980	71,293	74,714
Insurance commissions and fees	9,569	8,588	27,971	27,238
Other charges, commissions and fees	8,134	7,708	25,371	22,656
Net gain (loss) on securities transactions	6,409		6,414	6
Other	12,394	12,125	35,692	36,112
Total non-interest income	79,217	70,430	222,342	211,755
Non-interest expense:				
Salaries and wages	61,697	59,743	185,902	178,845
Employee benefits	12,004	12,698	40,365	39,894
Net occupancy	12,080	12,197	35,555	34,969
Furniture and equipment	13,106	12,165	38,015	35,316
Deposit insurance	2,583	4,661	9,941	15,533
Intangible amortization	1,108	1,276	3,335	3,908
Other	34,829	29,812	101,152	93,335
Total non-interest expense	137,407	132,552	414,265	401,800

Income before income taxes	78,161	70,194	212,085	199,530
Income taxes	23,654	15,199	49,964	43,817
Net income	$ 54,507	$ 54,995	$ 162,121	$ 155,713
Earnings per common share:				
Basic	$ 0.89	$ 0.90	$ 2.64	$ 2.57
Diluted	0.89	0.90	2.64	2.57

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)

	September 30, 2011	December 31, 2010	September 30, 2010
Assets:			
Cash and due from banks	$ 571,332	$ 587,847	$ 580,005
Interest-bearing deposits	3,885,202	2,171,828	2,264,241
Federal funds sold and resell agreements	30,827	61,302	8,638
Total cash and cash equivalents	4,487,361	2,820,977	2,852,884
Securities held to maturity, at amortized cost	366,267	283,629	256,724
Securities available for sale, at estimated fair value	5,339,812	5,157,470	5,255,006
Trading account securities	15,823	15,101	14,934
Loans, net of unearned discounts	8,089,577	8,117,020	8,052,948
Less: Allowance for loan losses	(115,433)	(126,316)	(126,157)
Net loans	7,974,144	7,990,704	7,926,791
Premises and equipment, net	321,517	316,909	315,259
Goodwill	528,072	527,684	527,684
Other intangible assets, net	11,656	14,335	15,552
Cash surrender value of life insurance policies	132,899	129,922	128,758
Accrued interest receivable and other assets	312,091	360,361	444,534
Total assets	$ 19,489,642	$ 17,617,092	$ 17,738,126
Liabilities:			
Deposits:			
Non-interest-bearing demand deposits	$ 6,541,239	$ 5,360,436	$ 5,294,993
Interest-bearing deposits	9,522,634	9,118,906	9,235,094
Total deposits	16,063,873	14,479,342	14,530,087
Federal funds purchased and repurchase agreements	658,246	475,673	430,737
Junior subordinated deferrable interest debentures	123,712	123,712	123,712
Other long-term borrowings	100,031	250,045	250,049
Accrued interest payable and other liabilities	296,904	226,640	287,404
Total liabilities	17,242,766	15,555,412	15,621,989
Shareholders Equity:			
Preferred stock, par value $0.01 per share; 10,000,000 shares authorized; none issued			
Junior participating preferred stock, par value $0.01 per share; 250,000 shares authorized; none issued			
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 61,271,603 shares issued at September 30, 2011, 61,108,184 shares issued at December 31, 2010 and 60,836,307 shares issued at September 30, 2010	613	611	608
Additional paid-in capital	676,079	657,335	640,398
Retained earnings	1,327,587	1,249,484	1,223,891
Accumulated other comprehensive income, net of tax	244,053	154,250	251,240
Treasury stock, 26,359 shares at September 30, 2011, at cost	(1,456)		
Total shareholders equity	2,246,876	2,061,680	2,116,137

Total liabilities and shareholders equity	$ 19,489,642	$ 17,617,092	$ 17,738,126

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Changes in Shareholders Equity

(Dollars in thousands, except per share amounts)

	Nine Months Ended September 30, 2011	2010
Total shareholders equity at beginning of period	$ 2,061,680	$ 1,894,424
Comprehensive income:		
Net income	162,121	155,713
Other comprehensive income	89,803	97,035
Total comprehensive income	251,924	252,748
Stock option exercises/deferred stock unit conversions (144,203 shares in 2011 and 611,253 shares in 2010)	7,239	28,530
Stock compensation expense recognized in earnings	10,016	10,480
Tax benefits related to stock compensation	304	464
Purchase of treasury stock (29,823 shares in 2011 and 3,406 shares in 2010)	(1,657)	(193)
Treasury stock issued/sold to the 401(k) stock purchase plan (40,019 shares in 2010)		2,069
Common stock issued/sold to the 401(k) stock purchase plan (22,680 shares in 2011 and 150,165 shares in 2010)	1,360	8,183
Cash dividends ($1.37 per share in 2011 and $1.33 per share in 2010)	(83,990)	(80,568)
Total shareholders equity at end of period	$ 2,246,876	$ 2,116,137

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Cash Flows

(Dollars in thousands)

	Nine Months Ended September 30,	
	2011	**2010**
Operating Activities:		
Net income	$ 162,121	$ 155,713
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	27,445	32,321
Deferred tax expense (benefit)	(137)	(878)
Accretion of loan discounts	(9,865)	(7,889)
Securities premium amortization (discount accretion), net	7,590	5,974
Net gain on securities transactions	(6,414)	(6)
Depreciation and amortization	28,082	27,929
Net (gain) loss on sale of loans held for sale and other assets	4,240	4,495
Stock-based compensation	10,016	10,480
Net tax benefit (deficiency) from stock-based compensation	(89)	(149)
Excess tax benefits from stock-based compensation	(393)	(613)
Earnings on life insurance policies	(2,977)	(3,353)
Net change in:		
Trading account securities	(722)	1,192
Student loans held for sale		24,029
Accrued interest receivable and other assets	41,588	(2,464)
Accrued interest payable and other liabilities	(1,145)	35,925
Net cash from operating activities	259,340	282,706
Investing Activities:		
Securities held to maturity:		
Purchases	(83,184)	(250,981)
Maturities, calls and principal repayments	464	541
Securities available for sale:		
Purchases	(6,195,375)	(11,004,691)
Sales	5,587,391	9,997,994
Maturities, calls and principal repayments	587,650	743,257
Net change in loans	(17,748)	255,555
Net cash paid in acquisitions	(1,044)	
Proceeds from sales of premises and equipment	1,256	905
Purchases of premises and equipment	(23,266)	(9,366)
Proceeds from sales of repossessed properties	11,825	17,896
Net cash from investing activities	(132,031)	(248,890)
Financing Activities:		
Net change in deposits	1,584,531	1,216,777
Net change in short-term borrowings	182,573	(51,311)
Principal payments on long-term borrowings	(150,014)	(18,885)
Proceeds from stock option exercises	7,239	28,530
Excess tax benefits from stock-based compensation	393	613
Purchase of treasury stock	(1,657)	(193)
Common stock/treasury stock sold to the 401(k) stock purchase plan		2,626
Cash dividends paid	(83,990)	(80,568)

Net cash from financing activities	1,539,075	1,097,589
Net change in cash and cash equivalents	1,666,384	1,131,405
Cash and equivalents at beginning of period	2,820,977	1,721,479
Cash and equivalents at end of period	$ 4,487,361	$ 2,852,884

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Notes to Consolidated Financial Statements

(Table amounts are stated in thousands, except for share and per share amounts)

Note 1 - Significant Accounting Policies

Nature of Operations. Cullen/Frost Bankers, Inc. (Cullen/Frost) is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout numerous Texas markets. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, investment banking, insurance, brokerage, leasing, asset-based lending, treasury management and item processing.

Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest (collectively referred to as the Corporation). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies the Corporation follows conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.

The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Corporation s financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with the Corporation s consolidated financial statements, and notes thereto, for the year ended December 31, 2010, included in the Corporation s Annual Report on Form 10-K filed with the SEC on February 3, 2011 (the 2010 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly subject to change.

Cash Flow Reporting. Additional cash flow information was as follows:

	Nine Months Ended September 30, 2011	2010
Cash paid for interest	$ 39,809	$ 47,976
Cash paid for income tax	35,612	47,351
Significant non-cash transactions:		
Loans foreclosed and transferred to other real estate owned and foreclosed assets	16,803	12,707
Loans to facilitate the sale of other real estate owned	75	869
Common stock/treasury stock issued to the Corporation s 401(k) stock purchase plan	1,360	7,626

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

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Note 2 - Securities

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

	September 30, 2011				December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held to Maturity								
U. S. Treasury	$ 247,701	$ 31,049	$	$ 278,750	$ 247,421	$ 13,517	$	$ 260,938
Residential mortgage-backed securities	12,081	157	6	12,232	4,405	136		4,541
States and political subdivisions	105,485	5,738		111,223	30,803		1,054	29,749
Other	1,000			1,000	1,000			1,000
Total	$ 366,267	$ 36,944	$ 6	$ 403,205	$ 283,629	$ 13,653	$ 1,054	$ 296,228
Available for Sale:								
U. S. Treasury	$ 773,362	$ 26,553	$	$ 799,915	$ 973,033	$ 13,998	$	$ 987,031
Residential mortgage-backed securities	2,244,650	149,689	1	2,394,338	1,989,299	103,018	987	2,091,330
States and political subdivisions	1,972,996	134,610	39	2,107,567	2,008,618	53,358	21,676	2,040,300
Other	37,992			37,992	38,809			38,809
Total	$ 5,029,000	$ 310,852	$ 40	$ 5,339,812	$ 5,009,759	$ 170,374	$ 22,663	$ 5,157,470

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities in the above table. The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law was $2.2 billion and $2.3 billion at September 30, 2011 and December 31, 2010.

As of September 30, 2011, securities, with unrealized losses segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
Residential mortgage-backed securities	$ 6,752	$ 6	$	$	$ 6,752	$ 6
Total	$ 6,752	$ 6	$	$	$ 6,752	$ 6
Available for Sale						
Residential mortgage-backed securities	$ 246	$ 1	$	$	$ 246	$ 1
States and political subdivisions	3,296	31	686	8	3,982	39
Total	$ 3,542	$ 32	$ 686	$ 8	$ 4,228	$ 40

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost.

Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time the Corporation will receive full value for the securities. Furthermore, as of September 30, 2011, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Corporation will not have to sell any such securities before a recovery of cost. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2011, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation s consolidated income statement.

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The amortized cost and estimated fair value of securities, excluding trading securities, at September 30, 2011 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Residential mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$	$	$ 32,816	$ 33,229
Due after one year through five years	1,000	1,000	831,398	861,967
Due after five years through ten years	251,039	282,332	174,398	187,265
Due after ten years	102,147	107,641	1,707,746	1,825,021
Residential mortgage-backed securities	12,081	12,232	2,244,650	2,394,338
Equity securities			37,992	37,992
Total	$ 366,267	$ 403,205	$ 5,029,000	$ 5,339,812

Sales of securities available for sale were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Proceeds from sales	$ 39,005	$	$ 5,587,391	$ 9,997,994
Gross realized gains	6,409		6,418	8
Gross realized losses			4	2

Trading account securities, at estimated fair value, were as follows:

	September 30, 2011	December 31, 2010
U.S. Treasury	$ 14,035	$ 14,986
States and political subdivisions	1,788	115
Total	$ 15,823	$ 15,101

Net gains and losses on trading account securities were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net gain on sales transactions	$ 303	$ 509	$ 772	$ 1,389
Net mark-to-market gains	4	20	11	143
Net gain on trading account securities	$ 307	$ 529	$ 783	$ 1,532

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Note 3 - Loans

Loans were as follows:

	September 30, 2011	Percentage of Total	December 31, 2010	Percentage of Total	September 30, 2010	Percentage of Total
Commercial and industrial:						
Commercial	$ 3,571,807	44.2%	$ 3,479,349	42.9%	$ 3,415,306	42.4%
Leases	184,614	2.3	186,443	2.3	189,810	2.4
Asset-based	175,120	2.1	122,866	1.5	123,658	1.5
Total commercial and industrial	3,931,541	48.6	3,788,658	46.7	3,728,774	46.3
Commercial real estate:						
Commercial mortgages	2,370,871	29.3	2,374,542	29.3	2,359,169	29.3
Construction	508,182	6.3	593,273	7.3	586,073	7.3
Land	214,436	2.6	234,952	2.9	238,060	3.0
Total commercial real estate	3,093,489	38.2	3,202,767	39.5	3,183,302	39.6
Consumer real estate:						
Home equity loans	277,284	3.4	275,806	3.4	279,106	3.5
Home equity lines of credit	190,958	2.4	186,465	2.3	180,538	2.2
1-4 family residential mortgages	47,455	0.6	57,877	0.7	60,177	0.7
Construction	17,965	0.2	23,565	0.3	24,446	0.3
Other	233,053	2.9	254,551	3.1	266,558	3.3
Total consumer real estate	766,715	9.5	798,264	9.8	810,825	10.0
Total real estate	3,860,204	47.7	4,001,031	49.3	3,994,127	49.6
Consumer and other:						
Consumer installment	299,417	3.7	319,384	3.9	322,239	4.0
Other	14,926	0.2	28,234	0.4	28,891	0.4
Total consumer and other	314,343	3.9	347,618	4.3	351,130	4.4
Unearned discounts	(16,511)	(0.2)	(20,287)	(0.3)	(21,083)	(0.3)
Total loans	$ 8,089,577	100.0%	$ 8,117,020	100.0%	$ 8,052,948	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 based on collateral, geography and risk grade criteria. As a general rule, the Corporation avoids financing single-purpose

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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 September 30, 2011, approximately 60% 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. Other than energy loans, as of September 30, 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 September 30, 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. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Corporation considers the borrower s debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Corporation s collateral position. Regulatory provisions would typically require the placement of a loan on non-accrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection, or (ii) full payment of principal and interest is not expected. 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 on non-accrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

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

	September 30, 2011	December 31, 2010	September 30, 2010
Commercial and industrial:			
Energy	$	$	$
Other commercial	58,208	60,408	66,128
Commercial real estate:			
Buildings, land and other	45,333	64,213	64,813
Construction	1,821	9,299	10,345
Consumer real estate	4,060	2,758	2,541
Consumer and other	756	462	1,073
Total	$ 110,178	$ 137,140	$ 144,900

As of September 30, 2011, non-accrual loans reported in the table above included $8.7 million ($191 thousand in other commercial loans, $7.1 million in buildings, land and other loans, $960 thousand in consumer real estate and $469 thousand in consumer loans) related to loans that were restructured as troubled debt restructurings during 2011. See the section captioned Troubled Debt Restructurings elsewhere in this note.

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 $823 thousand and $2.6 million for the three and nine months ended September 30, 2011, compared to $944 thousand and $2.9 million for the three and nine months ended September 30, 2010.

An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of September 30, 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	$ 450	$ 65	$ 515	$ 913,632	$ 914,147	$ 65
Other commercial	35,163	19,355	54,518	2,962,876	3,017,394	6,695
Commercial real estate:						
Buildings, land and other	23,905	26,969	50,874	2,534,433	2,585,307	6,910
Construction	4,544	958	5,502	502,680	508,182	910
Consumer real estate	5,929	4,712	10,641	756,074	766,715	2,962
Consumer and other	2,204	140	2,344	311,999	314,343	140
Unearned discounts				(16,511)	(16,511)	
Total	$ 72,195	$ 52,199	$ 124,394	$ 7,965,183	$ 8,089,577	$ 17,682

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 collectability 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.

Regulatory guidelines require the Corporation to reevaluate the fair value of collateral supporting impaired collateral dependent loans on at least an annual basis. While the Corporation s policy is to comply with the regulatory guidelines, the Corporation s general practice is to reevaluate the fair value of collateral supporting impaired collateral dependent loans on a quarterly basis. Thus, appraisals are never considered to be outdated, and the Corporation does not need to make any adjustments to the appraised values. The fair value of collateral supporting impaired collateral dependent loans is evaluated by the Corporation s internal appraisal services using a methodology that is consistent with the Uniform Standards of Professional Appraisal Practice. The fair value of collateral supporting impaired collateral dependent construction loans is based on an as is valuation.

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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.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment Quarter To Date	Average Recorded Investment Year To Date
September 30, 2011							
Commercial and industrial:							
Energy	$	$	$	$	$	$	$
Other commercial	79,327	42,583	10,387	52,970	6,883	60,696	57,455
Commercial real estate:							
Buildings, land and other	52,193	34,267	7,848	42,115	1,283	44,453	50,562
Construction	2,162	1,773		1,773		2,265	5,104
Consumer real estate	2,510	2,498		2,498		2,227	1,689
Consumer and other	568	568		568		335	193
Total	$ 136,760	$ 81,689	$ 18,235	$ 99,924	$ 8,166	$ 109,976	$ 115,003
December 31, 2010							
Commercial and industrial:							
Energy	$	$	$	$	$	$	$ 1,012
Other commercial	73,518	40,901	14,541	55,442	9,137	57,563	61,076
Commercial real estate:							
Buildings, land and other	72,099	50,551	11,254	61,805	4,076	62,231	59,179
Construction	9,834	8,553	747	9,300	300	9,715	8,132
Consumer real estate	517	517		517		654	960
Consumer and other						79	393
Total	$ 155,968	$ 100,522	$ 26,542	$ 127,064	$ 13,513	$ 130,242	$ 130,752
September 30, 2010							
Commercial and industrial:							
Energy	$	$	$	$	$	$ 715	$ 1,265
Other commercial	71,485	26,288	33,396	59,684	16,555	56,073	62,485
Commercial real estate:							
Buildings, land and other	75,002	50,410	12,246	62,656	3,827	62,296	58,523
Construction	10,576	9,383	747	10,130	150	8,905	7,840
Consumer real estate	792	792		792		885	1,071
Consumer and other	157	157		157		214	492
Total	$ 158,012	$ 87,030	$ 46,389	$ 133,419	$ 20,532	$ 129,088	$ 131,676

Troubled Debt Restructurings. The restructuring of a loan is considered a troubled debt restructuring if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Effective July 1, 2011, the Corporation adopted the provisions of Accounting Standards Update (ASU) No. 2011-02, Receivables (Topic 310) - A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring. As such, the Corporation reassessed all loan modifications occurring since January 1, 2011 for identification as troubled debt restructurings.

Troubled debt restructurings are set forth in the following table. There were no troubled debt restructurings during 2010.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Commercial and industrial:		
Other commercial	$ 191	$ 191
Commercial real estate:		
Buildings, land and other	3,325	7,519
Consumer real estate	969	969
Consumer	469	469
	$ 4,954	$ 9,148

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All of the loans identified as troubled debt restructurings by the Corporation were previously on non-accrual status and reported as impaired loans prior to restructuring. The modifications primarily related to extending the amortization periods of the loans. The Corporation did not grant interest-rate concessions on any restructured loan. All loans restructured during the nine months ended September 30, 2011 are on non-accrual status as of September 30, 2011. See the section captioned Non-accrual Loans elsewhere in this note. Because the loans were classified and on non-accrual status both before and after restructuring, the modifications did not impact the Corporation s determination of the allowance for loan losses. As of September 30, 2011, there have been no defaults on any loans that were modified as troubled debt restructurings during the preceding twelve months.

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) the delinquency status of consumer loans (see details above) (iv) net charge-offs, (v) non-performing loans (see details above) and (vi) 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.

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.

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In monitoring credit quality trends in the context of assessing the appropriate level of the allowance for loan losses, the Corporation monitors portfolio credit quality by the weighted-average risk grade of each class of commercial loan. Individual relationship managers review updated financial information for all pass grade loans to recalculate the risk grade on at least an annual basis. When a loan has a calculated risk grade of 9, it is still considered a pass grade loan; however, it is considered to be on management s watch list, where a significant risk-modifying action is anticipated in the near term. When a loan has a calculated risk grade of 10 or higher, a special assets officer monitors the loan on an on-going basis. The following table presents weighted average risk grades for all commercial loans by class.

	September 30, 2011		December 31, 2010		September 30, 2010	
	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans
Commercial and industrial:						
Energy						
Risk grades 1-8	5.18	$ 912,728	5.27	$ 786,664	5.13	$ 752,410
Risk grade 9	9.00	1,419	9.00	20,224	9.00	54,864
Risk grade 10	10.00		10.00		10.00	
Risk grade 11	11.00		11.00		11.00	
Risk grade 12	12.00		12.00		12.00	
Risk grade 13	13.00		13.00		13.00	
Total energy	5.19	$ 914,147	5.36	$ 806,888	5.39	$ 807,274
Other commercial						
Risk grades 1-8	6.20	$ 2,687,564	6.16	$ 2,572,011	6.26	$ 2,459,477
Risk grade 9	9.00	94,687	9.00	95,278	9.00	90,981
Risk grade 10	10.00	52,753	10.00	116,158	10.00	141,907
Risk grade 11	11.00	124,603	11.00	137,923	11.00	161,478
Risk grade 12	12.00	47,875	12.00	48,216	12.00	44,012
Risk grade 13	13.00	9,912	13.00	12,184	13.00	23,645
Total other commercial	6.67	$ 3,017,394	6.75	$ 2,981,770	6.93	$ 2,921,500
Commercial real estate:						
Buildings, land and other						
Risk grades 1-8	6.65	$ 2,259,305	6.71	$ 2,189,602	6.73	$ 2,188,518
Risk grade 9	9.00	91,035	9.00	137,314	9.00	92,320
Risk grade 10	10.00	72,975	10.00	91,962	10.00	126,589
Risk grade 11	11.00	116,659	11.00	126,403	11.00	123,276
Risk grade 12	12.00	42,391	12.00	54,366	12.00	58,247
Risk grade 13	13.00	2,942	13.00	9,847	13.00	8,279
Total commercial real estate	7.12	$ 2,585,307	7.29	$ 2,609,494	7.31	$ 2,597,229
Construction						
Risk grades 1-8	6.98	$ 439,502	7.10	$ 485,455	7.19	$ 489,289
Risk grade 9	9.00	30,358	9.00	52,817	9.00	30,985
Risk grade 10	10.00	28,255	10.00	32,055	10.00	32,616
Risk grade 11	11.00	8,246	11.00	13,646	11.00	22,839
Risk grade 12	12.00	1,821	12.00	9,300	12.00	10,130
Risk grade 13	13.00		13.00		13.00	214
Total construction	7.35	$ 508,182	7.59	$ 593,273	7.68	$ 586,073

The Corporation has established maximum loan to value standards to be applied during the origination process of commercial and consumer real estate loans. The Corporation does not subsequently monitor loan-to-value ratios (either individually or on a weighted-average basis) for loans that are subsequently considered to be of a pass grade (grades 9 or better) and/or current with respect to principal and interest payments. As stated above, when an individual commercial real estate loan has a calculated risk grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired. At that time, the Corporation reassesses the loan to value position in the loan. If the loan is determined to be collateral dependent, specific allocations of the allowance for loan losses are made for the amount of any collateral deficiency. If a collateral deficiency is ultimately deemed to be uncollectible, the amount is charged-off. These loans and related assessments of collateral position are monitored on an individual, case-by-case basis. The Corporation does not monitor loan-to-value ratios on a weighted-average basis for commercial real estate loans having a calculated risk grade of 10 or higher. Nonetheless, there were four commercial real estate loans having a calculated risk grade of 10 or higher in excess of $5 million as of September 30, 2011. Three of the loans totaled $29.7 million and had a weighted-average loan-to-value ratio of 62.4%. The fourth loan, totaling $7.3 million, is structured as a borrowing base facility secured by numerous rotating lots and single family residences that generally have a loan-to-value of 80% or less. When an individual consumer real estate loan becomes past due by more than 10 days, the assigned relationship manager will begin collection efforts. The Corporation only reassesses the loan to value position in a consumer real estate loan if, during the course of the collections process, it is determined that the loan has become collateral dependent, and any collateral deficiency is recognized as a charge-off to the allowance for loan losses. Accordingly, the Corporation does not monitor loan-to-value ratios on a weighted-average basis for collateral dependent consumer real estate loans.

Generally, a commercial loan, or a portion thereof, is charged-off immediately when it is determined, through the analysis of any available current financial information with regards to the borrower, that the borrower is incapable of servicing unsecured debt, there is little or no prospect for near term improvement and no realistic strengthening action of significance is pending or, in the case of secured debt, when it is determined, through analysis of current information with regards to the Corporation s collateral position, that amounts due from the borrower are in excess of the calculated current fair value of the collateral. Notwithstanding the foregoing, generally, commercial loans that become past due 180 cumulative days are classified as a loss and charged-off. Generally, a consumer loan, or a portion thereof, is charged-off in accordance with regulatory guidelines which provide that such loans be charged-off when the Corporation becomes aware of the loss, such as from a triggering event that may include new information about a borrower s intent/ability to repay the loan, bankruptcy, fraud or death, among other things, but in no case should the charge-off exceed specified delinquency timeframes. Such delinquency timeframes state that closed-end retail loans (loans with pre-defined maturity dates, such as real estate mortgages, home equity loans and consumer installment loans) that become past due 120 cumulative days and open-end retail loans (loans that roll-over at the end of each term, such as home equity lines of credit) that become past due 180 cumulative days should be classified as a loss and charged-off.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Commercial and industrial:				
Energy	$ 1	$ 1	$ 5	$ 7
Other commercial	(13,602)	(5,789)	(25,154)	(20,034)
Commercial real estate:				
Buildings, land and other	(1,162)	(1,522)	(8,689)	(5,414)
Construction	(121)	(91)	(473)	(633)
Consumer real estate	(750)	(429)	(1,642)	(1,375)
Consumer and other	(684)	(1,555)	(2,375)	(4,024)
Total	$ (16,318)	$ (9,385)	$ (38,328)	$ (31,473)

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 119.6 at August 31, 2011 (most recent date available), 118.2 at December 31, 2010 and 115.2 at September 30, 2010. A higher TLI value implies more favorable economic conditions.

Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for 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 loan loss methodology follows the accounting guidance set forth in U.S. generally accepted accounting principles and the Interagency Policy Statement on the Allowance for Loan and Lease Losses, which was jointly issued by the Corporation s regulatory agencies. In that regard, the Corporation s allowance for loan losses 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 loan losses is designed to account for credit deterioration as it occurs. The provision for 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 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 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.

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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 determination of the appropriate level 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 monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time.

The Corporation s allowance for 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 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.

The components of the general valuation allowance include (i) the additional reserves allocated to specific loan portfolio segments as a result of applying an environmental risk adjustment factor to the base historical loss allocation and (ii) the additional reserves that are not allocated to specific loan portfolio segments including allocations for groups of similar loans with risk characteristics that exceed certain concentration limits established by management.

The environmental adjustment factor is based upon a more qualitative analysis of risk and is calculated through a survey of senior officers who are involved in credit making decisions at a corporate-wide and/or regional level. On a quarterly basis, survey participants rate the degree of various risks utilizing a numeric scale that translates to varying grades of high, moderate or low levels of risk. The results are then input into a risk-weighting matrix to determine an appropriate environmental risk adjustment factor. The various risks that may be considered in the determination of the environmental adjustment factor include, 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) the impact of legislative and governmental influences affecting industry sectors; (v) the effectiveness of the internal loan review function; (vi) the impact of competition on loan structuring and pricing; and (vii) the impact of rising interest rates on portfolio risk. In periods where the surveyed risks are perceived to be higher, the risk-weighting matrix will generally result in a higher environmental adjustment factor, which, in turn will result in higher levels of general valuation allowance allocations. The opposite holds true in periods where the surveyed risks are perceived to be lower. The environmental adjustment factor resulted in additional general valuation allowance allocations to the various loan portfolio segments totaling $13.6 million at September 30, 2011, $9.5 million at December 31, 2010 and $10.1 million at September 30, 2010.

Certain general valuation allowances are not allocated to specific loan portfolio segments and are reported as the unallocated portion of the allowance for loan losses. 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, credit and/or collateral 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

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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. The net effect of these changes to the Corporation s methodology for the determination of general valuation allowances did not significantly impact the provision for loan losses recorded during the nine months ended September 30, 2011.

The following table presents details of the unallocated portion of the allowance for loan losses.

	September 30, 2011	December 31, 2010	September 30, 2010
Excessive industry concentrations	$ 1,961	$ 1,720	$ 2,024
Large relationship concentrations	2,185	2,127	1,878
Highly-leveraged credit relationships	3,763		
Policy exceptions	1,950	2,414	2,422
Credit and collateral exceptions	1,985	557	616
Loans not reviewed by concurrence	9,039		
Adjustment for recoveries	(11,948)		
General macroeconomic risk	22,548	17,978	4,099
	$ 31,483	$ 24,796	$ 11,039

The Corporation monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time. In assessing the general macroeconomic trends/conditions, the Corporation analyzes trends in the components of the TLI, as well as any available information related to regional, national and international economic conditions and events and the impact such conditions and events may have on the Corporation and its customers. With regard to assessing loan portfolio conditions, the Corporation analyzes trends in weighted-average portfolio risk-grades, classified and non-performing loans and charge-off activity. In periods where general macroeconomic and loan portfolio conditions are in a deteriorating trend or remain at deteriorated levels, based on historical trends, the Corporation would expect to see the allowance for loan loss allocation model, as a whole, calculate higher levels of required allowances than in periods where general macroeconomic and loan portfolio conditions are in an improving trend or remain at an elevated level, based on historical trends.

The following tables detail activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 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
Three months ended:						
September 30, 2011						
Beginning balance	$ 56,566	$ 20,901	$ 3,683	$ 12,611	$ 28,980	$ 122,741
Provision for loan losses	3,920	1,194	513	880	2,503	9,010
Charge-offs	(15,084)	(1,689)	(834)	(2,359)		(19,966)
Recoveries	1,483	406	84	1,675		3,648
Net charge-offs	(13,601)	(1,283)	(750)	(684)		(16,318)
Ending balance	$ 46,885	$ 20,812	$ 3,446	$ 12,807	$ 31,483	$ 115,433
September 30, 2010						

Beginning balance	$ 65,293	$ 31,229	$ 2,467	$ 18,763	$ 7,690	$ 125,442
Provision for loan losses	4,693	1,379	342	337	3,349	10,100
Charge-offs	(6,739)	(1,911)	(673)	(3,155)		(12,478)
Recoveries	951	298	244	1,600		3,093
Net charge-offs	(5,788)	(1,613)	(429)	(1,555)		(9,385)
Ending balance	$ 64,198	$ 30,995	$ 2,380	$ 17,545	$ 11,039	$ 126,157

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	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
Nine months ended:						
September 30, 2011						
Beginning balance	$ 57,789	$ 28,534	$ 3,223	$ 11,974	$ 24,796	$ 126,316
Provision for loan losses	14,245	1,440	1,865	3,208	6,687	27,445
Charge-offs	(28,258)	(10,261)	(2,113)	(7,058)		(47,690)
Recoveries	3,109	1,099	471	4,683		9,362
Net charge-offs	(25,149)	(9,162)	(1,642)	(2,375)		(38,328)
Ending balance	$ 46,885	$ 20,812	$ 3,446	$ 12,807	$ 31,483	$ 115,433
September 30, 2010						
Beginning balance	$ 57,394	$ 28,514	$ 2,560	$ 16,929	$ 19,912	$ 125,309
Provision for loan losses	26,831	8,528	1,195	4,640	(8,873)	32,321
Charge-offs	(22,241)	(6,982)	(1,734)	(8,748)		(39,705)
Recoveries	2,214	935	359	4,724		8,232
Net charge-offs	(20,027)	(6,047)	(1,375)	(4,024)		(31,473)
Ending balance	$ 64,198	$ 30,995	$ 2,380	$ 17,545	$ 11,039	$ 126,157

The following table details the amount of the allowance for loan losses allocated to each portfolio segment as of September 30, 2011 and 2010, disaggregated on the basis of the Corporation s impairment methodology.

	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
September 30, 2011						
Loans individually evaluated for impairment	$ 23,263	$ 4,075	$	$	$	$ 27,338
Loans collectively evaluated for impairment	23,622	16,737	3,446	12,807	31,483	88,095
Balance at September 30, 2011	$ 46,885	$ 20,812	$ 3,446	$ 12,807	$ 31,483	$ 115,433
September 30, 2010						
Loans individually evaluated for impairment	$ 44,329	$ 10,372	$	$	$	$ 54,701
Loans collectively evaluated for impairment	19,869	20,623	2,380	17,545	11,039	71,456
Balance at September 30, 2010	$ 64,198	$ 30,995	$ 2,380	$ 17,545	$ 11,039	$ 126,157

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The Corporation s recorded investment in loans as of September 30, 2011, December 31, 2010 and September 30, 2010 related to each balance in the allowance for 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
September 30, 2011						
Loans individually evaluated for impairment	$ 235,143	$ 273,289	$	$	$	$ 508,432
Loans collectively evaluated for impairment	3,696,398	2,820,200	766,715	314,343	(16,511)	7,581,145
Ending balance	$ 3,931,541	$ 3,093,489	$ 766,715	$ 314,343	$ (16,511)	$ 8,089,577
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
September 30, 2010						
Loans individually evaluated for impairment	$ 365,509	$ 372,032	$	$	$	$ 737,541
Loans collectively evaluated for impairment	3,363,265	2,811,270	810,825	351,130	(21,083)	7,315,407
Ending balance	$ 3,728,774	$ 3,183,302	$ 810,825	$ 351,130	$ (21,083)	$ 8,052,948

Note 4 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets are presented in the table below. The increases in goodwill and certain other intangible assets were related to the acquisition of Clark Benefit Group, an independent San Antonio based insurance agency that specialized in providing employee benefits to small and mid-size businesses, on May 1, 2011. The purchase of Clark Benefit Group did not significantly impact the Corporation s financial Statements.

	September 30, 2011	December 31, 2010
Goodwill	$ 528,072	$ 527,684
Other intangible assets:		
Core deposits	$ 9,089	$ 11,819
Customer relationship	2,271	2,253
Non-compete agreements	296	263
	$ 11,656	$ 14,335

The estimated aggregate future amortization expense for intangible assets remaining as of September 30, 2011 is as follows:

Remainder of 2011	$ 1,051
2012	3,638
2013	2,858
2014	2,029
2015	1,264

Thereafter	816
	$ 11,656

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Note 5 - Deposits

Deposits were as follows:

	September 30, 2011	Percentage of Total	December 31, 2010	Percentage of Total	September 30, 2010	Percentage of Total
Non-interest-bearing demand deposits:						
Commercial and individual	$ 5,759,723	35.8%	$ 4,791,149	33.1%	$ 4,774,943	32.9%
Correspondent banks	350,082	2.2	361,100	2.5	312,372	2.1
Public funds	431,434	2.7	208,187	1.4	207,678	1.4
Total non-interest-bearing demand deposits	6,541,239	40.7	5,360,436	37.0	5,294,993	36.4
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	2,579,745	16.1	2,505,143	17.3	2,302,753	15.9
Money market accounts	5,469,492	34.0	4,949,764	34.2	5,357,511	36.9
Time accounts of $100,000 or more	581,192	3.6	611,836	4.2	604,477	4.2
Time accounts under $100,000	546,583	3.4	571,447	4.0	586,158	4.0
Total private accounts	9,177,012	57.1	8,638,190	59.7	8,850,899	61.0
Public funds:						
Savings and interest checking	164,183	1.0	255,605	1.8	184,429	1.2
Money market accounts	46,099	0.3	84,093	0.6	97,225	0.7
Time accounts of $100,000 or more	132,657	0.9	137,506	0.9	99,751	0.7
Time accounts under $100,000	2,683		3,512		2,790	
Total public funds	345,622	2.2	480,716	3.3	384,195	2.6
Total interest-bearing deposits	9,522,634	59.3	9,118,906	63.0	9,235,094	63.6
Total deposits	$ 16,063,873	100.0%	$ 14,479,342	100.0%	$ 14,530,087	100.0%

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

	September 30, 2011	December 31, 2010	September 30, 2010
Money market deposits obtained through brokers	$ 28,246	$ 24,700	$ 324,106
Deposits from the Certificate of Deposit Account Registry Service (CDARS) deposits	60,979	60,972	61,819
Deposits from foreign sources (primarily Mexico)	729,933	748,255	776,448

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.

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

	September 30, 2011	December 31, 2010
Commitments to extend credit	$ 4,787,910	$ 4,528,196
Standby letters of credit	235,300	294,116
Deferred standby letter of credit fees	1,413	1,707

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $5.3 million and $16.1 million for the three and nine months ended September 30, 2011 and $5.4 million and $16.1 million for the three and nine months ended September 30, 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 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 Considered Well Capitalized	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
September 30, 2011						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,806,869	16.57%	$ 872,423	8.00%	$ 1,090,529	10.00%
Frost Bank	1,622,983	14.89	871,896	8.00	1,089,870	10.00
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,591,436	14.59	436,212	4.00	654,317	6.00
Frost Bank	1,507,550	13.83	435,948	4.00	653,922	6.00
Leverage Ratio						
Cullen/Frost	1,591,436	8.82	721,670	4.00	902,088	5.00
Frost Bank	1,507,550	8.36	721,150	4.00	901,438	5.00
December 31, 2010						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,720,691	15.91%	$ 865,081	8.00%	$ 1,081,351	10.00%
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	648,811	6.00
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	861,100	5.00
Frost Bank	1,432,661	8.33	688,196	4.00	860,246	5.00

Management believes that, as of September 30, 2011, Cullen/Frost and its bank subsidiary, Frost Bank, were 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 September 30, 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 September 30, 2011, Frost Bank could pay aggregate dividends of up to $276.4 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 September 30, 2011 would not affect the Corporation s ability to meet all capital adequacy requirements to which it is subject.

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, 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 of the 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 $74.6 million at September 30, 2011. The deferred gain will be reclassified into earnings through October 2014 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 September 30, 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.

	September 30, 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	$ 81,989	$ (8,805)	$ 104,088	$ (8,350)
Interest rate derivatives designated as hedges of cash flows:				
Interest rate swap on junior subordinated deferrable interest debentures	120,000	(9,137)	120,000	(9,895)
Non-hedging interest rate derivatives:				
Commercial loan/lease interest rate swaps	579,750	61,127	593,792	44,335
Commercial loan/lease interest rate swaps	579,750	(61,410)	593,792	(44,666)
Commercial loan/lease interest rate caps	20,000	66	20,000	388
Commercial loan/lease interest rate caps	20,000	(66)	20,000	(388)

The weighted-average rates paid and received for interest rate swaps outstanding at September 30, 2011 were as follows:

	Weighted-Average	
	Interest Rate Paid	Interest Rate Received
Interest rate swaps:		
Fair value hedge commercial loan/lease interest rate swaps	4.46%	0.23%
Cash flow hedge interest rate swaps on junior subordinated deferrable interest debentures	5.47	1.88
Non-hedging interest rate swaps	1.85	5.08
Non-hedging interest rate swaps	5.08	1.85

The weighted-average strike rate for outstanding interest rate caps was 3.10% at September 30, 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.

		September 30, 2011		December 31, 2010	
	Notional Units	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Non-hedging commodity swaps:					
Oil	Barrels	525	$ 6,947	321	$ 2,502
Oil	Barrels	525	(6,829)	321	(2,428)
Natural gas	MMBTUs	3,105	2,816	510	195
Natural gas	MMBTUs	3,105	(2,724)	510	(174)
Non-hedging commodity options:					
Oil	Barrels	2,639	21,605	1,288	7,706
Oil	Barrels	2,639	(21,605)	1,288	(7,706)
Natural gas	MMBTUs	1,440	1,549	3,820	3,774

Natural gas	MMBTUs	1,440	(1,549)	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 September 30, 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 September 30,		**Nine Months Ended September 30,**	
	2011	**2010**	**2011**	**2010**
Commercial loan/lease interest rate swaps:				
Amount of gain (loss) included in interest income on loans	$ (874)	$ (1,241)	$ (2,848)	$ (3,975)
Amount of (gain) loss included in other non-interest expense	(7)	(21)	(10)	(112)

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 September 30,		**Nine Months Ended September 30,**	
	2011	**2010**	**2011**	**2010**
Interest rate swaps/caps/floors on variable-rate loans:				
Amount reclassified from accumulated other comprehensive income to interest income on loans	$ 9,345	$ 11,129	$ 28,035	$ 33,099
Amount of gain (loss) recognized in other comprehensive income		20,944		71,675
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	1,117	1,061	3,304	3,256
Amount of gain (loss) recognized in other comprehensive income	(908)	(2,612)	(2,560)	(8,178)

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 $68.9 million at September 30, 2011 and $86.6 million at December 31, 2010. The Corporation currently expects approximately $5.4 million of the net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive income at September 30, 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.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Non-hedging interest rate derivatives:				
Other non-interest income	$ 90	$ 410	$ 826	$ 2,004
Other non-interest expense	79	34	(49)	112
Non-hedging commodity derivatives:				
Other non-interest income	82	80	544	126
Non-hedging foreign exchange derivatives:				