FIRST COMMUNITY BANCSHARES INC /NV/
Form 10-K
March 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013

Commission file number 000-19297

FIRST COMMUNITY BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Nevada	**55-0694814**
(State or other jurisdiction	**(I.R.S. Employer**
of incorporation)	**Identification No.)**
P.O. Box 989	
Bluefield, Virginia	**24605-0989**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (276) 326-9000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of exchange on which registered**
Common Stock, $1.00 par value	NASDAQ Global Select

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities

Act. ¨ Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the

Act. ¨ Yes x No

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. x Yes ¨ No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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	¨	Accelerated filer	x
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 Exchange Act). ¨ Yes x No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter.

Approximately $209.94 million based on the closing sales price at June 30, 2013.

Indicate the number of shares outstanding of each of the registrant s classes of Common Stock, as of the latest practicable date.

Class Common Stock, $1.00 Par Value; 18,384,279 shares outstanding as of February 28, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the Annual Meeting of Stockholders to be held on April 29, 2014, are incorporated by reference in Part III of this Form 10-K.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

We may make forward-looking statements in filings with the Securities and Exchange Commission (the SEC), including this Annual Report on Form 10-K and the Exhibits hereto, filings incorporated by reference, reports to our shareholders, and other communications that we make in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements represent our beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions. Such statements are subject to significant risks, uncertainties, and change based on various factors, many of which are beyond our control. The words may, could, should, would, believe, anticipate, estimate, expect, intend, plan, and other similar expressions are intended to identify forward-looking statem following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations;

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

inflation, interest rate, market and monetary fluctuations;

our timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;

the willingness of customers to substitute competitors products and services for our products and services and vice versa;

the impact of changes in financial services laws and regulations, including laws concerning taxes, banking, securities, and insurance, and the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act;

the impact of the U.S. Department of the Treasury and federal banking regulators continued implementation of programs to address capital and liquidity in the banking system; further, future and proposed rules, including those that are part of the process outlined in the International Basel Committee on Banking Supervision s Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, which are expected to require banking institutions to increase levels of capital;

technological changes;

the effect of acquisitions, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;

the growth and profitability of our noninterest, or fee, income being less than expected;

unanticipated regulatory or judicial proceedings;

- changes in consumer spending and saving habits; and

- our success at managing the risks involved in the foregoing.

We caution that the foregoing list of important factors is not all-inclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, our actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Annual Report on Form 10-K and other reports we filed with the SEC. Therefore, we caution you not to place undue reliance on our forward-looking information and statements. We do not intend to update any forward-looking statements, whether written or oral, to reflect changes. All forward-looking statements attributable to our Company are expressly qualified by these cautionary statements. See Item 1A, Risk Factors, in Part I of this report.

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FIRST COMMUNITY BANCSHARES, INC.

2013 FORM 10-K

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PART I

Unless the context suggests otherwise, the use of the terms First Community, Company, we, our, and us in this Annual Report on Form 10-K refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity.

Item 1. Business.
Corporate Overview

First Community Bancshares, Inc. (the Company), a financial holding company, was founded in 1989 and incorporated under the laws of Nevada in 1997. The Company provides banking products and services through its wholly-owned subsidiary First Community Bank (the Bank), a Virginia-chartered banking institution founded in 1874. The Bank operates under the trade names First Community Bank in Virginia, West Virginia, and North Carolina and Peoples Community Bank, a Division of First Community Bank, in Tennessee and South Carolina.

The Company provides insurance services through its wholly-owned, full-service insurance agency subsidiary Greenpoint Insurance Group, Inc. (Greenpoint), acquired in 2007. Greenpoint operates under the Greenpoint name and under the trade names First Community Insurance Services (FCIS) and Carolina Insurers Associates in North Carolina, Carr & Hyde Insurance and FCIS in Virginia, and FCIS in West Virginia. During 2013 we purchased one insurance agency. See Note 2, Acquisitions and Divestitures, to the Consolidated Financial Statements in Part II, Item 8 of this report.

In addition, the Bank offers wealth management and investment advice through its wholly-owned subsidiary First Community Wealth Management and the Bank s Trust Division. The Company is the common stockholder of FCBI Capital Trust (the Trust), which was created in October 2003 to issue trust preferred securities to raise capital for the Company.

Our focus is on organic growth that may be supplemented by strategic acquisitions.

The Company is a legal entity that is separate and distinct from its affiliates. As a financial holding company, the Company is required to act as a source of financial strength for its subsidiary bank. The Company s principal source of revenue is derived from dividends paid from the Bank, which are subject to certain restrictions by regulatory agencies and determined in relation to earnings, asset growth, and capital position. For additional information see Regulation and Supervision below.

Operations

We operate in one business segment, Community Banking, which consists of commercial and consumer banking, lending activities, wealth management, and insurance services. Our principal executive office is located at One Community Place, Bluefield, Virginia. As of December 31, 2013, our Community Banking operations were conducted through 80 locations in 5 states: Virginia, West Virginia, North Carolina, South Carolina, and Tennessee. We serve a diverse base of individuals and businesses that include a variety of industries, such as manufacturing, mining services, construction, retail, healthcare, military, and transportation. We have no material concentrations of deposits or loans from any single customer or industry. See Item 6, Selected Financial Data, in Part II of this report for a summary of our financial performance.

We offer a wide range of services and products to our customers that include:

- demand deposit accounts, savings and money market accounts, certificates of deposit, and individual retirement arrangements;
- commercial, consumer, and real estate mortgage loans, and lines of credit;
- various credit card, debit card, and automated teller machine card services;

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- corporate and personal trust services;
- investment management services; and
- life, health, and property and casualty insurance products.

Employees

We had 729 full-time equivalent employees as of December 31, 2013. No employees are represented by collective bargaining agreements, and management considers employee relations to be excellent.

Competition

The financial services industry is highly competitive and there is substantial competition in attracting deposit and loan relationships in our market areas. The ability of non-bank financial entities to provide services previously reserved for commercial banks has intensified competition. We compete with other commercial banks and financial service providers, including thrifts, savings and loan associations, credit unions, consumer finance companies, commercial finance and leasing companies, securities firms, brokerage firms, and insurance companies. Competition for deposits generally comes from other commercial banks, savings institutions, credit unions, mutual funds, and other investment alternatives. The primary factors that influence our ability to attract and retain deposits include interest rates, personalized services, quality and variety of financial offerings, convenience of office locations, automated services, and office hours. Competition for commercial and business loans generally comes from other commercial banks and commercial finance and leasing companies while competition for mortgage loans primarily comes from other commercial banks, savings institutions, mortgage banking firms, mortgage brokers, and insurance companies. The primary factors that influence our ability to originate loans include interest rates, loan origination fees, quality and variety of lending offerings, and personalized services. Our competitors may have greater resources and higher lending limits that allow for services to be offered that we do not provide. Competition could also intensify in the future as a result of general and local economic conditions, industry consolidation, bank failures, technological developments, and banking regulatory reform. See Competition in the Executive Overview section in Part II, Item 7 of this report.

Available Information

Under the Securities Exchange Act of 1934, as amended (the Exchange Act), we are required to file annual, quarterly, and current reports; proxy statements; and other information with the Securities and Exchange Commission (the SEC). Any document we file with the SEC may be read and copied at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at (800) SEC-0330 for further information about the public reference room. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Our website, www.fcbinc.com, makes available, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and other information, including any amendments thereto, as soon as reasonably practicable after we file such reports with, or furnish them to, the SEC. Investors are encouraged to access these reports and other information about our business. Information regarding our Board of Directors, executive officers, and corporate governance policies and principles is included on our website and includes the Standards of Conduct governing the Company s directors, officers, and employees; the charters of the standing committees of the Company s Board of Directors; and the Company s Insider Trading and Disclosure Policy. Additional information found on our website is not part of this report.

Regulation and Supervision

Banks and financial holding companies operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation under applicable federal and state laws and various regulatory agencies. Regulations are intended primarily for the protection of depositors, the Deposit Insurance Fund (DIF) of the Federal Deposit Insurance Corporation (FDIC), and the banking system as a whole and are generally not for the protection of stockholders or creditors. Banking agencies have broad enforcement powers over banks and financial holding companies to impose substantial fines and penalties for violations of laws and regulations.

The following discussion summarizes certain laws, rules, and regulations that affect our Company. These summaries are not intended to be complete and are qualified in their entirety by reference to the applicable statute or regulation. A change in laws, rules, and regulations may have a material effect on our Company.

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, sweeping financial regulatory reform legislation entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including the following provisions:

Centralizes responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (the CFPB), responsible for implementing, examining and enforcing compliance with federal consumer financial laws.

Requires financial holding companies, such as the Company, to be well capitalized and well managed as of July 21, 2011. Bank holding companies and banks must also be well capitalized and well managed to engage in interstate bank acquisitions.

Imposes comprehensive regulation of the over-the-counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institutions themselves.

Implements corporate governance revisions, including executive compensation and proxy access by shareholders.

Makes permanent the $250 thousand limit for federal deposit insurance.

Repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Amends the Electronic Fund Transfer Act to, among other things, give the Board of Governors of the Federal Reserve System (the Federal Reserve) the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and enforces a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

Increases the authority of the Federal Reserve to examine bank holding companies, such as the Company, and their non-bank subsidiaries. Another section of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act (the Mortgage Reform Act), contains new underwriting and servicing standards for the mortgage industry, as well as restrictions on compensation for mortgage originators. In addition, the Mortgage Reform Act grants broad discretionary regulatory authority to the CFPB to prohibit or condition terms, acts, or practices relating to residential mortgage loans that the CFPB finds abusive, unfair, deceptive, or predatory, as well as to take other actions that the CFPB finds are necessary or proper to ensure that responsible affordable mortgage credit remains available to consumers. The Dodd-Frank Act also contains laws affecting the securitization of mortgages, and other assets, with requirements for risk retention by securitizers and requirements for regulating credit rating agencies. Many aspects of the Dodd-Frank Act continue to be subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on our Company, our customers, or the general financial industry. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits, and interchange fees could increase costs associated with deposits, as well as place limitations on certain revenues those deposits may generate.

First Community Bancshares, Inc.

The Company is a financial holding company organized pursuant to the Gramm-Leach-Bliley Act of 1999 (the GLB Act) and a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the BHC Act). Accordingly, the Company is subject to supervision, regulation, and examination by the Federal Reserve. The GLB Act, BHC Act, and other federal laws subject financial and bank holding companies to particular restrictions on the types of activities they may engage in and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. The BHC Act generally provides for umbrella regulation of financial holding companies, such as the Company, by the Federal Reserve, as well as functional regulation of banking activities by bank regulators, securities activities by securities regulators, and insurance activities by insurance regulators.

The Company is also under the jurisdiction of the SEC and is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Exchange Act as administered by the SEC. The Company s common stock is listed on the NASDAQ Global Select Market (NASDAQ) under the trading symbol FCBC , and is subject to the rules of NASDAQ for listed companies.

Regulatory Restrictions on Dividends; Source of Strength

The Federal Reserve s policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, even when it may not be in a financial position to provide such resources. According to Federal Reserve policy, bank holding companies may pay cash dividends on common stock only from income available over the past year and only if prospective earnings retention is consistent with the organization s expected future needs and financial condition. In addition, bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to their banking subsidiaries. A bank holding company may be required to guarantee the capital restoration plan of an undercapitalized banking subsidiary in certain situations.

In addition, the Company and the Bank are subject to other regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The appropriate federal regulatory authority is authorized to determine that the payment of dividends would be an unsafe or unsound practice, under certain circumstances regarding the financial condition of a bank holding company or a bank, and to prohibit payment thereof. The appropriate federal regulatory authorities have stated that paying dividends that deplete a bank s capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings. In the current financial and economic environment, the Federal Reserve has discouraged payment ratios that are at maximum allowable levels, unless both asset quality and capital are very strong, and has noted that bank holding companies should carefully review their dividend policy.

Scope of Permissible Activities

Under the BHC Act, bank holding companies are limited to banking, managing or controlling banks, furnishing services to or performing services for their subsidiaries, or other activities that the Federal Reserve has determined to be closely related to banking or managing and controlling banks as to be a proper incident thereto. The BHC Act requires every bank holding company to obtain the prior approval of the Federal Reserve before it may acquire all, or substantially all, of the assets of any bank or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. When approving bank acquisitions by bank holding companies, the Federal Reserve is required to consider the financial and managerial resources and future prospects of the bank holding company and the target bank, the convenience and needs of the communities to be served, and various competitive factors. The BHC Act also prohibits a bank holding company from acquiring direct or indirect control of more than 5% of the outstanding voting stock of any company engaged in a non-banking business unless such business is determined by the Federal Reserve to be so closely related to banking as to be a proper incident thereto.

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Notwithstanding the foregoing, the GLB Act eliminated the barriers to affiliations among banks, securities firms, insurance companies, and other financial service providers and permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The GLB Act defines financial in nature to include securities underwriting, dealing, and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve has determined to be closely related to banking. Regulatory approval is not generally required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature, or incidental to activities that are financial in nature, as determined by the Federal Reserve.

Under the GLB Act, a bank holding company may become a financial holding company by filing a declaration with the Federal Reserve if each of its subsidiary banks is well capitalized under the FDIC Improvement Act prompt corrective action provisions, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act. The Company elected financial holding company status in December 2006. Since July 2011, the Company s status is dependent on maintaining a well capitalized and well-managed status under applicable Federal Reserve regulations. If a financial holding company ceases to meet these requirements, the Federal Reserve may impose corrective capital and/or managerial requirements on the financial holding company and place limitations on its ability to conduct the broader financial activities permissible for financial holding companies. In addition, the Federal Reserve may require divestiture of the holding company s depository institutions if the deficiencies persist.

The Dodd-Frank Act amended the BHC Act to require federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the Volcker Rule. The Federal Reserve adopted final rules implementing the Volcker Rule on December 10, 2013. The Volcker Rule became effective on July 21, 2012 and the final rules are effective April 1, 2014, but the Federal Reserve issued an order extending the period during which institutions have to conform their activities and investments to the requirements of the Volcker Rule to July 21, 2015. On January 14, 2014, the banking agencies approved an interim rule to permit banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities from the prohibitions under the Volcker Rule. Although we continue to evaluate the impact of the Volcker Rule and the final rules adopted, we do not currently anticipate that the Volcker Rule will have a material effect on the operations of the Company and subsidiaries, as the Company does not engage in the businesses prohibited by the Volcker Rule. The Company may incur costs to adopt additional policies and systems to ensure compliance with the Volcker Rule, but any such costs are not expected to be material.

Anti-Tying Restrictions

Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Stock Repurchases

A bank holding company is required to give the Federal Reserve prior notice of any redemption or repurchase of its own equity securities, subject to certain exemptions, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company s consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation.

Capital Adequacy Requirements

The Federal Reserve currently uses two types of capital adequacy guidelines for holding companies, a two-tiered risk-based capital guideline and a leverage capital ratio guideline. The two-tiered risk-based capital guideline assigns risk weightings to all assets and certain off-balance sheet items of the holding company s operations and then establishes a minimum ratio of the holding company s Tier 1 capital to the aggregate dollar amount of risk-weighted assets (which amount is usually less than the aggregate dollar amount of such assets without risk weighting) and a minimum ratio of the holding company s total capital (Tier 1 capital plus Tier 2 capital, as adjusted) to the aggregate dollar amount of such risk-weighted assets. The leverage ratio guideline establishes a minimum ratio of the holding company s Tier 1 capital to its total tangible assets (total assets less goodwill and certain identifiable intangibles) without risk-weighting. As discussed below, the Bank is subject to similar capital requirements.

Under both guidelines, Tier 1 capital is defined to include common shareholders equity, including retained earnings; qualifying noncumulative perpetual preferred stock and related surplus; qualifying cumulative perpetual preferred stock and related surplus; minority interests in the equity accounts of consolidated subsidiaries, which are limited to a maximum of 25% of Tier 1 capital; and certain trust preferred securities. The Dodd-Frank Act excludes trust preferred securities issued after May 19, 2010, from being included in Tier 1 capital, unless the issuing company is a bank holding company with less than $500 million in total assets. Trust preferred securities issued before that date continue to count as Tier 1 capital for bank holding companies with less than $15 billion in total assets, such as the Company. Goodwill and most intangible assets are deducted from Tier 1 capital. For purposes of the total risk-based capital guidelines Tier 2 capital, sometimes referred to as supplementary capital, is defined to include, subject to limitations: perpetual preferred stock not included in Tier 1 capital, intermediate-term preferred stock and any related surplus, certain hybrid capital instruments, perpetual debt and mandatory convertible debt securities, allowances for loan and lease losses, and intermediate-term subordinated debt instruments. The maximum amount of qualifying Tier 2 capital is 100% of qualifying Tier 1 capital. For purposes of the total capital guideline, total capital equals Tier 1 capital, plus qualifying Tier 2 capital, minus investments in unconsolidated subsidiaries, reciprocal holdings of bank holding company capital securities, and deferred tax assets and other deductions. The Federal Reserve s current capital adequacy guidelines require that a bank holding company maintain a Tier 1 risk-based capital ratio of at least 4.0% and a total risk-based capital ratio of at least 8.0%. As of December 31, 2013, the Company s ratio of Tier 1 capital to total risk-weighted assets was 15.19% and ratio of total capital to risk-weighted assets was 16.44%.

In addition, the Federal Reserve uses a leverage ratio as an added tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company s Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies are required to maintain a leverage ratio of 4.0% or more, depending on their overall condition. As of December 31, 2013, the Company s leverage ratio was 9.95%.

The federal banking agencies risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. Federal Reserve guidelines provide that regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum when circumstances warrant. These guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets.

The current risk-based capital guidelines that apply to the Company and the Bank are based on the 1988 capital accord of the International Basel Committee on Banking Supervision, a committee of central banks and bank supervisors, implemented by the Federal Reserve. In July 2013, the Federal Reserve published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee s December 2010 framework known as Basel III for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank, compared to the current U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions regulatory capital ratios and replace the existing risk-weighting approach, which was derived from the Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee s 2004 Basel II capital accords. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies rules. The Basel III Capital Rules are effective for the Company and the Bank, subject to a phase-in period, on January 1, 2015.

The Basel III Capital Rules, among other things, (i) introduce a new capital measure called Common Equity Tier 1 (CET1), (ii) specify that Tier 1 capital consists of CET1 and Additional Tier 1 capital instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expand the scope of the deductions/adjustments as compared to existing regulations.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and the Bank to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% capital conservation buffer (which is added to the 4.5% CET1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets (as compared to a current minimum leverage ratio of 3% for banking organizations that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority s risk-adjusted measure for market risk).

The Basel III Capital Rules also provides for a countercyclical capital buffer that is applicable to only certain covered institutions and is not expected to have any current applicability to the Company or the Bank. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

Under the Basel III Capital Rules, the initial minimum capital ratios as of January 1, 2015, will be as follows:

- 4.5% CET1 to risk-weighted assets.
- 6.0% Tier 1 capital to risk-weighted assets.
- 8.0% Total capital to risk-weighted assets.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, the effects of certain accumulated other comprehensive items are not excluded; however, non-advanced approaches banking organizations, including the Company and the Bank, may make a one-time permanent election to continue to exclude these items. The Company and the Bank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Company s available-for-sale securities portfolio. The Basel III Capital Rules also preclude certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies, subject to phase-out. The rules do not require a phase-out of trust preferred securities issued prior to May 19, 2010, for holding companies of depository institutions with

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less than $15 billion in consolidated total assets, as of December 1, 2009, which includes the Company. Therefore, the Company s trust preferred securities that were issued prior to May 19, 2010, are permanently grandfathered in as Tier 1 or Tier 2 capital instruments,

Implementation of the deductions and other adjustments to CET1 will begin on January 1, 2015 and will be phased in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1st, until it reaches 2.5% on January 1, 2019).

With respect to the Bank, the Basel III Capital Rules also revise the prompt corrective action regulations pursuant to Section 38 of the Federal Deposit Insurance Act, as discussed below under Prompt Corrective Action.

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expand the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. Specifics changes to current rules impacting the Company s determination of risk-weighted assets include, among other things:

- Applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans.

- Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due.

- Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%).

- Providing for a risk weight, generally not less than 20% with certain exceptions, for securities lending transactions based on the risk weight category of the underlying collateral securing the transaction.

- Providing for a 100% risk weight for claims on securities firms. Eliminating the current 50% cap on the risk weight for OTC derivatives.

In addition, the Basel III Capital Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation. Management believes that, as of December 31, 2013, the Company and the Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

Liquidity Requirements

Historically, the regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio (LCR), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (NSFR), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. In October 2013, the federal banking agencies proposed rules implementing the LCR for advanced approaches banking organizations and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approaches banking organizations, neither of which would apply to the Company or the Bank. The federal banking agencies have not yet proposed rules to implement the NSFR.

Incentive Compensation

In June 2010, the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the FDIC issued their final guidance on policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk taking. The final guidance, which covers all employees who have the ability to materially affect the risk profile of an organization, is based upon the key principles that a banking organization s incentive compensation arrangements should (i) provide incentives that do not encourage risk taking beyond the organization s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization s board of directors. The Federal Reserve indicated that all banking organizations are to evaluate their incentive compensation arrangements and related risk management, controls, and corporate governance processes and immediately address deficiencies in these arrangements or processes that are inconsistent with safety and soundness.

The Federal Reserve reviews, as part of their regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as ours, that are not large, complex banking organizations. These reviews will be tailored to each organization based on the scope and complexity of the organization s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization s supervisory ratings, which can affect the organization s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk management control or governance processes, pose a risk to the organization s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In February 2011, the Federal Reserve, the OCC, and the FDIC approved a joint proposed rulemaking to implement Section 956 of the Dodd-Frank Act, which prohibits incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions and are deemed to be excessive, or that may lead to material losses.

The scope and content of the U.S. banking regulators policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect our ability to attract, hire, retain, and motivate key employees.

First Community Bank

The Bank is a Virginia state-chartered bank supervised and regulated by the Virginia Bureau of Financial Institutions (Virginia Bureau). As a member of the Federal Reserve, the Bank s primary federal regulator is the Federal Reserve Bank (FRB) of Richmond. The Virginia Bureau and FRB of Richmond are based in the Company s home state of Virginia. The regulations of these agencies govern most aspects of the Bank s business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowing, dividends, and location and number of branch offices.

Restrictions on Transactions with Affiliates and Insiders

Transactions between the Bank and its non-banking subsidiaries or affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act the (FRA). In general, Section 23A imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties that are collateralized by the securities or obligations of the Company.

Affiliate transactions are also subject to Section 23B of the FRA which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other non-affiliated persons. The Federal Reserve has issued Regulation W which codifies prior regulations under Sections 23A and 23B of the FRA and interpretive guidance with respect to affiliate transactions.

The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates under Sections 23A and 23B of the FRA, including an expanded definition of covered transactions and increased amount of time for which collateral requirements regarding covered credit transactions must be satisfied. Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivatives transactions, repurchase agreements, reverse repurchase agreements, and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including that such sales be on market terms and, in certain circumstances, approved by the institution s board of directors.

The restrictions on loans to directors, executive officers, principal shareholders, and their related interests contained in the FRA and Regulation O apply to all insured institutions, their subsidiaries, and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to such persons. These loans cannot exceed the institution s total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets

Dividends paid by the Bank to the Company provide and are anticipated to remain the primary source of the Company s operating funds. Capital adequacy requirements applicable to insured depository institutions serve to limit the amount of dividends that may be paid by the Bank. Under federal law, the Bank cannot pay a dividend if, after paying the dividend, it will be classified as undercapitalized. Further, prior approval of the FRB is required if cash dividends declared in any given year exceed the total of the Bank s net profits for such year, plus its retained profits for the preceding two years. Virginia law also imposes restrictions on the ability of Virginia-chartered banks to pay dividends if such dividends would impair a bank s paid-in capital. The payment of dividends by the Bank may also be limited by other factors, such as requirements to maintain capital above regulatory guidelines. The Virginia Bureau and the FRB of Richmond have the general authority to limit dividends paid by the Bank if such payments are deemed to constitute an unsafe and unsound practice.

Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary s liquidation or reorganization will be subject to the prior claims of the subsidiary s creditors. In the event of liquidation or other resolution of an insured depository institution, such as the Bank, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository institution holding company or any shareholder or creditor thereof.

Examinations

Under the FDIC Improvement Act, all insured institutions must undergo regular on-site examination by their appropriate banking agency and such agency may assess the institution for its costs of conducting the examination. As a state-chartered Federal Reserve member bank, the Bank is subject to examination by the Virginia Bureau and FRB of Richmond. These examinations review areas such as capital adequacy, reserves, loan portfolio quality, investments, information systems, disaster recovery, contingency planning, management practices, and other compliance issues.

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Capital Adequacy Requirements

The various federal bank regulatory agencies have adopted risk-based capital requirements for assessing the capital adequacy of banks and bank holding companies. The federal capital standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, as adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profile among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

Pursuant to the Federal Reserve s risk-based capital requirements, state member banks are required to meet a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories for the Bank are the same as those for the Company. In addition to the risk-based capital requirements, the Federal Reserve has adopted regulations that supplement the risk-based guidelines to include a minimum leverage ratio of Tier 1 capital to quarterly average assets of 3.0%. The Federal Reserve has emphasized that the foregoing standards are supervisory minimums and that a banking organization will be permitted to maintain such minimum levels of capital only if it receives the highest rating under the regulatory rating system and the banking organization is not experiencing or anticipating significant growth. All other banking organizations are required to maintain a leverage ratio of at least 4.0% to 5.0% of Tier 1 capital. See Capital Adequacy Requirements in the First Community Bancshares, Inc. section above.

Corrective Measures for Capital Deficiencies

The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. A well capitalized institution has a total risk-based capital ratio of 10.0% or higher, a Tier 1 risk-based capital ratio of 6.0% or higher, a leverage ratio of 5.0% or higher, and is not subject to any written agreement, order, or directive requiring it to maintain a specific capital level for any capital measure. An adequately capitalized institution has a total risk-based capital ratio of 8.0% or higher, a Tier 1 risk-based capital ratio of 4.0% or higher, a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth), and does not meet the criteria for a well capitalized bank. An undercapitalized institution has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0%, or a leverage ratio of less than 4.0%. A significantly undercapitalized institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0%, or a leverage ratio of less than 3.0%. A critically undercapitalized institution s tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank s overall financial condition or prospects for other purposes. The Bank was classified as well capitalized for purposes of the FDIC s prompt corrective action regulation as of December 31, 2013.

The Basel III Capital Rules revise the current prompt corrective action requirements effective January 1, 2015 by (i) introducing a CET1 ratio requirement at each level (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category (other than critically undercapitalized), with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to the current 6%); and (iii) eliminating the current provision that provides that a bank with a composite supervisory rating of 1 may have a 3% leverage ratio and still be adequately capitalized. The Basel III Capital Rules do not change the total risk-based capital requirement for any prompt corrective action category.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions, including asset growth, acquisitions, branch establishment, and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution s capital decreases, the federal regulators enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management, and other restrictions. The FDIC has limited discretion in dealing with a critically undercapitalized institution and is generally required to appoint a receiver or conservator. Banks with risk-based capital and leverage ratios below the required minimums may be subject to certain administrative actions, including termination of deposit insurance upon notice and hearing or temporary suspension of insurance without a hearing if the institution has no tangible capital.

Deposit Insurance Assessments

The Bank s deposits are insured up to applicable limits by the DIF of the FDIC and are subject to deposit insurance assessments to maintain the DIF. Currently the FDIC utilizes a risk-based assessment system to evaluate the risk of each financial institution based on three primary sources of information: its supervisory rating, its financial ratios, and its long-term debt issuer rating, if the institution has one. The FDIC s initial base assessment schedule can be adjusted up or down, and premiums in effect from January 1, 2010, through March 31, 2011, ranged from 12 basis points in the lowest risk category to 45 basis points for banks in the highest risk category. Effective April 1, 2011, the FDIC set initial base assessment rates from 5 basis points in the lowest risk category to 35 basis points for banks in the highest risk category.

The Dodd-Frank Act requires the FDIC to increase the DIF s reserves against future losses, which will necessitate increased deposit insurance premiums that are to be borne primarily by institutions with assets of greater than $10 billion. In October 2010, the FDIC addressed plans to bolster the DIF by increasing the required reserve ratio for the industry to 1.35 percent (ratio of reserves to insured deposits) by September 30, 2020, as required by the Dodd-Frank Act. The FDIC also proposed to raise its industry target ratio of reserves to insured deposits to 2 percent, 65 basis points above the statutory minimum.

In February 2011, the FDIC adopted new rules that amend its current deposit insurance assessment regulations. The new rules implement a provision in the Dodd-Frank Act that changed the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average tangible equity. The rules also changed the assessment rate schedules for insured depository institutions so that approximately the same amount of revenue would be collected using the new assessment base as would be collected using the current rate schedule and the schedules previously proposed by the FDIC in October 2010. In addition, the new rules revised the risk-based assessment system for large insured depository institutions, which generally include institutions with at least $10 billion in total assets and highly complex institutions, by requiring the FDIC to use a scorecard method to calculate assessment rates for all such institutions. The Bank is not considered a highly complex institution for these purposes.

Under the Federal Deposit Insurance Act, as amended (the FDIA), the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

In addition to deposit insurance assessments by the DIF, all FDIC-insured depository institutions must pay an annual assessment to provide funds for the repayment of debt obligations of the Financing Corporation (FICO). The FICO is a government-sponsored entity that was formed to borrow the money necessary to carry out the closing and ultimate disposition of failed thrift institutions by the Resolution Trust Corporation. The FICO

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assessments are set quarterly. The Bank s FICO assessments totaled $154 thousand in 2013 and $140 thousand in 2012. The Bank s FDIC deposit insurance assessments and premiums totaled $1.72 million in 2013 and $1.57 million in 2012.

Safety and Soundness Standards

The FDIA requires that the federal bank regulatory agencies prescribe standards, by regulations or guidelines, relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and other operational and managerial standards the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal stockholder. The agencies adopted regulations that authorize them to order an institution that has been given notice by an agency not satisfying any of such safety and soundness standards to submit a compliance plan. If after being so notified an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the prompt corrective action provisions of the FDIA. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties. See Corrective Measures for Capital Deficiencies in the Bank section above.

Enforcement Powers

The FDIC and the other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties, and appoint a conservator or receiver. Failure to comply with applicable laws, regulations, and supervisory agreements could subject us, including officers, directors, and other institution-affiliated parties, to administrative sanctions and potentially substantial civil money penalties. The appropriate federal banking agency may appoint the FDIC as conservator or receiver for a banking institution (or the FDIC may appoint itself, under certain circumstances) if any one or more of a number of circumstances exist, including, without limitation, the banking institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized; fails to become adequately capitalized when required to do so; fails to submit a timely and acceptable capital restorati