INTERNATIONAL BANCSHARES CORP
Form 10-Q
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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 000-09439

INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

Texas	74-2157138

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1200 San Bernardo Avenue, Laredo, Texas 78042-1359

(Address of principal executive offices)

(Zip Code)

(956) 722-7611

(Registrant's telephone number, including area code)

None

(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 No

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

Indicate by check mark if 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.

Large accelerated filer	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 Exchange Act). Yes No

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

Class	Shares Issued and Outstanding
Common Stock, $1.00 par value	65,948,190 shares outstanding at August 2, 2016

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	June 30, 2016	December 31, 2015
Assets		
Cash and cash equivalents	$ 245,351	$ 273,053
Investment securities:		
Held to maturity (Market value of $2,400 on June 30, 2016 and $2,400 on December 31, 2015)	2,400	2,400
Available for sale (Amortized cost of $4,169,804 on June 30, 2016 and $4,196,034 on December 31, 2015)	4,233,319	4,199,372
Total investment securities	4,235,719	4,201,772
Loans	5,951,597	5,950,914
Less allowance for probable loan losses	(62,033)	(66,988)
Net loans	5,889,564	5,883,926
Bank premises and equipment, net	511,485	516,716
Accrued interest receivable	31,347	31,572
Other investments	470,243	468,791
Identified intangible assets, net	89	153
Goodwill	282,532	282,532
Other assets	110,310	114,354
Total assets	$ 11,776,640	$ 11,772,869

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition, continued (Unaudited)

(Dollars in Thousands)

	June 30, 2016	December 31, 2015
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand—non-interest bearing	$ 3,099,467	$ 3,149,618
Savings and interest bearing demand	3,049,405	3,020,222
Time	2,275,990	2,366,413
Total deposits	8,424,862	8,536,253
Securities sold under repurchase agreements	794,939	827,772
Other borrowed funds	552,125	505,750
Junior subordinated deferrable interest debentures	161,416	161,416
Other liabilities	102,674	76,175
Total liabilities	10,036,016	10,107,366
Shareholders' equity:		
Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 95,881,118 shares on June 30, 2016 and 95,866,218 shares on December 31, 2015	95,881	95,866
Surplus	168,687	167,980
Retained earnings	1,727,148	1,683,600
Accumulated other comprehensive income (including $(3,689) on June 30, 2016 and $(4,026) on December 31, 2015 of comprehensive loss related to other-than-temporary impairment for non-credit related issues)	40,977	2,167
	2,032,693	1,949,613
Less cost of shares in treasury, 29,934,516 shares on June 30, 2016 and 29,585,646 on December 31, 2015	(292,069)	(284,110)
Total shareholders' equity	1,740,624	1,665,503
Total liabilities and shareholders' equity	$ 11,776,640	$ 11,772,869

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Interest income:				
Loans, including fees	$ 74,606	$ 72,927	$ 148,857	$ 145,370
Investment securities:				
Taxable	20,596	23,257	40,716	47,140
Tax-exempt	2,627	2,749	5,274	5,522
Other interest income	67	42	106	78
Total interest income	97,896	98,975	194,953	198,110
Interest expense:				
Savings deposits	1,199	901	2,160	1,778
Time deposits	2,394	2,833	4,968	5,707
Securities sold under repurchase agreements	5,552	6,062	11,111	12,056
Other borrowings	757	369	1,384	844
Junior subordinated deferrable interest debentures	1,122	1,045	2,218	2,069
Total interest expense	11,024	11,210	21,841	22,454
Net interest income	86,872	87,765	173,112	175,656
Provision for probable loan losses	7,097	7,767	16,231	10,144
Net interest income after provision for probable loan losses	79,775	79,998	156,881	165,512
Non-interest income:				
Service charges on deposit accounts	17,854	19,850	35,964	39,042
Other service charges, commissions and fees				
Banking	10,957	13,075	21,334	23,528
Non-banking	1,694	1,856	2,991	2,966
Investment securities transactions, net	(227)	(427)	(360)	(428)
Other investments, net	2,766	3,462	10,617	7,717
Other income	3,567	2,328	6,996	4,153
Total non-interest income	$ 36,611	$ 40,144	$ 77,542	$ 76,978

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Non-interest expense:				
Employee compensation and benefits	$ 31,155	$ 29,650	$ 61,938	$ 61,402
Occupancy	5,906	6,681	12,072	12,860
Depreciation of bank premises and equipment	6,208	6,332	12,388	12,558
Professional fees	3,446	4,020	6,739	7,267
Deposit insurance assessments	1,508	1,440	3,001	2,930
Net expense, other real estate owned	1,377	928	2,255	2,396
Amortization of identified intangible assets	32	161	64	280
Advertising	2,319	2,023	4,424	4,030
Software and software maintenance	3,723	2,563	7,034	5,129
Impairment charges (Total other-than-temporary impairment charges, $(300) net of $(367), $(54), net of $(278), $(332) net of $(523) and $(176), net of $(627), included in other comprehensive income)	67	224	191	451
Other	16,243	14,249	29,796	26,591
Total non-interest expense	71,984	68,271	139,902	135,894
Income before income taxes	44,402	51,871	94,521	106,596
Provision for income taxes	14,714	17,996	31,849	36,859
Net income	$ 29,688	$ 33,875	$ 62,672	$ 69,737
Basic earnings per common share:				
Weighted average number of shares outstanding	65,944,220	66,424,723	65,979,167	66,420,511
Net income	$ 0.45	$ 0.51	$ 0.95	$ 1.05
Fully diluted earnings per common share:				
Weighted average number of shares outstanding	66,159,105	66,684,136	66,138,593	66,619,788

Net income	$ 0.45	$ 0.51	$ 0.95	$ 1.05

See accompanying notes to consolidated financial statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Net income	$ 29,688	$ 33,875	$ 62,672	$ 69,737
Other comprehensive income, net of tax:				
Net unrealized holding gains (losses) on securities available for sale arising during period (net of tax effects of $5,451, $(13,610), $20,705, and $(1,854))	10,124	(25,275)	38,452	(3,443)
Reclassification adjustment for losses on securities available for sale included in net income (net of tax effects of $79, $149, $126, and $150)	148	278	234	278
Reclassification adjustment for impairment charges on available for sale securities included in net income (net of tax effects of $23, $78, $67, and $158)	44	146	124	293
	10,316	(24,851)	38,810	(2,872)
Comprehensive income	$ 40,004	$ 9,024	$ 101,482	$ 66,865

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Six Months Ended June 30, 2016	2015
Operating activities:		
Net income	$ 62,672	$ 69,737
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for probable loan losses	16,231	10,144
Specific reserve, other real estate owned	570	118
Depreciation of bank premises and equipment	12,388	12,558
Gain on sale of bank premises and equipment	(40)	(143)
Gain on sale of other real estate owned	(55)	(205)
Accretion of investment securities discounts	(259)	(886)
Amortization of investment securities premiums	12,311	14,074
Investment securities transactions, net	360	428
Impairment charges on available for sale securities	191	451
Amortization of identified intangible assets	64	280
Stock based compensation expense	554	583
Earnings from affiliates and other investments	(5,555)	(6,527)
Deferred tax expense	386	118
Decrease in accrued interest receivable	225	119
Increase in other assets	(1,894)	(972)
Net increase in other liabilities	5,006	511
Net cash provided by operating activities	103,155	100,388
Investing activities:		
Proceeds from maturities of securities	—	1,075
Proceeds from sales and calls of available for sale securities	195,538	30,282
Purchases of available for sale securities	(582,117)	(241,570)
Principal collected on mortgage backed securities	407,011	432,542
Net increase in loans	(23,852)	(115,735)
Purchases of other investments	(1,509)	(12,491)
Distributions from other investments	3,942	10,332
Purchases of bank premises and equipment	(7,160)	(11,983)
Proceeds from sales of bank premises and equipment	43	10,922

Proceeds from sales of other real estate owned	2,010	891
Net cash (used in) provided by investing activities	$ (6,094)	$ 104,265

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INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Six Months Ended June 30, 2016	2015
Financing activities:		
Net (decrease) increase in non-interest bearing demand deposits	$ (50,151)	$ 74,961
Net increase (decrease) in savings and interest bearing demand deposits	29,183	(10,341)
Net decrease in time deposits	(90,423)	(39,411)
Net (decrease) increase in securities sold under repurchase agreements	(32,833)	48,861
Net increase (decrease) in other borrowed funds	46,375	(253,619)
Purchase of treasury stock	(7,959)	(1,245)
Proceeds from stock transactions	168	645
Payments of cash dividends - common	(19,123)	(19,258)
Net cash used in financing activities	(124,763)	(199,407)
(Decrease) increase in cash and cash equivalents	(27,702)	5,246
Cash and cash equivalents at beginning of year	273,053	255,146
Cash and cash equivalents at end of year	$ 245,351	$ 260,392
Supplemental cash flow information:		
Interest paid	$ 23,207	$ 22,606
Income taxes paid	26,175	37,840
Non-cash investing and financing activities:		
Purchases of available-for-sale securities not yet settled	6,804	2,279
Net transfers from loans to other real estate owned	1,983	6,084

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 — Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (the "Corporation") and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the "Company") conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo ("IBC"), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation's wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Trading Company, Premier Tierra Holdings, Inc., IBC Charitable and Community Development Corporation, and IBC Capital Corporation. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. These financial statements should be read in conjunction with the financial statements and the notes thereto in the Company's latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2015 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable. Operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results for the year ending December 31, 2016 or any future period.

The Company operates as one segment. The operating information used by the Company's chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville. The Company applies the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"), FASB ASC 280, "Segment Reporting," in determining its reportable segments and related disclosures.

The Company has evaluated all events or transactions that occurred through the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

In June 2016, the Financial Accounting Standards Board issued Accounting Standards Update No. 2016-13, to ASC 326, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The update requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, the update amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The update will be effective on for interim and fiscal years ending after December 31, 2019. The Company is currently evaluating the potential impact of the update on the Company’s consolidated financial statements.

Note 2 — Fair Value Measurements

ASC Topic 820, “Fair Value Measurements and Disclosures” (“ASC 820”), defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; it also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs - Observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Inputs - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy is set forth below.

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of June 30, 2016 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in Thousands)		
	Assets/Liabilities Measured at Fair Value June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured on a recurring basis:				
Assets:				
Available for sale securities				
Residential mortgage-backed securities	$ 3,925,794	$ —	$ 3,906,421	$ 19,373
States and political subdivisions	278,596	—	278,596	—
Other	28,929	28,929	—	—
	$ 4,233,319	$ 28,929	$ 4,185,017	$ 19,373

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of December 31, 2015 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value December 31, 2015	Fair Value Measurements at Reporting Date Using (in Thousands) Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Measured on a recurring basis:				
Assets:				
Available for sale securities				
Residential mortgage - backed securities	$ 3,893,211	$ —	$ 3,871,982	$ 21,229
States and political subdivisions	277,704	—	277,704	—
Other	28,457	28,457	—	—
	$ 4,199,372	$ 28,457	$ 4,149,686	$ 21,229

Investment securities available-for-sale are classified within Level 2 and Level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within Level 1. For investments classified as Level 2 in the fair value hierarchy, the Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Investment securities classified as Level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in inactive markets and markets that have experienced significant decreases in volume and level of activity, as evidenced by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company used a discounted cash flow model to determine fair value. Inputs in the model included both historical performance and expected future performance based on information currently available.

Assumptions used in the discounted cash flow model as of June 30, 2016 and December 31, 2015 were applied separately to those portions of the bond where the underlying residential mortgage loans had been performing under original contract terms for at least the prior 24 months and those where the underlying residential mortgages had not been meeting the original contractual obligation for the same period. Unobservable inputs included in the model are estimates on future principal prepayment rates and default and loss severity rates. For that portion of the bond where the underlying residential mortgage had been meeting the original contract terms for at least 24 months, the Company used the following estimates in the model: (i) a voluntary prepayment rate of 7%, (ii) a 1% default rate, (iii) a loss severity rate of 25%, and (iv) a discount rate of 13%. The assumptions used in the model for the rest of the bond included the following estimates: (i) a voluntary prepayment rate of 2%, (ii) a default rate of 4.5%, (iii) a loss severity rate that started at 60% for the first year (2012) then declines by 5% for the following five years (2013, 2014, 2015, 2016 and 2017) and remains at 25% thereafter (2018 and beyond), and (iv) a discount rate of 13%. The estimates used in the model to determine fair value are based on observable historical data of the underlying collateral. The model anticipates that the housing market will gradually improve and that the underlying collateral will eventually all perform in accordance with the original contract terms on the bond. Should the number of loans in the underlying collateral that default and go into foreclosure or the severity of the losses in the underlying collateral significantly change, the results of the model would be impacted. The Company will continue to evaluate the actual historical performance of the underlying collateral and will modify the assumptions used in the model as necessary.

The following table presents a reconciliation of activity for such mortgage-backed securities on a net basis (Dollars in Thousands):

Balance at December 31, 2015	$ 21,229
Principal paydowns	(2,188)
Total unrealized gains (losses) included in:	
Other comprehensive income	523
Impairment realized in earnings	(191)
Balance at June 30, 2016	$ 19,373

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis. The instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended June 30, 2016 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in thousands)			
	Assets/Liabilities Measured at Fair Value Year ended June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision (Credit) During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 34,468	$ —	$ —	$ 34,468	$ 17,057
Other real estate owned	4,338	—	—	4,338	570

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended December 31, 2015 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Year ended December 31, 2015	Fair Value Measurements at Reporting Date Using (in thousands) Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net (Credit) Provision During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	$ 18,033	$ —	$ —	$ 18,033	$ (8,589)
Other real estate owned	12,705	—	—	12,705	1,023

The Company's assets measured at fair value on a non-recurring basis are limited to impaired loans and other real estate owned. Impaired loans are classified within Level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, "Receivables". Impaired loans are primarily comprised of collateral-dependent commercial loans. Understanding that as the primary sources of loan repayments decline, the secondary repayment source takes on greater significance and correctly evaluating the fair value of that secondary source, the collateral, becomes even more important. Re-measurement of the impaired loan to fair value is done through a specific valuation allowance included in the allowance for probable loan losses. The fair value of impaired loans is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for the Company's appraisal and appraisal review process is based on regulatory guidelines and strives to comply with all regulatory appraisal laws, regulations, and the Uniform Standards of Professional Appraisal Practice. All appraisals and evaluations are "as is" (the property's highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of June 30, 2016, the Company had $28,184,000 of impaired commercial collateral dependent loans, of which $12,603,000 had an appraisal performed within the immediately preceding twelve months, and of which $7,922,000 had an evaluation performed within the immediately preceding twelve months. As of December 31, 2015, the Company had $51,021,000 of impaired commercial collateral dependent loans, of which $39,520,000 had an appraisal performed within the immediately preceding twelve months and of which $2,958,000 had an evaluation performed within the immediately preceding twelve months.

The determination to either seek an appraisal or to perform an evaluation begins in weekly credit quality meetings, where the committee analyzes the existing collateral values of the impaired loans and where obsolete appraisals are identified. In order to determine whether the Company would obtain a new appraisal or perform an internal evaluation to determine the fair value of the collateral, the credit committee reviews the existing appraisal to determine if the collateral value is reasonable in view of the current use of the collateral and the economic environment related to the collateral. If the analysis of the existing appraisal does not find that the collateral value is reasonable under the current circumstances, the Company would obtain a new appraisal on the collateral or perform an internal evaluation of the collateral. The ultimate decision to get a new appraisal rests with the independent credit administration group. A new appraisal is not required if an internal evaluation, as performed by in-house experts, is able to appropriately update the original appraisal assumptions to reflect current market conditions and provide an estimate of the collateral's market value for impairment analysis. The internal evaluations must be in writing and contain sufficient information detailing the analysis, assumptions and conclusions, and they must support performing an evaluation in lieu of ordering a new appraisal.

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate owned is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal) within Level 3 of the fair value hierarchy. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. The fair value is reviewed periodically and subsequent write-downs are made, accordingly, through a charge to operations. Other real estate owned is included in other assets on the consolidated financial statements. For the three and six months ended June 30, 2016, the Company recorded $149,000 and $381,000, respectively, in charges to the allowance for probable loan losses in connection with loans transferred to other real estate owned. For the three and six months ended June 30, 2016, respectively, the Company recorded $523,000 and $570,000 in adjustments to fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for the Company's financial instruments at June 30, 2016 and December 31, 2015 are outlined below.

Cash and Cash Equivalents

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Time Deposits with Banks

The carrying amounts of time deposits with banks approximate fair value.

Investment Securities Held-to-Maturity

The carrying amounts of investments held-to-maturity approximate fair value.

Investment Securities

For investment securities, which include U.S. Treasury securities, obligations of other U.S. government agencies, obligations of states and political subdivisions and mortgage pass through and related securities, fair values are from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. See disclosures of fair value of investment securities in Note 6.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate and consumer loans as outlined by regulatory reporting guidelines. Each category is segmented into fixed and variable interest rate terms and by performing and non-performing categories.

For variable rate performing loans, the carrying amount approximates the fair value. For fixed-rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed-rate performing loans are within Level 3 of the fair value hierarchy. At June 30, 2016, and December 31, 2015, the carrying amount of fixed-rate performing loans was $1,404,016,000 and $1,383,836,000 respectively, and the estimated fair value was $1,372,931,000 and $1,362,248,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of June 30, 2016 and December 31, 2015. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. Time deposits are within Level 3 of the fair value hierarchy. At June 30, 2016 and December 31, 2015, the carrying amount of time deposits was $2,275,990,000 and

$2,366,413,000, respectively, and the estimated fair value was $2,272,019,000 and $2,365,390,000, respectively.

Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements include both short- and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at June 30, 2016 and December 31, 2015. The fair value of the long-term instruments is based on established market spreads using option adjusted spread methodology. Long-term repurchase agreements are within Level 3 of the fair value hierarchy. At June 30, 2016 and December 31, 2015, the carrying amount of long-term repurchase agreements was $560,000,000 and $560,000,000, respectively, and the estimated fair value was $531,898,300 and $527,198,600, respectively.

Junior Subordinated Deferrable Interest Debentures

The Company currently has floating-rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating-rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at June 30, 2016 and December 31, 2015.

Other Borrowed Funds

The Company currently has short-term borrowings issued from the Federal Home Loan Bank ("FHLB"). Due to the contractual terms of the short-term borrowings, the carrying amounts approximated fair value at June 30, 2016 and December 31, 2015.

Commitments to Extend Credit and Letters of Credit

Commitments to extend credit and fund letters of credit are principally at current interest rates, and, therefore, the carrying amount approximates fair value.

Limitations

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-statement of condition financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include the bank premises and equipment and core deposit value. In addition, the tax ramifications related to the effect of fair value estimates have not been considered in the above estimates.

Note 3 — Loans

A summary of loans, by loan type at June 30, 2016 and December 31, 2015 is as follows:

June 30,

	2016	December 31, 2015
	(Dollars in Thousands)	
Commercial, financial and agricultural	$ 3,035,149	$ 3,101,748
Real estate - mortgage	997,309	962,582
Real estate - construction	1,686,111	1,649,827
Consumer	56,117	57,744
Foreign	176,911	179,013
Total loans	$ 5,951,597	$ 5,950,914

Note 4 — Allowance for Probable Loan Losses

The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the bank subsidiaries. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each bank subsidiary is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance for probable loan losses is derived from the following elements: (i) allowances established on specific impaired loans, which are based on a review of the individual characteristics of each loan, including the customer's ability to repay the loan, the underlying collateral values, and the industry in which the customer operates; (ii) allowances based on actual historical loss experience for similar types of loans in the Company's loan portfolio; and (iii) allowances based on general economic conditions, changes in the mix of loans, company resources, border risk and credit quality indicators, among other things. All segments of the loan portfolio continue to be impacted by the prolonged economic recovery. Loans secured by real estate could be impacted negatively by the continued economic environment and resulting decrease in collateral values. Consumer loans may be impacted by continued and prolonged unemployment rates.

The Company's management continually reviews the allowance for loan losses of the bank subsidiaries using the amounts determined from the allowances established on specific impaired loans, the allowance established on quantitative historical loss percentages, and the allowance based on qualitative data to establish an appropriate amount to maintain in the Company's allowance for loan losses. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, the Company's estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses. While the calculation of the allowance for probable loan losses utilizes management's best judgment and all information reasonably available, the adequacy of the allowance is dependent on a variety of factors beyond the Company's control, including, among other things, the performance of the entire loan portfolio, the economy, changes in interest rates and the view of regulatory authorities towards loan classifications.

The loan loss provision is determined using the following methods. On a weekly basis, loan past due reports are reviewed by the credit quality committee to determine if a loan has any potential problems and if a loan should be placed on the Company's internal classified report. Additionally, the Company's credit department reviews the majority of the Company's loans for proper internal classification purposes, regardless of whether they are past due, and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, the Company determines if a loan should be placed on an internal classified report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

A summary of the transactions in the allowance for probable loan losses by loan class is as follows:

	Three Months Ended June 30, 2016								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at March 31,	$ 25,783	$ 10,870	$ 16,974	$ 910	$ 2,369	$ 3,420	$ 530	$ 928	$ 61,784
Losses charged to allowance	(5,396)	(2)	(1,843)	—	(23)	(155)	(116)	—	(7,535)
Recoveries credited to allowance	513	3	75	—	4	76	5	11	687
Net (losses) recoveries charged to allowance	(4,883)	1	(1,768)	—	(19)	(79)	(111)	11	(6,848)
Provision charged to operations	5,082	238	1,736	(55)	(73)	59	113	(3)	7,097
Balance at June 30,	$ 25,982	$ 11,109	$ 16,942	$ 855	$ 2,277	$ 3,400	$ 532	$ 936	$ 62,033

	Three Months Ended June 30, 2015								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at March 31,	$ 23,519	$ 14,369	$ 17,976	$ 840	$ 3,573	$ 4,261	$ 644	$ 1,069	$ 66,251
Losses charged to allowance	(13,073)	(685)	(339)	—	(1)	(5)	(239)	—	(14,342)
Recoveries credited to allowance	534	38	7	—	10	145	124	4	862
	(12,539)	(647)	(332)	—	9	140	(115)	4	(13,480)

Net losses charged to allowance									
Provision charged to operations	7,922	(198)	241	(155)	(148)	(93)	96	102	7,767
Balance at June 30,	$ 18,902	$ 13,524	$ 17,885	$ 685	$ 3,434	$ 4,308	$ 625	$ 1,175	$ 60,538

	Six Months Ended June 30, 2016								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
alance at ecember 31,	$ 21,431	$ 13,920	$ 19,769	$ 1,248	$ 3,509	$ 5,321	$ 638	$ 1,152	$ 66,988
osses charged to owance	(24,467)	(2)	(1,890)	(180)	(30)	(324)	(217)	—	(27,110)
ecoveries credited allowance	5,656	7	86	—	7	114	42	12	5,924
et (losses) coveries charged allowance	(18,811)	5	(1,804)	(180)	(23)	(210)	(175)	12	(21,186)
ovision charged operations	23,362	(2,816)	(1,023)	(213)	(1,209)	(1,711)	69	(228)	16,231
alance at June 30,	$ 25,982	$ 11,109	$ 16,942	$ 855	$ 2,277	$ 3,400	$ 532	$ 936	$ 62,033

	Six Months Ended June 30, 2015								
	Domestic							Foreign	
	Commercial	Commercial Real Estate: Other Construction & Land Development	Commercial Real Estate: Farmland & Commercial	Commercial Real Estate: Multifamily	Residential: First Lien	Residential: Junior Lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31,	$ 22,352	$ 12,955	$ 18,683	$ 846	$ 3,589	$ 4,683	$ 660	$ 1,060	$ 64,828
Losses charged to allowance	(15,382)	(685)	(356)	—	(91)	(102)	(413)	—	(17,029)
Recoveries credited to allowance	1,330	39	813	—	24	251	130	8	2,595
Net (losses) recoveries charged to allowance	(14,052)	(646)	457	—	(67)	149	(283)	8	(14,434)
Provision charged to operations	10,602	1,215	(1,255)	(161)	(88)				