CULLEN FROST BANKERS INC
Form 10-Q
October 21, 2009
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United States

Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended: September 30, 2009

Or

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

Commission file number: 001-13221

Cullen/Frost Bankers, Inc.

(Exact name of registrant as specified in its charter)

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

(210) 220-4011

(Registrant s telephone number, including area code)

N/A

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

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

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

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

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

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

As of October 15, 2009, there were 59,940,184 shares of the registrant s Common Stock, $.01 par value, outstanding.

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Cullen/Frost Bankers, Inc.

Quarterly Report on Form 10-Q

September 30, 2009

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Part I. Financial Information

Item 1. Financial Statements (Unaudited)
Cullen/Frost Bankers, Inc.

Consolidated Statements of Income

(Dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Interest income:				
Loans, including fees	$ 107,578	$ 125,446	$ 325,382	$ 379,164
Securities:				
Taxable	30,214	35,233	95,420	109,234
Tax-exempt	16,989	5,632	44,556	16,411
Interest-bearing deposits	692	21	1,215	141
Federal funds sold and resell agreements	17	344	198	3,284
Total interest income	155,490	166,676	466,771	508,234
Interest expense:				
Deposits	13,593	23,218	44,983	83,462
Federal funds purchased and repurchase agreements	243	2,976	928	10,954
Junior subordinated deferrable interest debentures	1,814	1,537	5,439	5,234
Other long-term borrowings	5,851	4,209	17,336	12,640
Total interest expense	21,501	31,940	68,686	112,290
Net interest income	133,989	134,736	398,085	395,944
Provision for possible loan losses	16,940	18,940	43,142	29,273
Net interest income after provision for possible loan losses	117,049	115,796	354,943	366,671
Non-interest income:				
Trust fees	16,755	19,749	49,599	57,071
Service charges on deposit accounts	26,395	22,642	76,457	63,869
Insurance commissions and fees	8,505	8,261	26,362	26,434
Other charges, commissions and fees	6,845	10,723	19,895	27,150
Net gain (loss) on securities transactions		78	49	(26)
Other	10,991	15,862	34,999	43,626
Total non-interest income	69,491	77,315	207,361	218,124
Non-interest expense:				
Salaries and wages	58,591	57,803	171,907	167,475
Employee benefits	13,445	10,677	42,468	36,702
Net occupancy	11,111	10,342	32,665	30,080
Furniture and equipment	11,133	9,657	32,158	27,789
Deposit insurance	4,643	1,859	20,686	2,812
Intangible amortization	1,564	1,976	5,064	5,977
Other	31,747	30,658	93,074	92,267

Total non-interest expense	132,234	122,972	398,022	363,102
Income before income taxes	54,306	70,139	164,282	221,693
Income taxes	9,607	21,174	36,742	67,401
Net income	$ 44,699	$ 48,965	$ 127,540	$ 154,292
Earnings per common share:				
Basic	$ 0.75	$ 0.83	$ 2.14	$ 2.62
Diluted	0.75	0.83	2.14	2.61

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)

	September 30, 2009	December 31, 2008	September 30, 2008
Assets:			
Cash and due from banks	$ 425,047	$ 656,339	$ 944,214
Interest-bearing deposits	1,355,129	495,867	4,547
Federal funds sold and resell agreements	9,115	85,125	180,026
Total cash and cash equivalents	1,789,291	1,237,331	1,128,787
Securities held to maturity, at amortized cost	6,351	6,948	7,144
Securities available for sale, at estimated fair value	4,531,687	3,554,529	3,170,655
Trading account securities	14,914	14,552	25,371
Loans, net of unearned discounts	8,518,608	8,844,082	8,595,986
Less: Allowance for possible loan losses	(123,122)	(110,244)	(107,109)
Net loans	8,395,486	8,733,838	8,488,877
Premises and equipment, net	313,271	267,025	248,419
Goodwill	527,684	526,567	526,876
Other intangible assets, net	20,933	24,266	26,579
Cash surrender value of life insurance policies	124,270	121,197	119,974
Accrued interest receivable and other assets	434,338	547,889	318,802
Total assets	$ 16,158,225	$ 15,034,142	$ 14,061,484
Liabilities:			
Deposits:			
Non-interest-bearing demand deposits	$ 4,426,907	$ 4,152,348	$ 3,817,314
Interest-bearing deposits	8,494,831	7,356,589	6,800,906
Total deposits	12,921,738	11,508,937	10,618,220
Federal funds purchased and repurchase agreements	452,921	1,073,279	1,286,449
Junior subordinated deferrable interest debentures	136,084	136,084	256,581
Other long-term borrowings	486,566	256,577	136,084
Accrued interest payable and other liabilities	255,030	295,738	153,290
Total liabilities	14,252,339	13,270,615	12,450,624
Shareholders Equity:			
Preferred stock, par value $0.01 per share; 10,000,000 shares authorized; none issued			
Junior participating preferred stock, par value $0.01 per share; 250,000 shares authorized; none issued			
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 60,236,862 shares issued	602	602	602
Additional paid-in capital	599,984	589,065	589,010
Retained earnings	1,125,059	1,080,160	1,053,129
Accumulated other comprehensive income (loss), net of tax	197,061	137,294	17,771
Treasury stock, 307,948 shares, 820,429 shares and 937,447 shares, at cost	(16,820)	(43,594)	(49,652)

Total shareholders equity	1,905,886	1,763,527	1,610,860
Total liabilities and shareholders equity	$ 16,158,225	$ 15,034,142	$ 14,061,484

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Changes in Shareholders Equity

(Dollars in thousands, except per share amounts)

	Nine Months Ended September 30, 2009	2008
Total shareholders equity at beginning of period	$ 1,763,527	$ 1,477,088
Cumulative effect of adoption of a new accounting principle on January 1, 2008		(240)
Comprehensive income:		
Net income	127,540	154,292
Other comprehensive income (loss):		
Change in accumulated gain/loss on effective cash flow hedging derivatives of $(43,416) in 2009 and $34,937 in 2008, net of tax effect of $(15,196) in 2009 and $12,228 in 2008	(28,220)	22,709
Change in unrealized gain/loss on securities available for sale of $132,241 in 2009 and $2,813 in 2008, net of reclassification adjustment of $(49) in 2009 and $26 in 2008 and tax effect of $46,267 in 2009 and $994 in 2008	85,925	1,845
Change in the net actuarial gain/loss on defined benefit post-retirement benefit plans of $3,173 in 2009 and $922 and 2008, net of tax effect of $1,111 in 2009 and $323 in 2008	2,062	599
Total other comprehensive income	59,767	25,153
Total comprehensive income	187,307	179,445
Stock option exercises (417,425 shares in 2009 and 1,041,600 shares in 2008)	15,855	34,469
Stock compensation expense recognized in earnings	9,488	7,435
Tax benefits related to stock compensation, includes excess tax benefits of $630 in 2009 and $7,231 in 2008	1,431	7,776
Purchase of treasury stock (404,315 shares in 2008)		(21,918)
Treasury stock issued/sold to the 401(k) stock purchase plan (95,056 shares in 2009)	4,600	
Cash dividends ($1.28 per share in 2009 and $1.24 per share in 2008)	(76,322)	(73,195)
Total shareholders equity at end of period	$ 1,905,886	$ 1,610,860

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Cash Flows

(Dollars in thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Operating Activities:		
Net income	$ 127,540	$ 154,292
Adjustments to reconcile net income to net cash from operating activities:		
Provision for possible loan losses	43,142	29,273
Deferred tax expense (benefit)	(6,492)	(5,359)
Accretion of loan discounts	(11,130)	(9,171)
Securities premium amortization (discount accretion), net	1,829	529
Net (gain) loss on securities transactions	(49)	26
Depreciation and amortization	27,099	24,650
Net (gain) loss on sale of loans held for sale and other assets	1,695	(2,340)
Stock-based compensation expense	9,488	7,435
Tax benefits from stock-based compensation	801	545
Excess tax benefits from stock-based compensation	(630)	(7,231)
Earnings on life insurance policies	(3,723)	(3,743)
Net change in:		
Trading account securities	(362)	(13,458)
Student loans held for sale	4,660	31,439
Accrued interest receivable and other assets	78,099	(1,251)
Accrued interest payable and other liabilities	(58,410)	15,411
Net cash from operating activities	213,557	221,047
Investing Activities:		
Securities held to maturity:		
Maturities, calls and principal repayments	597	978
Securities available for sale:		
Purchases	(11,616,333)	(3,287,822)
Sales	9,947	888,295
Maturities, calls and principal repayments	10,759,640	2,638,171
Net change in loans	277,925	(871,391)
Net cash paid in acquisitions	(1,205)	(229)
Proceeds from sales of premises and equipment	70	1,284
Purchases of premises and equipment	(62,458)	(43,711)
Benefits received on life insurance policies	650	
Proceeds from sales of repossessed properties	5,319	4,800
Net cash from investing activities	(625,848)	(669,625)
Financing Activities:		
Net change in deposits	1,412,801	88,547
Net change in short-term borrowings	(620,358)	353,377
Proceeds from long-term borrowings	230,000	
Principal payments on long-term borrowings	(11)	(7,658)
Proceeds from stock option exercises	15,855	34,469
Excess tax benefits from stock-based compensation arrangements	630	7,231
Purchase of treasury stock		(21,918)
Treasury stock sold to the 401(k) stock purchase plan	1,656	

Cash dividends paid	(76,322)	(73,195)
Net cash from financing activities	964,251	380,853
Net change in cash and cash equivalents	551,960	(67,725)
Cash and equivalents at beginning of period	1,237,331	1,196,512
Cash and equivalents at end of period	$ 1,789,291	$ 1,128,787

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Notes to Consolidated Financial Statements

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

Note 1 - Significant Accounting Policies

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

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

The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Corporation s financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with the Corporation s consolidated financial statements, and notes thereto, for the year ended December 31, 2008, included in the Corporation s Annual Report on Form 10-K filed with the SEC on February 3, 2009 (the 2008 Form 10-K). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period. The Corporation has evaluated subsequent events for potential recognition and/or disclosure through October 21, 2009, the date the consolidated financial statements included in this Quarterly Report on Form 10-Q were issued.

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

Accounting Standards Codification. The Financial Accounting Standards Board s (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB s officially recognized source of authoritative U.S. generally accepted accounting principles (GAAP) applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the away companies refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content through the Topic, Subtopic, Section and Paragraph structure.

Cash Flow Reporting. Cash paid for interest totaled $75.9 million and $124.8 million during the nine months ended September 30, 2009 and 2008. Cash paid for income taxes totaled $59.2 million and $65.0 million during the nine months ended September 30, 2009 and 2008. Significant non-cash transactions during the nine months ended September 30, 2009 and 2008 included transfers of loans to other real estate owned and foreclosed assets in connection with loan foreclosures totaling $25.7 million during 2009 and $9.8 million during 2008, common stock issued to the Corporation s 401(k) plan in connection with matching contributions totaling $2.9 million during 2009 and loans to facilitate the sale of other real estate owned totaling $1.8 million in 2009.

Comprehensive Income. Comprehensive income includes all changes in shareholders equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of the Corporation s comprehensive income include the after tax effect of changes in the net unrealized gain/loss on securities available for sale, changes in the net actuarial gain/loss on defined benefit post-retirement benefit plans and changes in the accumulated gain/loss on effective cash flow hedging instruments. Comprehensive income for the nine months ended September 30, 2009 and 2008 is reported in the accompanying consolidated statements of changes in shareholders equity. The Corporation had comprehensive income of $119.7 million and $81.7 million for the three months ended September 30, 2009 and 2008. Comprehensive income during

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the three months ended September 30, 2009 included net after-tax gains of $70.2 million due to an increase in the net unrealized gain on securities available for sale and $4.2 million due to a change in the accumulated gain/loss on cash flow hedging derivatives. Comprehensive income during the three months ended September 30, 2008 included net after-tax gains of $12.7 million due to a decrease in the net unrealized loss on securities available for sale and $19.8 million due to a change in the accumulated gain/loss on cash flow hedging derivatives.

Earnings Per Share. Effective January 1, 2009, the Corporation adopted new authoritative accounting guidance under FASB ASC Topic 260, Earnings Per Share, which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The Corporation has determined that its outstanding non-vested stock awards and deferred stock units are participating securities. Accordingly, effective January 1, 2009, earnings per common share is computed using the two-class method prescribed under FASB ASC Topic 260. All previously reported earnings per common share data has been retrospectively adjusted to conform to the new computation method.

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

Note 2 - Securities

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

	September 30, 2009				December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Held to Maturity:								
Residential mortgage-backed securities issued by U.S. government agencies and corporations	$ 5,351	$ 139	$	$ 5,490	$ 5,948	$ 60	$ 60	$ 5,948
Other	1,000			1,000	1,000			1,000
Total	$ 6,351	$ 139	$	$ 6,490	$ 6,948	$ 60	$ 60	$ 6,948
Securities Available for Sale:								
U. S. Treasury	$ 424,169	$ 976	$	$ 425,145	$ 24,927	$ 72	$	$ 24,999
Residential mortgage-backed securities issued by U.S. government agencies and corporations	2,219,412	105,582	1	2,324,993	2,495,596	65,558	283	2,560,871
States and political subdivisions	1,620,813	113,323	60	1,734,076	908,793	26,823	4,543	931,073
Other	47,473			47,473	37,586			37,586
Total	$ 4,311,867	$ 219,881	$ 61	$ 4,531,687	$ 3,466,902	$ 92,453	$ 4,826	$ 3,554,529

Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities in the table above. Securities with a carrying value totaling $1.8 billion at September 30, 2009 and $2.5 billion at December 31, 2008 were pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law.

Sales of securities available for sale were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008

Proceeds from sales	$	$ 32,100	$ 9,947	$ 888,295
Gross realized gains		83	49	5,917
Gross realized losses		5		5,943

As of September 30, 2009, securities, with unrealized losses segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Available for Sale						
Residential mortgage-backed securities	$ 45	$	$ 322	$ 1	$ 367	$ 1
States and political subdivisions	27,475	60			27,475	60
Total	$ 27,520	$ 60	$ 322	$ 1	$ 27,842	$ 61

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

Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time the Corporation will receive full value for the securities. Furthermore, as of September 30, 2009, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Corporation will not have to sell any such securities before a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2009, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation s consolidated income statement.

The amortized cost and estimated fair value of securities, excluding trading securities, at September 30, 2009 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 1,000	$ 1,000	$ 282,720	$ 283,262
Due after one year through five years			272,673	276,056
Due after five years through ten years			125,497	133,095
Due after ten years			1,364,092	1,466,808
Mortgage-backed securities	5,351	5,490	2,219,412	2,324,993
Equity securities			47,473	47,473
Total	$ 6,351	$ 6,490	$ 4,311,867	$ 4,531,687

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

	September 30, 2009	December 31, 2008
U.S. Treasury	$ 14,914	$ 14,489
Equity securities		63
	$ 14,914	$ 14,552

The net gain on trading account securities, which includes amounts realized from sale transactions and mark-to-market adjustments, totaled $546 thousand and $1.5 million during the three and nine months ended September 30, 2009 and $741 thousand and $1.9 million during the three and nine months ended September 30, 2008.

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Note 3 - Loans

Loans were as follows:

	September 30, 2009	Percentage of Total	December 31, 2008	Percentage of Total	September 30, 2008	Percentage of Total
Commercial and industrial:						
Commercial	$ 3,710,928	43.6%	$ 3,950,648	44.7%	$ 3,815,826	44.4%
Leases	198,813	2.3	205,290	2.3	198,774	2.3
Asset-based	121,091	1.4	85,865	1.0	103,400	1.2
Total commercial and industrial	4,030,832	47.3	4,241,803	48.0	4,118,000	47.9
Real estate:						
Construction:						
Commercial	661,289	7.8	755,704	8.6	677,035	7.9
Consumer	37,905	0.4	55,947	0.6	58,888	0.7
Land:						
Commercial	289,181	3.4	346,591	3.9	370,935	4.3
Consumer	1,751		1,716		1,892	
Commercial mortgages	2,289,835	26.9	2,250,442	25.5	2,200,798	25.6
1-4 family residential mortgages	67,036	0.8	79,446	0.9	83,099	1.0
Home equity and other consumer	740,833	8.7	707,974	8.0	688,153	8.0
Total real estate	4,087,830	48.0	4,197,820	47.5	4,080,800	47.5
Consumer:						
Student loans held for sale	24,358	0.3	28,889	0.3	32,097	0.4
Other	353,345	4.2	349,641	3.9	345,105	4.0
Other	46,284	0.5	53,662	0.6	47,238	0.5
Unearned discounts	(24,041)	(0.3)	(27,733)	(0.3)	(27,254)	(0.3)
Total loans	$ 8,518,608	100.0%	$ 8,844,082	100.0%	$ 8,595,986	100.0%

Concentrations of Credit. Most of the Corporation s lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio as well as other markets. The majority of the Corporation s loan portfolio consists of commercial and industrial and commercial real estate loans. As of September 30, 2009, other than energy, which totaled approximately 10.4%, of total loans, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

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

Foreign Loans. The Corporation has U.S. dollar denominated loans and commitments to borrowers domiciled in Mexico as well as certain non-U.S. dollar denominated loans and commitments to borrowers domiciled in the United States. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at September 30, 2009 or December 31, 2008.

Non-Performing/Past Due Loans. Loans are placed on non-accrual status when, in management s opinion, the borrower may be unable to meet payment obligations, which typically occurs when principal or interest payments are more than 90 days past due. Non-accrual loans totaled $191.8 million at September 30, 2009 and $65.2 million at December 31, 2008. Accruing loans past due more than 90 days totaled $32.7 million at September 30, 2009 and $19.8 million at December 31, 2008.

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

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Impaired loans were as follows:

	September 30, 2009	December 31, 2008	September 30, 2008
Balance of impaired loans with no allocated allowance	$ 90,165	$ 38,095	$ 22,235
Balance of impaired loans with an allocated allowance	92,638	20,849	17,260
Total recorded investment in impaired loans	$ 182,803	$ 58,944	$ 39,495
Amount of the allowance allocated to impaired loans	$ 28,251	$ 8,188	$ 6,181

The impaired loans included in the table above were primarily comprised of collateral dependent commercial and commercial real estate loans. The average recorded investment in impaired loans was $171.1 million and $126.8 million for the three and nine months ended September 30, 2009 and $36.7 million and $28.2 million for the three and nine months ended September 30, 2008. No interest income was recognized on these loans subsequent to their classification as impaired.

Note 4 - Allowance for Possible Loan Losses

The allowance for possible loan losses is a reserve established through a provision for possible loan losses charged to expense, which represents management s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio, as well as trends in the foregoing. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Corporation s control, including the performance of the Corporation s loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

Activity in the allowance for possible loan losses was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Balance at the beginning of the period	$ 122,501	$ 94,520	$ 110,244	$ 92,339
Provision for possible loan losses	16,940	18,940	43,142	29,273
Net charge-offs:				
Losses charged to the allowance	(18,987)	(8,093)	(37,077)	(21,298)
Recoveries of loans previously charged off	2,668	1,742	6,813	6,795
Net charge-offs	(16,319)	(6,351)	(30,264)	(14,503)
Balance at the end of the period	$ 123,122	$ 107,109	$ 123,122	$ 107,109

Note 5 - Goodwill and Other Intangible Assets

Goodwill. Goodwill totaled $527.7 million at September 30, 2009 and $526.6 million at December 31, 2008. The increase in goodwill was related to purchase accounting adjustments related to the acquisitions of a Dallas-based insurance agency on March 1, 2009 and a San Marcos-based insurance agency on July 1, 2009.

Other Intangible Assets. Other intangible assets totaled $20.9 million at September 30, 2009 including $17.3 million related to core deposits, $3.2 million related to customer relationships and $493 thousand related to non-compete agreements. Other intangible assets totaled $24.3

million at December 31, 2008 including $21.3 million related to core deposits, $2.5 million related to customer relationships and $515 thousand related to non-compete agreements. The changes in intangibles related to customer relationships and non-compete agreements, net of amortization, were related to the aforementioned acquisitions.

Amortization expense related to intangible assets totaled $1.6 million and $5.1 million during the three and nine months ended September 30, 2009 and totaled $2.0 million and $6.0 million during the three and nine months ended September 30, 2008. The estimated aggregate future amortization expense for intangible assets remaining as of September 30, 2009 is as follows:

Remainder of 2009	$ 1,472
2010	5,125
2011	4,299
2012	3,500
2013	2,729
Thereafter	3,808
	$ 20,933

Note 6 - Deposits

Deposits were as follows:

	September 30, 2009	Percentage of Total	December 31, 2008	Percentage of Total	September 30, 2008	Percentage of Total
Non-interest-bearing demand deposits:						
Commercial and individual	$ 3,972,598	30.7%	$ 3,593,390	31.2%	$ 3,303,191	31.1%
Correspondent banks	316,215	2.5	468,632	4.1	435,880	4.1
Public funds	138,094	1.1	90,326	0.8	78,243	0.8
Total non-interest-bearing demand deposits	4,426,907	34.3	4,152,348	36.1	3,817,314	36.0
Interest-bearing deposits:						
Private accounts:						
Savings and interest checking	2,106,872	16.3	1,898,303	16.5	1,715,707	16.1
Money market accounts	4,411,682	34.1	3,543,487	30.8	3,475,607	32.7
Time accounts under $100,000	808,931	6.3	884,214	7.7	591,535	5.6
Time accounts of $100,000 or more	775,337	6.0	633,972	5.5	697,871	6.6
Public funds	392,009	3.0	396,613	3.4	320,186	3.0
Total interest-bearing deposits	8,494,831	65.7	7,356,589	63.9	6,800,906	64.0
Total deposits	$ 12,921,738	100.0%	$ 11,508,937	100.0%	$ 10,618,220	100.0%

At September 30, 2009 and December 31, 2008, interest-bearing public funds deposits included $194.3 million and $215.9 million in savings and interest checking accounts, $72.2 million and $116.1 million in money market accounts, $3.3 million and $4.1 million in time accounts under $100 thousand and $122.3 million and $60.5 million in time accounts of $100 thousand or more.

Some of the Corporation s interest-bearing deposits were obtained through brokered transactions and the Corporation s participation in the Certificate of Deposit Account Registry Service (CDARS). Brokered money market deposits totaled $105.2 million at September 30, 2009 and $49.5 million at December 31, 2008. CDARS deposits totaled $200.1 million at September 30, 2009 and $13.3 million at December 31, 2008. Deposits from foreign sources, primarily Mexico, totaled $738.7 million at September 30, 2009 and $653.4 million at December 31, 2008.

Note 7 - Borrowed Funds

In January 2009, the Corporation borrowed an aggregate of $230 million in three separate variable-rate Federal Home Loan Bank (FHLB) advances (one $30 million advance and two $100 million advances). Each of the advances bear interest at a rate per annum equal to three-month

LIBOR for the related interest period plus 0.36%, payable quarterly in January, April, July and October commencing in April 2009. Principal payments on the advances are due upon maturity in January 2019; however, the advances are redeemable at the option of the Corporation at any time. The advances are collateralized by a blanket floating lien on all first mortgage loans, certain pledged securities, the FHLB capital stock owned by the Corporation and any funds on deposit with the FHLB.

The weighted-average rate on the advances was 1.03% at September 30, 2009. Concurrent with the advances, the Corporation entered into three separate interest rate swap transactions that effectively fix the interest rates on the advances at a weighted-average rate of 2.85%. See Note 10 - Derivative Financial Instruments for additional information related to the interest rate swaps.

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Note 8 - Commitments and Contingencies

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

Commitments to Extend Credit. The Corporation enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Commitments to extend credit totaled $4.4 billion at September 30, 2009 and $4.8 billion at December 31, 2008.

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Corporation would be entitled to seek recovery from the customer. The Corporation s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit totaled $251.5 million at September 30, 2009 and $288.4 million at December 31, 2008.

The Corporation considers the fees collected in connection with the issuance of standby letters of credit to be representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, the Corporation defers fees collected in connection with the issuance of standby letters of credit. The fees are then recognized in income proportionately over the life of the standby letter of credit agreement. The Corporation had deferred standby letter of credit fees totaling $1.3 million at September 30, 2009 and $1.4 million at December 31, 2008, which represents the fair value of the Corporation s potential obligations under the standby letter of credit guarantees.

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $5.0 million and $15.3 million for the three and nine months ended September 30, 2009 and $4.5 million and $13.8 million for the three and nine months ended September 30, 2008. There has been no significant change in the future minimum lease payments payable by the Corporation since December 31, 2008. See the 2008 Form 10-K for information regarding these commitments.

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

Note 9 - Regulatory Matters

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

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

Cullen/Frost s and Frost Bank s Tier 1 capital consists of shareholders equity excluding unrealized gains and losses on securities available for sale, the accumulated gain or loss on effective cash flow hedging derivatives, the net actuarial gain/loss on the Corporation s defined benefit post-retirement benefit plans, goodwill and other intangible assets. Tier 1 capital for Cullen/Frost also includes $132 million of trust preferred securities issued by unconsolidated subsidiary trusts. Cullen/Frost s and Frost Bank s total capital is comprised of Tier 1 capital for each entity plus $30 million of the Corporation s aggregate $150 million of 6.875% subordinated notes payable (of which the permissible portion decreases 20% per year during the final five years of the term of the notes) and a permissible portion of the allowance for possible loan losses. The Corporation s aggregate $100 million of 5.75% fixed-to-floating rate subordinated notes are not included in Tier 1 capital but are included in total capital of Cullen/Frost.

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

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

	Actual		Minimum Required for Capital Adequacy Purposes		Required to be Well Capitalized Under Prompt Corrective Action Regulations	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
September 30, 2009						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,555,642	13.72%	$ 907,045	8.00%	N/A	N/A
Frost Bank	1,440,707	12.72	906,252	8.00	$ 1,132,816	10.00%
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,302,520	11.49	453,523	4.00	N/A	N/A
Frost Bank	1,287,585	11.37	453,126	4.00	679,689	6.00
Leverage Ratio						
Cullen/Frost	1,302,520	8.47	615,151	4.00	N/A	N/A
Frost Bank	1,287,585	8.38	614,550	4.00	768,188	5.00
December 31, 2008						
Total Capital to Risk-Weighted Assets						
Cullen/Frost	$ 1,489,046	12.58%	$ 946,579	8.00%	N/A	N/A
Frost Bank	1,392,351	11.78	945,853	8.00	$ 1,182,316	10.00%
Tier 1 Capital to Risk-Weighted Assets						
Cullen/Frost	1,218,802	10.30	473,289	4.00	N/A	N/A
Frost Bank	1,222,107	10.34	472,926	4.00	709,389	6.00
Leverage Ratio						
Cullen/Frost	1,218,802	8.80	554,281	4.00	N/A	N/A
Frost Bank	1,222,107	8.83	553,796	4.00	692,245	5.00

Cullen/Frost believes that, as of September 30, 2009, its bank subsidiary, Frost Bank, was well capitalized based on the ratios presented above.

Cullen/Frost is subject to the regulatory capital requirements administered by the Federal Reserve, while Frost Bank is subject to the regulatory capital requirements administered by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Regulatory authorities can initiate certain mandatory actions if Cullen/Frost or Frost Bank fail to meet the minimum capital requirements, which could have a direct material effect on the Corporation s financial statements. Management believes, as of September 30, 2009, that Cullen/Frost and Frost Bank met all capital adequacy requirements to which they are subject.

Dividend Restrictions. In the ordinary course of business, Cullen/Frost is dependent upon dividends from Frost Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of Frost Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. At September 30, 2009, Frost Bank could pay aggregate dividends of up to $254.5 million to Cullen/Frost without prior regulatory approval.

Trust Preferred Securities. In accordance with the applicable accounting standard related to variable interest entities, the accounts of the Corporation s wholly owned subsidiary trusts, Cullen/Frost Capital Trust II and Summit Bancshares Statutory Trust I, have not been included in the Corporation s consolidated financial statements. However, the $132.0 million in trust preferred securities issued by these subsidiary trusts have been included in the Tier 1 capital of Cullen/Frost for regulatory capital purposes pursuant to guidance from the Federal Reserve Board.

Note 10 - Derivative Financial Instruments

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

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

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

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

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

During the first quarter of 2009, the Corporation entered into three interest rate swap contracts on FHLB advances with a total notional amount of $230.0 million. The interest rate swap contracts were designated as hedging instruments in cash flow hedges with the objective of protecting the forty quarterly interest payments on each of the Corporation s variable-rate (three-month LIBOR plus a margin of 0.36%) FHLB advances which, in the aggregate, total $230 million throughout the forty quarterly periods beginning in January 2009 and ending in January 2019 from the risk of variability of those payments resulting from changes in the three-month LIBOR interest rate. Under the swaps, the Corporation will pay a weighted-average fixed interest rate of 2.85% and receive a variable interest rate of three-month LIBOR plus a margin of 0.36% on a total notional amount of $230.0 million, with quarterly settlements

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

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The notional amounts and estimated fair values of interest rate derivative contracts outstanding at September 30, 2009 and December 31, 2008 are presented in the following table. The Corporation obtains dealer quotations to value its interest rate derivative contracts designated as hedges of cash flows, while the fair values of other interest rate derivative contracts are estimated utilizing internal valuation models with observable market data inputs.

	September 30, 2009		December 31, 2008	
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Interest rate derivatives designated as hedges of fair value:				
Commercial loan/lease interest rate swaps	$ 138,511	$ (11,423)	$ 157,835	$ (15,777)
Interest rate derivatives designated as hedges of cash flows:				
Interest rate swaps on variable-rate loans	1,200,000	128,495	1,200,000	191,087
Interest rate swap on junior subordinated deferrable interest debentures	120,000	(7,781)	120,000	(10,316)
Interest rate swaps on FHLB advances	230,000	15,297		
Non-hedging interest rate derivatives:				
Commercial loan/lease interest rate swaps	619,629	42,476	587,540	61,248
Commercial loan/lease interest rate swaps	619,629	(42,694)	587,540	(61,248)
Commercial loan/lease interest rate caps	23,164	958	4,236	1
Commercial loan/lease interest rate caps	23,164	(958)	4,236	(1)
Commercial loan/lease interest rate floors	3,164	61	4,236	95
Commercial loan/lease interest rate floors	3,164	(61)	4,236	(95)

The weighted-average rates paid and received for interest rate swaps outstanding at September 30, 2009 were as follows:

	Weighted-Average	
	Interest Rate Paid	Interest Rate Received
Interest rate swaps:		
Fair value hedge commercial loan/lease interest rate swaps	4.85%	0.31%
Cash flow hedge interest rate swaps on variable-rate loans	3.25	7.56
Cash flow hedge interest rate swaps on junior subordinated deferrable interest debentures	5.47	1.91
Cash flow hedge interest rate swaps on FHLB advances	2.85	0.88
Non-hedging interest rate swaps	1.66	5.11
Non-hedging interest rate swaps	5.11	1.66

The weighted-average strike rates for interest rate caps and floors outstanding at September 30, 2009 were as follows:

Non-hedging commercial loan/lease interest rate caps	3.15%
Non-hedging commercial loan/lease interest rate floors	3.29

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

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

		September 30, 2009		December 31, 2008	
	Notional Units	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Non-hedging commodity swaps:					
Oil	Barrels	104	$ 1,025	153	$ 2,268
Oil	Barrels	104	(1,002)	153	(2,230)
Natural gas	MMBTUs	345	425	1,640	1,642
Natural gas	MMBTUs	345	(416)	1,640	(1,590)
Non-hedging commodity options:					
Oil	Barrels	1,204	8,400	1,184	23,295
Oil	Barrels	1,204	(8,400)	1,184	(23,268)
Natural gas	MMBTUs	8,180	5,408	4,300	2,656
Natural gas	MMBTUs	8,180	(5,408)	4,300	(2,656)

Foreign Currency Derivatives. The Corporation enters into foreign currency forward contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a foreign currency forward contract with a customer, the Corporation simultaneously enters into an offsetting contract with a third party to negate the exposure to fluctuations in foreign currency exchange rates. The Corporation also utilizes foreign currency forward contracts that are not designated as hedging instruments to mitigate the economic effect of fluctuations in foreign currency exchange rates on certain short-term, non-U.S. dollar denominated loans. The notional amounts and fair values of open foreign currency forward contracts were not significant at September 30, 2009 and December 31, 2008.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Commercial loan/lease interest rate swaps:				
Amount of gain (loss) included in interest income on loans	$ (1,484)	$ (786)	$ (4,441)	$ (2,243)
Amount of (gain) loss included in other non-interest expense	23	15	419	2

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Interest rate swaps/caps/floors on variable-rate loans:				
Amount reclassified from accumulated other comprehensive income to interest income on loans	$ 13,214	$ 7,581	$ 39,237	$ 19,307
Amount of gain (loss) recognized in other comprehensive income	27,460	38,084	(23,388)	54,243
Interest rate swaps on junior subordinated deferrable interest debentures:				
Amount reclassified from accumulated other comprehensive income to interest expense on junior subordinated deferrable interest debentures	1,028		2,503	
Amount of gain (loss) recognized in other comprehensive income	(2,655)		387	
Interest rate swaps on FHLB advances:				
Amount reclassified from accumulated other comprehensive income to interest expense on other long-term borrowings	1,114		2,552	
Amount of gain (loss) recognized in other comprehensive income	(7,295)		13,767	

No ineffectiveness related to interest rate derivatives designated as hedges of cash flows was recognized in the consolidated statements of income during the reported periods. The accumulated net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive income totaled $87.8 million at September 30, 2009 and $116.0 million at December 31, 2008.

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

Amounts included in the consolidated statements of income related to non-hedging interest rate and commodity derivative instruments were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Non-hedging interest rate derivatives:				
Other non-interest income	$ 249	$ 126	$ 879	$ 1,258
Other non-interest expense	155		238	
Non-hedging commodity derivatives:				
Other non-interest income	35	54	277	109

Counterparty Credit Risk. Derivative contracts involve the risk of dealing with both bank customers and institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have an investment grade credit rating and be approved by the Corporation s Asset/Liability Management Committee. The Corporation s credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty, while the Corporation s credit exposure on commodity swaps/options is limited to the net favorable value of all swaps/options by each counterparty. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. There are no credit-risk-related contingent features associated with any of the Corporation s derivative contracts.

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The Corporation s credit exposure relating to interest rate swaps and commodity swaps/options with bank customers was approximately $45.9 million at September 30, 2009. This credit exposure is partly mitigated as transactions with customers are generally secured by the collateral, if any, securing the underlying transaction being hedged. The Corporation s credit exposure, net of collateral pledged, relating to interest rate swaps and commodity swaps/options with upstream financial institution counterparties was approximately $1.7 million at September 30, 2009. Collateral levels for upstream financial institution counterparties are monitored and adjusted as necessary.

The aggregate fair value of securities posted as collateral by the Corporation related to derivative contracts totaled $16.4 million at September 30, 2009. At such date, the Corporation also had $6.8 million in cash collateral on deposit with other financial institution counterparties.

Note 11 - Earnings Per Common Share

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Distributed earnings allocated to common stock	$ 25,619	$ 24,760	$ 76,016	