FIRST CITIZENS BANCSHARES INC /DE/
Form 10-Q
August 04, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-Q

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x 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

Commission File Number: 001-16715

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First Citizens BancShares, Inc.
(Exact name of Registrant as specified in its charter)

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| Delaware | 56-1528994 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| | |
| 4300 Six Forks Road, Raleigh, North Carolina | 27609 |
| (Address of principle executive offices) | (Zip code) |

(919) 716-7000
(Registrant’s telephone number, including area code)

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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 twelve 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 ninety 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 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 definition of ‘accelerated filer’ and ‘large accelerated filer’ in Rule 12b-2 of the Exchange Act:

| Large accelerated filer | x | Accelerated filer | ¨ |
|---|---|---|---|
| Non-accelerated filer | ¨ | 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 x
Class A Common Stock—$1 Par Value—11,005,220 shares
Class B Common Stock—$1 Par Value—1,005,185 shares
(Number of shares outstanding, by class, as of August 3, 2016)

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PART I

Item 1. Financial Statements

First Citizens BancShares, Inc. and Subsidiaries
Consolidated Balance Sheets

| (Dollars in thousands, unaudited) | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Assets | | |
| Cash and due from banks | $507,569 | $534,086 |
| Overnight investments | 2,276,080 | 2,063,132 |
| Investment securities available for sale | 6,557,580 | 6,861,293 |
| Investment securities held to maturity | 156 | 255 |
| Loans held for sale | 84,795 | 59,766 |
| Loans and leases | 20,742,571 | 20,239,990 |
| Allowance for loan and lease losses | (208,008) | (206,216) |
| Net loans and leases | 20,534,563 | 20,033,774 |
| Premises and equipment | 1,120,970 | 1,135,829 |
| Other real estate owned | 67,089 | 65,559 |
| Income earned not collected | 71,916 | 70,036 |
| FDIC loss share receivable | 5,281 | 4,054 |
| Goodwill | 139,773 | 139,773 |
| Other intangible assets | 80,555 | 90,986 |
| Other assets | 784,076 | 417,391 |
| Total assets | $32,230,403 | $31,475,934 |
| Liabilities | | |
| Deposits: | | |
| Noninterest-bearing | $9,779,926 | $9,274,470 |
| Interest-bearing | 17,477,848 | 17,656,285 |
| Total deposits | 27,257,774 | 26,930,755 |
| Short-term borrowings | 728,562 | 594,733 |
| Long-term obligations | 850,504 | 704,155 |
| FDIC loss share payable | 94,252 | 126,453 |
| Other liabilities | 263,607 | 247,729 |
| Total liabilities | 29,194,699 | 28,603,825 |
| Shareholders’ equity | | |
| Common stock: | | |
| Class A - $1 par value (16,000,000 shares authorized; 11,005,220 shares issued and outstanding at June 30, 2016 and December 31, 2015) | 11,005 | 11,005 |
| Class B - $1 par value (2,000,000 shares authorized; 1,005,185 shares issued and outstanding at June 30, 2016 and December 31, 2015) | 1,005 | 1,005 |
| Surplus | 658,918 | 658,918 |
| Retained earnings | 2,379,803 | 2,265,621 |
| Accumulated other comprehensive loss | (15,027) | (64,440) |
| Total shareholders’ equity | 3,035,704 | 2,872,109 |
| Total liabilities and shareholders’ equity | $32,230,403 | $31,475,934 |

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Income

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands, except per share data, unaudited) | 2016 | 2015 | 2016 | 2015 |
| Interest income | | | | |
| Loans and leases | $215,442 | $222,682 | $431,846 | $433,544 |
| Investment securities and dividend income | 24,702 | 21,806 | 47,744 | 41,116 |
| Overnight investments | 3,225 | 1,525 | 6,891 | 2,863 |
| Total interest income | 243,369 | 246,013 | 486,481 | 477,523 |
| Interest expense | | | | |
| Deposits | 4,601 | 5,534 | 9,260 | 11,163 |
| Short-term borrowings | 454 | 1,658 | 888 | 3,592 |
| Long-term obligations | 6,125 | 4,171 | 11,424 | 7,953 |
| Total interest expense | 11,180 | 11,363 | 21,572 | 22,708 |
| Net interest income | 232,189 | 234,650 | 464,909 | 454,815 |
| Provision for loan and lease losses | 4,562 | 7,719 | 9,405 | 13,511 |
| Net interest income after provision for loan and lease losses | 227,627 | 226,931 | 455,504 | 441,304 |
| Noninterest income | | | | |
| Gain on acquisitions | 3,290 | — | 4,994 | 42,930 |
| Cardholder services | 21,054 | 19,214 | 40,412 | 37,615 |
| Merchant services | 24,236 | 22,070 | 46,213 | 40,950 |
| Service charges on deposit accounts | 21,884 | 22,361 | 43,734 | 44,419 |
| Wealth management services | 21,291 | 21,555 | 40,925 | 42,435 |
| Securities gains | 12,529 | 147 | 17,157 | 5,273 |
| Other service charges and fees | 7,137 | 5,730 | 14,126 | 11,235 |
| Mortgage income | 4,537 | 5,571 | 5,848 | 10,120 |
| Insurance commissions | 2,265 | 2,456 | 5,443 | 5,753 |
| ATM income | 1,845 | 1,825 | 3,610 | 3,489 |
| Adjustments to FDIC loss share receivable | (2,367) | (4,553) | (4,900) | (5,600) |
| Net impact from FDIC loss share termination | 16,559 | — | 16,559 | — |
| Other | 5,990 | 11,074 | 11,411 | 19,584 |
| Total noninterest income | 140,250 | 107,450 | 245,532 | 258,203 |
| Noninterest expense | | | | |
| Salaries and wages | 104,059 | 109,895 | 207,958 | 215,366 |
| Employee benefits | 25,661 | 28,002 | 53,011 | 59,220 |
| Occupancy expense | 24,955 | 25,532 | 49,967 | 51,152 |
| Equipment expense | 22,715 | 23,296 | 45,060 | 46,837 |
| FDIC insurance expense | 4,588 | 4,551 | 9,377 | 8,822 |
| Foreclosure-related expenses | (1,116) | 1,019 | 615 | 3,576 |
| Merger-related expenses | 1,385 | 4,573 | 1,423 | 7,570 |
| Other | 76,056 | 67,823 | 142,563 | 130,314 |
| Total noninterest expense | 258,303 | 264,691 | 509,974 | 522,857 |
| Income before income taxes | 109,574 | 69,690 | 191,062 | 176,650 |
| Income taxes | 40,258 | 25,168 | 69,674 | 64,970 |
| Net income | $69,316 | $44,522 | $121,388 | $111,680 |
| Average shares outstanding | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 |
| Net income per share | $5.77 | $3.71 | $10.11 | $9.30 |

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income

| (Dollars in thousands, unaudited) | 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 | $69,316 | $44,522 | $121,388 | $111,680 |
| Other comprehensive income: | | | | |
| Unrealized gains (losses) on securities: | | | | |
| Change in unrealized securities gains (losses) arising during period | 24,176 | (29,226) | 92,209 | 1,189 |
| Tax effect | (9,261) | 11,352 | (35,277) | (461) |
| Reclassification adjustment for net gains realized and included in income before income taxes | (12,529) | (147) | (17,157) | (5,273) |
| Tax effect | 4,793 | 74 | 6,563 | 2,051 |
| Total change in unrealized gains (losses) on securities, net of tax | 7,179 | (17,947) | 46,338 | (2,494) |
| Change in fair value of cash flow hedges: | | | | |
| Change in unrecognized loss on cash flow hedges | 729 | 709 | 1,429 | 1,285 |
| Tax effect | (274) | (274) | (537) | (496) |
| Total change in unrecognized loss on cash flow hedges, net of tax | 455 | 435 | 892 | 789 |
| Change in pension obligation: | | | | |
| Amortization of actuarial losses and prior service cost | 1,882 | 2,887 | 3,534 | 5,773 |
| Tax effect | (719) | (1,123) | (1,351) | (2,246) |
| Total change in pension obligation, net of tax | 1,163 | 1,764 | 2,183 | 3,527 |
| Other comprehensive income (loss) | 8,797 | (15,748) | 49,413 | 1,822 |
| Total comprehensive income | $78,113 | $28,774 | $170,801 | $113,502 |

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity

| (Dollars in thousands, unaudited) | Class A Common Stock | Class B Common Stock | Surplus | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2014 | $ 11,005 | $ 1,005 | $658,918 | $2,069,647 | $ (52,981) | $2,687,594 |
| Net income | — | — | — | 111,680 | — | 111,680 |
| Other comprehensive income, net of tax | — | — | — | — | 1,822 | 1,822 |
| Cash dividends ($0.60 per share) | — | — | — | (7,206) | — | (7,206) |
| Balance at June 30, 2015 | $ 11,005 | $ 1,005 | $658,918 | $2,174,121 | $ (51,159) | $2,793,890 |
| Balance at December 31, 2015 | $ 11,005 | $ 1,005 | $658,918 | $2,265,621 | $ (64,440) | $2,872,109 |
| Net income | — | — | — | 121,388 | — | 121,388 |
| Other comprehensive income, net of tax | — | — | — | — | 49,413 | 49,413 |
| Cash dividends ($0.60 per share) | — | — | — | (7,206) | — | (7,206) |
| Balance at June 30, 2016 | $ 11,005 | $ 1,005 | $658,918 | $2,379,803 | $ (15,027) | $3,035,704 |

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

| | Six months ended June 30 | |
|---|---|---|
| (Dollars in thousands, unaudited) | 2016 | 2015 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $121,388 | $111,680 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Provision for loan and lease losses | 9,405 | 13,511 |
| Deferred tax benefit | (8,501) | (23,762) |
| Net change in current taxes | (5,757) | (25,261) |
| Depreciation | 44,476 | 44,312 |
| Net change in accrued interest payable | 624 | (2,359) |
| Net increase in income earned not collected | (1,872) | (9,475) |
| Gain on acquisitions | (4,994) | (42,930) |
| Securities gains | (17,157) | (5,273) |
| Loss on termination of FDIC loss share agreements | 3,377 | — |
| Origination of loans held for sale | (361,652) | (355,819) |
| Proceeds from sale of loans | 342,505 | 338,466 |
| Gain on sale of loans | (5,882) | (3,991) |
| Net writedowns/losses on other real estate | 3,884 | 3,188 |
| Net accretion of premiums and discounts | (23,859) | (45,662) |
| Amortization of intangible assets | 11,135 | 8,302 |
| Reduction in FDIC receivable for loss share agreements | 7,571 | 27,291 |
| Net change in FDIC payable for loss share agreements | (14,001) | 5,503 |
| Net change in other assets | (25,924) | 14,243 |
| Net change in other liabilities | 19,718 | 25,085 |
| Net cash provided by operating activities | 94,484 | 77,049 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Net increase in loans outstanding | (416,812) | (566,524) |
| Purchases of investment securities available for sale | (1,966,181) | (1,435,387) |
| Proceeds from maturities/calls of investment securities held to maturity | 99 | 167 |
| Proceeds from maturities/calls of investment securities available for sale | 627,971 | 757,780 |
| Proceeds from sales of investment securities available for sale | 1,370,768 | 522,024 |
| Net change in overnight investments | (173,134) | 21,578 |
| Proceeds from sales of loans | 13,328 | — |
| Cash paid to the FDIC for loss share agreements | (13,502) | (10,890) |
| Net cash paid to the FDIC for termination of loss share agreements | (20,115) | — |
| Proceeds from sales of other real estate | 16,010 | 47,391 |
| Additions to premises and equipment | (29,617) | (31,921) |
| Business acquisition, net of cash acquired | 27,943 | 123,137 |
| Net cash used by investing activities | (563,242) | (572,645) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net decrease in time deposits | (250,151) | (359,125) |
| Net increase in demand and other interest-bearing deposits | 421,082 | 926,092 |
| Net change in short-term borrowings | 132,167 | (269,460) |
| Repayment of long-term obligations | (3,651) | (4,483) |
| Origination of long-term obligations | 150,000 | 120,000 |

| | | |
|---|---|---|
| Cash dividends paid | (7,206 ) | (7,206 ) |
| Net cash provided by financing activities | 442,241 | 405,818 |
| Change in cash and due from banks | (26,517 ) | (89,778 ) |
| Cash and due from banks at beginning of period | 534,086 | 604,182 |
| Cash and due from banks at end of period | $507,569 | $514,404 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Transfers of loans to other real estate | $21,280 | $30,350 |
| Dividends declared but not paid | 3,603 | 3,603 |
| Unsettled sales of investment securities | 361,225 | — |

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

## NOTE A - ACCOUNTING POLICIES AND BASIS OF PRESENTATION

First Citizens BancShares, Inc. (BancShares) is a financial holding company organized under the laws of Delaware and conducts operations through its banking subsidiary, First-Citizens Bank & Trust Company (FCB), which is headquartered in Raleigh, North Carolina.

### General

These consolidated financial statements and notes thereto are presented in accordance with instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and notes necessary for a complete presentation of financial position, results of operations and cash flow activity required in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the consolidated financial position and consolidated results of operations have been made. The unaudited interim consolidated financial statements included in this Form 10-Q should be read in conjunction with the consolidated financial statements and footnotes included in BancShares' Annual Report on Form 10-K for the year ended December 31, 2015.

### Reclassifications

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to the current financial statement presentation. Such reclassifications had no effect on previously reported shareholders' equity or net income.

### Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates, and different assumptions in the application of these policies could result in material changes in BancShares' consolidated financial position, the consolidated results of operations or related disclosures. Material estimates that are particularly susceptible to significant change include:

- Allowance for loan and lease losses
- Fair value of financial instruments, including acquired assets and assumed liabilities
- Pension plan assumptions
- Cash flow estimates on purchased credit-impaired loans
- Receivable from and payable to the Federal Deposit Insurance Corporation (FDIC) for loss share agreements
- Income tax assets, liabilities and expense

### Recently Adopted Accounting Pronouncements

Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments

This ASU eliminates the requirement to retrospectively account for adjustments made to provisional amounts recognized in a business combination and requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts must be calculated as if the accounting had been completed at the acquisition date. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The amendments in this ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date of this ASU with earlier

application permitted for financial statements that have not been issued. We adopted the guidance effective in the first quarter of 2016. The initial adoption did not have an impact on our consolidated financial position or consolidated results of operations.

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During the second quarter of 2016, adjustments were made to the acquisition fair values for the FDIC-assisted acquisition of North Milwaukee State Bank (NMSB) of Milwaukee, Wisconsin, primarily based upon updated collateral valuations, resulting in an increase of $1.2 million to the gain on acquisition reflected in the three months ended June 30, 2016. These adjustments brought the total gain on the transaction to $2.9 million which is included in noninterest income in the Consolidated Statements of Income.

FASB ASU 2015-03, Interest–Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs

This ASU simplifies the presentation of debt issuance costs by requiring that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this update.

This ASU is effective for fiscal years beginning after December 15, 2015 for public business entities, including interim periods within those fiscal years, and is to be applied retrospectively. We adopted the guidance effective in the first quarter of 2016. The initial adoption did not have an impact on our consolidated financial position or consolidated results of operations.

FASB ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis

This ASU improves targeted areas of consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. In addition to reducing the number of consolidation models from four to two, the new standard places more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs.

The amendments in this ASU are effective for fiscal years beginning after December 15, 2015 for public business entities, including interim periods within those fiscal years. We adopted the guidance effective in the first quarter of 2016. The initial adoption did not have an impact on our consolidated financial position or consolidated results of operations.

Recently Issued Accounting Pronouncements

FASB ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

This ASU eliminates the delayed recognition of the full amount of credit losses until the loss was probable of occurring and instead will reflect an entity's current estimate of all expected credit losses. The amendments in this ASU broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The ASU does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations of the credit loss estimate based on the entity's size, complexity and risk profile. In addition, the disclosures of credit quality indicators in relation to the amortized cost of financing receivables, a current disclosure requirement, are further disaggregated by year of origination.

The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018. We are currently evaluating the impact of the new standard and we will adopt the guidance by the first quarter of 2020.

FASB ASU 2016-07, Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting

This ASU eliminates the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The ASU requires that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting.

Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. Further, the ASU requires that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings, the unrealized gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method.
The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of the new standard and will adopt the guidance during the first quarter of 2017.

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FASB ASU 2016-06, Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments
This ASU clarifies what steps are required when assessing whether the economic characteristics and risks of call (put) options are clearly and closely related to the economic characteristics and risks of their debt hosts, which is one of the criteria for bifurcating an embedded derivative. When a call (put) option is contingently exercisable, an entity does not have to assess whether the event that triggers the ability to exercise a call (put) option is related to interest rates or credit risks.
The amendments in the ASU are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. We will adopt the guidance during the first quarter of 2017. BancShares does not anticipate any effect on our consolidated financial position or consolidated results of operations as a result of adoption.
FASB ASU 2016-02, Leases (Topic 842)
This ASU increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The key difference between existing standards and this ASU is the requirement for lessees to recognize on their balance sheet all lease contracts. An entity may make an accounting election by classification to not recognize leases with terms less than 12 months on their balance sheet. Both a right-of-use asset, representing the right to use the leased asset, and a lease liability, representing the contractual obligation, are required to be recognized on the balance sheet of the lessee at lease commencement. Further, this ASU requires lessees to classify leases as either operating or finance leases, which are substantially similar to the current operating and capital leases classifications. The distinction between these two classifications under the new standard does not relate to balance sheet treatment, but relates to treatment in the statements of income and cash flows. Lessor guidance remains largely unchanged with the exception of how a lessor determines the appropriate lease classification for each lease to better align the lessor guidance with revised lessee classification guidance.
The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of the new standard and we will adopt during the first quarter of 2019.
FASB ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities
This ASU addresses certain aspects of recognition, measurement, presentation and disclosure of certain financial instruments. The amendments in this ASU (1) require equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplify the impairment assessment of equity investments without a readily determinable fair value; (3) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (4) require public business entities to use exit price notion, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (5) require separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (6) require separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) state that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets.
The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The ASU only permits early adoption of the instrument-specific credit risk provision. We are currently evaluating the impact of the new standard and we will adopt during the first quarter of 2018.
FASB ASU 2014-09, Revenue from Contracts with Customers (Topic 606)
In May 2014, the FASB issued a standard on the recognition of revenue from contracts with customers with the core principle being for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The

new standard also results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations, to improve the operability and understandability of the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, to clarify guidance for identifying performance obligations and licensing implementation. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, to clarify and improve the guidance for certain aspects of Topic 606.

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Per ASU 2015-14, Deferral of the Effective Date, this guidance was deferred and is effective for fiscal periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Early adoption is permitted for fiscal periods beginning after December 15, 2016. We are currently evaluating the impact of the new standard and we will adopt during the first quarter of 2018 using one of two retrospective application methods.

NOTE B - BUSINESS COMBINATIONS

Cordia Bancorp Inc.

On May 19, 2016, FCB entered into a definitive merger agreement with Cordia Bancorp Inc. (Cordia). Cordia had total assets of $347.8 million at March 31, 2016. The agreement provides for the acquisition by FCB of Midlothian, Virginia-based Cordia and its bank subsidiary, Bank of Virginia. Under the terms of the agreement, cash consideration of $5.15 will be paid to Cordia's shareholders in exchange for each of their shares of Cordia's common stock. Total consideration is estimated to be $35.0 million based on Cordia's common stock outstanding at March 31, 2016. The agreement has been approved by the Board of Directors of both companies. The transaction is expected to close no later than the fourth quarter of 2016, subject to the receipt of regulatory approvals and the approval of Cordia's shareholders.

First CornerStone Bank

On May 6, 2016, FCB entered into an agreement with the FDIC, as Receiver, to purchase certain assets and assume certain liabilities of First CornerStone Bank (FCSB) of King of Prussia, Pennsylvania. The acquisition provided FCB with value enhancement from expanded banking relationships in Pennsylvania as FCSB operated six branch locations in Chadds Ford, King of Prussia, Malvern, Media, Phoenixville and Ridley, Pennsylvania.

The FCSB transaction was accounted for under the acquisition method of accounting and, accordingly, assets acquired and liabilities assumed were recorded at their estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding closing date fair values becomes available.

The fair value of the assets acquired was $86.6 million, including $43.2 million in loans and $390 thousand of identifiable intangible assets. Liabilities assumed were $96.9 million of which the majority were deposits. As a result of the transaction, FCB recorded a gain on the acquisition of $2.1 million which is included in noninterest income in the Consolidated Statements of Income.

The following table provides the identifiable assets acquired and liabilities assumed at their estimated fair values as of the acquisition date.

| (Dollars in thousands) | As recorded by FCB |
|---|---|
| Assets | |
| Cash and cash equivalents | $ 748 |
| Overnight investments | 37,540 |
| Investment securities | 4,564 |
| Loans | 43,170 |
| Other real estate owned | 144 |
| Income earned not collected | 8 |
| Intangible assets | 390 |
| Other assets | 13 |
| Total assets acquired | 86,577 |
| Liabilities | |
| Deposits | 96,882 |
| Other liabilities | 23 |
| Total liabilities assumed | 96,905 |
| Fair value of net liabilities assumed | (10,328 ) |
| Cash received from FDIC | 12,450 |

| | |
|---|---|
| Gain on acquisition of FCSB | $ 2,122 |

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Merger-related expenses of $793 thousand from the FCSB transaction were recorded in the Consolidated Statements of Income for the three and six months ended June 30, 2016. Loan-related interest income generated from FCSB was approximately $324 thousand since the acquisition date.
All loans resulting from the FCSB transaction were recorded at the acquisition date with a discount attributable, at least in part, to credit quality, and are therefore accounted for as purchased credit-impaired (PCI) loans under ASC 310-30.
North Milwaukee State Bank
On March 11, 2016, FCB entered into an agreement with the FDIC, as Receiver, to purchase certain assets and assume certain liabilities of NMSB with two branches in Milwaukee, Wisconsin. The acquisition provided FCB with value enhancement from expanded banking relationships.

The NMSB transaction was accounted for under the acquisition method of accounting and, accordingly, assets acquired and liabilities assumed were recorded at their estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding closing date fair values becomes available.

The fair value of the assets acquired was $53.6 million, including $36.9 million in loans and $240 thousand of identifiable intangible assets. Liabilities assumed were $60.9 million of which $59.2 million were deposits. During the second quarter of 2016, adjustments were made to the acquisition fair values primarily based upon updated collateral valuations resulting in an increase of $1.2 million to the gain on acquisition reflected in the three months ended June 30, 2016. These adjustments brought the total gain on the transaction to $2.9 million which is included in noninterest income in the Consolidated Statements of Income.

The following table provides the identifiable assets acquired and liabilities assumed at their estimated fair values as of the acquisition date.

| (Dollars in thousands) | As recorded by FCB |
|---|---|
| Assets | |
| Cash and cash equivalents | $ 4,545 |
| Overnight investments | 2,274 |
| Investment securities | 9,425 |
| Loans | 36,914 |
| Intangible assets | 240 |
| Other assets | 216 |
| Total assets acquired | 53,614 |
| Liabilities | |
| Deposits | 59,206 |
| Short-term borrowings | 1,662 |
| Other liabilities | 74 |
| Total liabilities assumed | 60,942 |
| Fair value of net liabilities assumed | (7,328 ) |
| Cash received from FDIC | 10,200 |
| Gain on acquisition of NMSB | $ 2,872 |

Merger-related expenses of $438 thousand and $476 thousand from the NMSB transaction were recorded in the Consolidated Statements of Income for the three and six months ended June 30, 2016, respectively. Loan-related interest income generated from NMSB was approximately $676 thousand for the second quarter of 2016 and $799 thousand since the acquisition date.

All loans resulting from the NMSB transaction were recorded at the acquisition date with a discount attributable, at least in part, to credit quality, and are therefore accounted for as PCI loans under ASC 310-30.

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NOTE C - INVESTMENTS

The amortized cost and fair value of investment securities classified as available for sale and held to maturity at June 30, 2016 and December 31, 2015, are as follows:

| | June 30, 2016 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| Investment securities available for sale | | | | |
| U.S. Treasury | $1,538,211 | $ 3,268 | $ — | $1,541,479 |
| Government agency | 355,014 | 531 | — | 355,545 |
| Mortgage-backed securities | 4,489,218 | 48,888 | 2,275 | 4,535,831 |
| Equity securities | 81,114 | 2,062 | 1,786 | 81,390 |
| Corporate bonds | 41,360 | 25 | — | 41,385 |
| Other | 2,115 | — | 165 | 1,950 |
| Total investment securities available for sale | $6,507,032 | $ 54,774 | $ 4,226 | $6,557,580 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| U.S. Treasury | $1,675,996 | $ 4 | $ 1,118 | $1,674,882 |
| Government agency | 498,804 | 230 | 374 | 498,660 |
| Mortgage-backed securities | 4,692,447 | 5,120 | 29,369 | 4,668,198 |
| Equity securities | 7,935 | 968 | 10 | 8,893 |
| Corporate bonds | 8,500 | — | — | 8,500 |
| Other | 2,115 | 45 | — | 2,160 |
| Total investment securities available for sale | $6,885,797 | $ 6,367 | $ 30,871 | $6,861,293 |

| | June 30, 2016 | | | |
|---|---|---|---|---|
| | Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| Investment securities held to maturity | | | | |
| Mortgage-backed securities | $156 | $ 9 | $ — | $165 |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| Mortgage-backed securities | $255 | $ 10 | $ — | $265 |

Investments in mortgage-backed securities primarily represent securities issued by the Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation. Investments in equity securities and corporate bonds represent positions in securities of other financial institutions. The following table provides the amortized cost and fair value by contractual maturity. Expected maturities will differ from contractual maturities on certain securities because borrowers and issuers may have the right to call or prepay obligations with or without prepayment penalties. Repayments of mortgage-backed securities are dependent on the repayments of the underlying loan balances. Equity securities do not have a stated maturity date.

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| | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| (Dollars in thousands) | Cost | Fair value | Cost | Fair value |
| Investment securities available for sale | | | | |
| Non-amortizing securities maturing in: | | | | |
| One year or less | $1,653,165 | $1,655,553 | $1,255,714 | $1,255,094 |
| One through five years | 240,060 | 241,471 | 919,086 | 918,448 |
| Five through 10 years | 41,360 | 41,385 | 8,500 | 8,500 |
| Over 10 years | 2,115 | 1,950 | 2,115 | 2,160 |
| Mortgage-backed securities | 4,489,218 | 4,535,831 | 4,692,447 | 4,668,198 |
| Equity securities | 81,114 | 81,390 | 7,935 | 8,893 |
| Total investment securities available for sale | $6,507,032 | $6,557,580 | $6,885,797 | $6,861,293 |
| Investment securities held to maturity | | | | |
| Mortgage-backed securities held to maturity | $156 | $165 | $255 | $265 |

For each period presented, securities gains (losses) included the following:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Gross gains on sales of investment securities available for sale | $12,555 | $151 | $17,488 | $5,286 |
| Gross losses on sales of investment securities available for sale | (26) | (4) | (331) | (13) |
| Total securities gains | $12,529 | $147 | $17,157 | $5,273 |

The following table provides information regarding securities with unrealized losses as of June 30, 2016 and December 31, 2015.

| | June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| (Dollars in thousands) | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Investment securities available for sale: | | | | | | |
| Mortgage-backed securities | $364,840 | $ 1,236 | $197,332 | $ 1,039 | $562,172 | $ 2,275 |
| Equity securities | 44,489 | 1,786 | — | — | 44,489 | 1,786 |
| Other | 1,950 | 165 | — | — | 1,950 | 165 |
| Total | $411,279 | $ 3,187 | $197,332 | $ 1,039 | $608,611 | $ 4,226 |

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | 12 months or more | | Total | |
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Investment securities available for sale: | | | | | | |
| U.S. Treasury | $1,539,637 | $ 1,118 | $— | $ — | $1,539,637 | $ 1,118 |
| Government agency | 229,436 | 374 | — | — | 229,436 | 374 |
| Mortgage-backed securities | 3,570,470 | 23,275 | 280,126 | 6,094 | 3,850,596 | 29,369 |
| Equity securities | 728 | 10 | — | — | 728 | 10 |
| Total | $5,340,271 | $ 24,777 | $280,126 | $ 6,094 | $5,620,397 | $ 30,871 |

Investment securities with an aggregate fair value of $197.3 million and $280.1 million had continuous unrealized losses for more than 12 months with a corresponding aggregate unrealized loss of $1.0 million and $6.1 million as of June 30, 2016 and December 31, 2015, respectively. As of June 30, 2016, all 36 of these investments are government sponsored enterprise-issued mortgage-backed securities. None of the unrealized losses identified as of June 30, 2016 or December 31, 2015 relate to the marketability of the securities or the issuer’s ability to honor redemption

obligations. Rather, the unrealized losses relate to changes in interest rates relative to when the investment securities were purchased. For all periods presented, BancShares had the ability and intent to retain these securities for a period of time sufficient to recover all unrealized losses. Therefore, none of the securities were deemed to be other than temporarily impaired.
Investment securities having an aggregate carrying value of $4.77 billion at June 30, 2016 and $4.73 billion at December 31, 2015 were pledged as collateral to secure public funds on deposit and certain short-term borrowings, and for other purposes as required by law.

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NOTE D - LOANS AND LEASES

BancShares' accounting methods for loans and leases differ depending on whether they are purchased credit-impaired (PCI) or non-PCI. Non-PCI loans and leases include originated commercial, originated noncommercial, purchased non-impaired loans, purchased leases and certain purchased revolving credit. For purchased non-impaired loans to be included as non-PCI, it must be determined that the loans do not have a discount due, at least in part, to credit quality at the time of acquisition. Conversely, loans for which it is probable at acquisition that all required payments will not be collected in accordance with contractual terms are considered PCI loans. PCI loans are evaluated at acquisition and where a discount is required at least in part due to credit quality, the nonrevolving loans are accounted for under the guidance in ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. PCI loans and leases are recorded at fair value at the date of acquisition. No allowance for loan and lease losses is recorded on the acquisition date as the fair value of the acquired assets incorporates assumptions regarding credit risk. An allowance is recorded if there is additional credit deterioration after the acquisition date.

BancShares reports PCI and non-PCI loan portfolios separately, and each portfolio is further divided into commercial and non-commercial based on the type of borrower, purpose, collateral, and/or our underlying credit management processes. Additionally, loans are assigned to loan classes, which further disaggregate loans based upon common risk characteristics.

Commercial – Commercial loans include construction and land development, mortgage, other commercial real estate, commercial and industrial, lease financing and other.

Construction and land development – Construction and land development consists of loans to finance land for development, investment, and use in a commercial business enterprise; multifamily apartments; and other commercial buildings that may be owner-occupied or income generating investments for the owner.

Commercial mortgage – Commercial mortgage consists of loans to purchase or refinance owner-occupied nonresidential and investment properties. Investment properties include office buildings and other facilities that are rented or leased to unrelated parties.

Other commercial real estate – Other commercial real estate consists of loans secured by farmland (including residential farms and other improvements) and multifamily (5 or more) residential properties.

Commercial and industrial – Commercial and industrial consists of loans or lines of credit to finance corporate credit cards, accounts receivable, inventory and other general business purposes.

Lease financing – Lease financing consists solely of lease financing agreements for business equipment, vehicles and other assets.

Other – Other consists of all other commercial loans not classified in one of the preceding classes. These typically include loans to non-profit organizations such as churches, hospitals, educational and charitable organizations.

Noncommercial – Noncommercial consist of residential and revolving mortgage, construction and land development, and consumer loans.

Residential mortgage – Residential real estate consists of loans to purchase, construct or refinance the borrower's primary dwelling, second residence or vacation home.

Revolving mortgage – Revolving mortgage consists of home equity lines of credit that are secured by first or second liens on the borrower's primary residence.

Construction and land development – Construction and land development consists of loans to construct the borrower's primary or secondary residence or vacant land upon which the owner intends to construct a dwelling at a future date.

Consumer – Consumer loans consist of installment loans to finance purchases of vehicles, unsecured home improvements and revolving lines of credit that can be secured or unsecured, including personal credit cards.

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Loans and leases outstanding included the following at June 30, 2016 and December 31, 2015:

| (Dollars in thousands) | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Non-PCI loans and leases: | | |
| Commercial: | | |
| Construction and land development | $624,806 | $620,352 |
| Commercial mortgage | 8,505,259 | 8,274,548 |
| Other commercial real estate | 337,618 | 321,021 |
| Commercial and industrial | 2,386,159 | 2,368,958 |
| Lease financing | 784,861 | 730,778 |
| Other | 365,269 | 314,832 |
| Total commercial loans | 13,003,972 | 12,630,489 |
| Noncommercial: | | |
| Residential mortgage | 2,777,863 | 2,695,985 |
| Revolving mortgage | 2,533,528 | 2,523,106 |
| Construction and land development | 226,322 | 220,073 |
| Consumer | 1,279,419 | 1,219,821 |
| Total noncommercial loans | 6,817,132 | 6,658,985 |
| Total non-PCI loans and leases | 19,821,104 | 19,289,474 |
| PCI loans: | | |
| Commercial: | | |
| Construction and land development | 27,742 | 33,880 |
| Commercial mortgage | 513,021 | 525,468 |
| Other commercial real estate | 20,166 | 17,076 |
| Commercial and industrial | 12,854 | 15,182 |
| Other | 3,159 | 2,008 |
| Total commercial loans | 576,942 | 593,614 |
| Noncommercial: | | |
| Residential mortgage | 294,625 | 302,158 |
| Revolving mortgage | 47,230 | 52,471 |
| Construction and land development | 467 | — |
| Consumer | 2,203 | 2,273 |
| Total noncommercial loans | 344,525 | 356,902 |
| Total PCI loans | 921,467 | 950,516 |
| Total loans and leases | $20,742,571 | $20,239,990 |

At June 30, 2016, $95.5 million of total loans and leases were covered under loss share agreements, compared to $272.6 million at December 31, 2015. Loss share protection for United Western Bank (UWB) non-single family residential loans with a balance of $107.0 million at June 30, 2016 expired at the beginning of the second quarter of 2016. Additionally, as a result of entering into an agreement with the FDIC to terminate five of FCB's nine loss share agreements during the second quarter of 2016, loans of $43.5 million that were previously covered by the loss share agreements were classified as non-covered at June 30, 2016. See Note G for more information on the loss share termination agreement entered into with the FDIC during the quarter.

At June 30, 2016, $8.47 billion in noncovered loans with a lendable collateral value of $6.00 billion were used to secure $660.2 million in Federal Home Loan Bank (FHLB) of Atlanta advances, resulting in additional borrowing capacity of $5.34 billion. At December 31, 2015, $8.58 billion in noncovered loans with a lendable collateral value of $6.08 billion were used to secure $510.3 million in FHLB of Atlanta advances, resulting in additional borrowing capacity of $5.57 billion.

Net deferred fees on originated non-PCI loans and leases, including unearned income and unamortized costs, fees, premiums and discounts, were $10.8 million and $16.6 million at June 30, 2016 and December 31, 2015, respectively. The unamortized discount related to the non-PCI loans and leases acquired in the First Citizens Bancorporation, Inc. (Bancorporation) merger was $35.0 million and $41.1 million at June 30, 2016 and December 31, 2015, respectively. During the three months ended June 30, 2016 and June 30, 2015, accretion income on non-PCI loans was $2.9 million and $4.9 million, respectively. During the six months ended June 30, 2016 and June 30, 2015, accretion income on non-PCI loans was $6.1 million and $10.6 million, respectively.

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Credit quality indicators

Loans and leases are monitored for credit quality on a recurring basis. The credit quality indicators used are dependent on the portfolio segment to which the loan relates. Commercial and noncommercial loans and leases have different credit quality indicators as a result of the unique characteristics of the loan segment being evaluated. The credit quality indicators for non-PCI and PCI commercial loans and leases are developed through a review of individual borrowers on an ongoing basis. Each commercial loan is evaluated annually with more frequent evaluation of more severely criticized loans or leases. The credit quality indicators for non-PCI and PCI noncommercial loans are based on the delinquency status of the borrower. As the borrower becomes more delinquent, the likelihood of loss increases. The indicators represent the rating for loans or leases as of the date presented based on the most recent assessment performed. These credit quality indicators are defined as follows:

Pass – A pass rated asset is not adversely classified because it does not display any of the characteristics for adverse classification.

Special mention – A special mention asset has potential weaknesses that deserve management’s close attention. If left uncorrected, such potential weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention assets are not adversely classified and do not warrant adverse classification.

Substandard – A substandard asset is inadequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Assets classified as substandard generally have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These assets are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Doubtful – An asset classified as doubtful has all the weaknesses inherent in an asset classified substandard with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable on the basis of currently existing facts, conditions and values.

Loss – Assets classified as loss are considered uncollectible and of such little value that it is inappropriate to be carried as an asset. This classification is not necessarily equivalent to no potential for recovery or salvage value, but rather that it is not appropriate to defer a full charge-off even though partial recovery may be effected in the future.

Ungraded – Ungraded loans represent loans that are not included in the individual credit grading process due to their relatively small balances or borrower type. The majority of ungraded loans at June 30, 2016 and December 31, 2015 relate to business credit cards. Business credit card loans are subject to automatic charge-off when they become 120 days past due in the same manner as unsecured consumer lines of credit. The remaining balance is comprised of a small amount of commercial mortgage and other commercial real estate loans.

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Non-PCI loans and leases outstanding at June 30, 2016 and December 31, 2015 by credit quality indicator are provided below:

| (Dollars in thousands) | June 30, 2016 Non-PCI commercial loans and leases | | | | | | |
|---|---|---|---|---|---|---|---|
| Grade: | Construction and land development | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Total non-PCI commercial loans and leases |
| Pass | $621,625 | $8,269,622 | $ 333,803 | $2,232,669 | $ 776,827 | $363,096 | $12,597,642 |
| Special mention | 1,156 | 90,904 | 1,723 | 15,088 | 2,759 | 1,310 | 112,940 |
| Substandard | 2,025 | 141,708 | 918 | 17,869 | 5,184 | 863 | 168,567 |
| Doubtful | — | 424 | — | 16 | 44 | — | 484 |
| Ungraded | — | 2,601 | 1,174 | 120,517 | 47 | — | 124,339 |
| Total | $624,806 | $8,505,259 | $ 337,618 | $2,386,159 | $ 784,861 | $365,269 | $13,003,972 |

| | December 31, 2015 Non-PCI commercial loans and leases | | | | | | |
|---|---|---|---|---|---|---|---|
| | Construction and land development | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Total non-PCI commercial loans and leases |
| Pass | $611,314 | $8,024,831 | $ 318,187 | $2,219,606 | $ 719,338 | $311,401 | $12,204,677 |
| Special mention | 5,191 | 100,220 | 475 | 19,361 | 4,869 | 1,905 | 132,021 |
| Substandard | 3,847 | 146,071 | 959 | 21,322 | 6,375 | 1,526 | 180,100 |
| Doubtful | — | 599 | — | 408 | 169 | — | 1,176 |
| Ungraded | — | 2,827 | 1,400 | 108,261 | 27 | — | 112,515 |
| Total | $620,352 | $8,274,548 | $ 321,021 | $2,368,958 | $ 730,778 | $314,832 | $12,630,489 |

| | June 30, 2016 Non-PCI noncommercial loans and leases | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Residential mortgage | Revolving mortgage | Construction and land development | Consumer | Total non-PCI noncommercial loans and leases |
| Current | $2,735,841 | $2,517,033 | $ 223,471 | $1,270,407 | $ 6,746,752 |
| 30-59 days past due | 21,317 | 8,056 | 1,019 | 5,573 | 35,965 |
| 60-89 days past due | 5,545 | 2,476 | 278 | 2,044 | 10,343 |
| 90 days or greater past due | 15,160 | 5,963 | 1,554 | 1,395 | 24,072 |
| Total | $2,777,863 | $2,533,528 | $ 226,322 | $1,279,419 | $ 6,817,132 |

| | December 31, 2015 Non-PCI noncommercial loans and leases | | | | |
|---|---|---|---|---|---|
| | Residential mortgage | Revolving mortgage | Construction and land development | Consumer | Total non-PCI noncommercial loans and leases |
| Current | $2,651,209 | $2,502,065 | $ 214,555 | $1,210,832 | $ 6,578,661 |
| 30-59 days past due | 23,960 | 11,706 | 3,211 | 5,545 | 44,422 |
| 60-89 days past due | 7,536 | 3,704 | 669 | 1,822 | 13,731 |

| | | | | | |
|---|---|---|---|---|---|
| 90 days or greater past due | 13,280 | 5,631 | 1,638 | 1,622 | 22,171 |
| Total | $2,695,985 | $2,523,106 | $ 220,073 | $1,219,821 | $ 6,658,985 |

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PCI loans outstanding at June 30, 2016 and December 31, 2015 by credit quality indicator are provided below:

| | June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | PCI commercial loans | | | | | |
| Grade: | Construction and land development | Commercial mortgage | Other commercial real estate | Commercial and industrial | Other | Total PCI commercial loans |
| Pass | $12,786 | $ 285,428 | $ 9,314 | $ 9,090 | $2,110 | $ 318,728 |
| Special mention | 679 | 80,009 | 1,025 | 418 | — | 82,131 |
| Substandard | 11,313 | 135,925 | 8,599 | 3,023 | 1,049 | 159,909 |
| Doubtful | 2,964 | 11,340 | 982 | 255 | — | 15,541 |
| Ungraded | — | 319 | 246 | 68 | — | 633 |
| Total | $27,742 | $ 513,021 | $ 20,166 | $ 12,854 | $3,159 | $ 576,942 |

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | PCI commercial loans | | | | | |
| | Construction and land development | Commercial mortgage | Other commercial real estate | Commercial and industrial | Other | Total PCI commercial loans |
| Pass | $14,710 | $ 262,579 | $ 7,366 | $ 9,302 | $706 | $ 294,663 |
| Special mention | 758 | 87,870 | 60 | 937 | — | 89,625 |
| Substandard | 14,131 | 163,801 | 9,229 | 4,588 | 1,302 | 193,051 |
| Doubtful | 4,281 | 10,875 | — | 282 | — | 15,438 |
| Ungraded | — | 343 | 421 | 73 | — | 837 |
| Total | $33,880 | $ 525,468 | $ 17,076 | $ 15,182 | $2,008 | $ 593,614 |

| | June 30, 2016 | | | | |
|---|---|---|---|---|---|
| | PCI noncommercial loans | | | | |
| (Dollars in thousands) | Residential mortgage | Revolving mortgage | Construction and land development | Consumer | Total PCI noncommercial loans |
| Current | $252,675 | $ 41,655 | $ 467 | $ 1,986 | $ 296,783 |
| 30-59 days past due | 11,015 | 1,323 | — | 122 | 12,460 |
| 60-89 days past due | 4,654 | 358 | — | 45 | 5,057 |
| 90 days or greater past due | 26,281 | 3,894 | — | 50 | 30,225 |
| Total | $294,625 | $ 47,230 | $ 467 | $ 2,203 | $ 344,525 |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | PCI noncommercial loans | | | | |
| | Residential mortgage | Revolving mortgage | Construction and land development | Consumer | Total PCI noncommercial loans |
| Current | $257,207 | $ 47,901 | $ — | $ 1,981 | $ 307,089 |
| 30-59 days past due | 12,318 | 1,127 | — | 86 | 13,531 |
| 60-89 days past due | 4,441 | 501 | — | 132 | 5,074 |
| 90 days or greater past due | 28,192 | 2,942 | — | 74 | 31,208 |
| Total | $302,158 | $ 52,471 | $ — | $ 2,273 | $ 356,902 |

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The aging of the outstanding non-PCI loans and leases, by class, at June 30, 2016 and December 31, 2015 is provided in the table below.
The calculation of days past due begins on the day after payment is due and includes all days through which all required interest or principal has not been paid. Loans and leases 30 days or less past due are considered current as various grace periods allow borrowers to make payments within a stated period after the due date and still remain in compliance with the loan agreement.

| | June 30, 2016 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | 30-59 days past due | 60-89 days past due | 90 days or greater | Total past due | Current | Total loans and leases |
| Non-PCI loans and leases: | | | | | | |
| Construction and land development - commercial | $229 | $ 188 | $295 | $712 | $624,094 | $624,806 |
| Commercial mortgage | 9,098 | 6,026 | 10,896 | 26,020 | 8,479,239 | 8,505,259 |
| Other commercial real estate | 1,114 | 99 | 27 | 1,240 | 336,378 | 337,618 |
| Commercial and industrial | 6,722 | 896 | 2,169 | 9,787 | 2,376,372 | 2,386,159 |
| Lease financing | 1,096 | 106 | 368 | 1,570 | 783,291 | 784,861 |
| Residential mortgage | 21,317 | 5,545 | 15,160 | 42,022 | 2,735,841 | 2,777,863 |
| Revolving mortgage | 8,056 | 2,476 | 5,963 | 16,495 | 2,517,033 | 2,533,528 |
| Construction and land development - noncommercial | 1,019 | 278 | 1,554 | 2,851 | 223,471 | 226,322 |
| Consumer | 5,573 | 2,044 | 1,395 | 9,012 | 1,270,407 | 1,279,419 |
| Other | 184 | 142 | 397 | 723 | 364,546 | 365,269 |
| Total non-PCI loans and leases | $54,408 | $ 17,800 | $38,224 | $110,432 | $19,710,672 | $19,821,104 |

| | December 31, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | 30-59 days past due | 60-89 days past due | 90 days or greater | Total past due | Current | Total loans and leases |
| Non-PCI loans and leases: | | | | | | |
| Construction and land development - commercial | $987 | $ 283 | $463 | $1,733 | $618,619 | $620,352 |
| Commercial mortgage | 13,023 | 3,446 | 14,495 | 30,964 | 8,243,584 | 8,274,548 |
| Other commercial real estate | 884 | — | 142 | 1,026 | 319,995 | 321,021 |
| Commercial and industrial | 2,133 | 1,079 | 1,780 | 4,992 | 2,363,966 | 2,368,958 |
| Lease financing | 2,070 | 2 | 164 | 2,236 | 728,542 | 730,778 |
| Residential mortgage | 23,960 | 7,536 | 13,280 | 44,776 | 2,651,209 | 2,695,985 |
| Revolving mortgage | 11,706 | 3,704 | 5,631 | 21,041 | 2,502,065 | 2,523,106 |
| Construction and land development - noncommercial | 3,211 | 669 | 1,638 | 5,518 | 214,555 | 220,073 |
| Consumer | 5,545 | 1,822 | 1,622 | 8,989 | 1,210,832 | 1,219,821 |
| Other | 3 | 164 | 134 | 301 | 314,531 | 314,832 |
| Total non-PCI loans and leases | $63,522 | $ 18,705 | $39,349 | $121,576 | $19,167,898 | $19,289,474 |

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The recorded investment, by class, in loans and leases on nonaccrual status, and loans and leases greater than 90 days past due and still accruing at June 30, 2016 and December 31, 2015 for non-PCI loans and leases, were as follows:

| | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| (Dollars in thousands) | Nonaccrual loans and leases | Loans and leases > 90 days and accruing | Nonaccrual loans and leases | Loans and leases > 90 days and accruing |
| Non-PCI loans and leases: | | | | |
| Construction and land development - commercial | $529 | $— | $425 | $273 |
| Commercial mortgage | 32,500 | 1,324 | 42,116 | 242 |
| Other commercial real estate | 126 | — | 239 | — |
| Commercial and industrial | 4,385 | 597 | 6,235 | 953 |
| Lease financing | 544 | — | 389 | — |
| Residential mortgage | 33,863 | — | 29,977 | 838 |
| Revolving mortgage | 12,728 | — | 12,704 | — |
| Construction and land development - noncommercial | 2,496 | — | 2,164 | — |
| Consumer | 1,584 | 865 | 1,472 | 1,007 |
| Other | 251 | 231 | 133 | 2 |
| Total non-PCI loans and leases | $89,006 | $3,017 | $95,854 | $3,315 |

Purchased credit-impaired loans (PCI) loans

The following table relates to PCI loans acquired in the NMSB and FCSB acquisitions and summarizes the contractually required payments, which include principal and interest, expected cash flows to be collected, and the fair value of PCI loans at the acquisition date.

| (Dollars in thousands) | |
|---|---|
| Contractually required payments | $108,578 |
| Cash flows expected to be collected | $92,363 |
| Fair value of loans at acquisition | $80,084 |

The recorded fair values of PCI loans acquired in the NMSB and FCSB acquisitions as of the acquisition date were as follows:

| (Dollars in thousands) | |
|---|---|
| Commercial: | |
| Construction and land development | $550 |
| Commercial mortgage | 50,497 |
| Other commercial real estate | 2,637 |
| Commercial and industrial | 3,790 |
| Other | 1,609 |
| Total commercial loans | 59,083 |
| Noncommercial: | |
| Residential mortgage | 18,122 |
| Revolving mortgage | 1,258 |
| Construction and land development | 365 |
| Consumer | 1,256 |
| Total noncommercial loans | 21,001 |
| Total PCI loans and leases | $80,084 |

The following table provides changes in the carrying value of all purchased credit-impaired loans during the six months ended June 30, 2016 and June 30, 2015:

| (Dollars in thousands) | 2016 | 2015 |
|---|---|---|
| Balance at January 1 | $950,516 | $1,186,498 |
| Fair value of acquired loans | 80,084 | 154,496 |
| Accretion | 41,821 | 59,182 |
| Payments received and other changes, net | (150,954 ) | (276,937 ) |
| Balance at June 30 | $921,467 | $1,123,239 |
| Unpaid principal balance at June 30 | $1,614,998 | $2,025,905 |

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The carrying value of loans on the cost recovery method was $568 thousand at June 30, 2016 and $5.3 million at December 31, 2015. The cost recovery method is applied to loans when the timing of future cash flows is not reasonably estimable due to borrower nonperformance or uncertainty in the ultimate disposition of the asset. The recorded investment of PCI loans on nonaccrual status was $3.8 million and $7.6 million at June 30, 2016 and December 31, 2015, respectively.

For PCI loans, improved credit loss expectations generally result in the reclassification of nonaccretable difference to accretable yield. Changes in expected cash flows not related to credit improvements or deterioration do not affect the nonaccretable difference.

The following table documents changes to the amount of accretable yield for the first six months of 2016 and 2015.

| (Dollars in thousands) | 2016 | 2015 |
| --- | --- | --- |
| Balance at January 1 | $343,856 | $418,160 |
| Additions from acquisitions | 12,279 | 53,192 |
| Accretion | (41,821) | (59,182) |
| Reclassifications from nonaccretable difference | 18,384 | 12,322 |
| Changes in expected cash flows that do not affect nonaccretable difference | 30,239 | (45,391) |
| Balance at June 30 | $362,937 | $379,101 |

During the three months ended June 30, 2016 and June 30, 2015, accretion income on PCI loans was $20.4 million and $34.1 million, respectively.

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NOTE E - ALLOWANCE FOR LOAN AND LEASE LOSSES (ALLL)

The following tables present the activity in the ALLL for non-PCI loan and lease losses by loan class for the three and six months ended June 30, 2016 and June 30, 2015:

Three months ended June 30, 2016

| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Non-PCI Loans Allowance for loan and lease losses: | | | | | | | | | | | |
| Balance at April 1 | $16,885 | $70,456 | $2,207 | $44,479 | $5,422 | $1,777 | $14,727 | $16,125 | $1,575 | $19,373 | $193,026 |
| Provision | 291 | 701 | (79) | 81 | 343 | 37 | 1,487 | 1,470 | 78 | 2,299 | 6,708 |
| Charge-offs | (136) | (44) | — | (1,177) | — | (88) | (179) | (1,081) | — | (3,136) | (5,841) |
| Recoveries | 129 | 500 | 10 | 525 | 1 | 29 | 41 | 214 | — | 1,111 | 2,560 |
| Balance at June 30 | $17,169 | $71,613 | $2,138 | $43,908 | $5,766 | $1,755 | $16,076 | $16,728 | $1,653 | $19,647 | $196,453 |

Three months ended June 30, 2015

| | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Balance at April 1 | $13,108 | $82,038 | $1,031 | $36,954 | $4,293 | $2,981 | $11,328 | $17,529 | $1,056 | $17,616 | $187,934 |
| Provision | 88 | (1,878) | (227) | 4,547 | 408 | (1,824) | 1,162 | 31 | 74 | 6,613 | 8,994 |
| Charge-offs | (221) | (47) | (9) | (2,318) | (6) | — | (90) | (616) | — | (2,743) | (6,050) |
| Recoveries | 104 | 323 | 9 | 209 | 11 | 31 | 305 | 346 | 3 | 630 | 1,971 |
| Balance at June 30 | $13,079 | $80,436 | $804 | $39,392 | $4,706 | $1,188 | $12,705 | $17,290 | $1,133 | $22,116 | $192,849 |

Six months ended June 30, 2016

| | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Balance at January 1 | $16,288 | $69,896 | $2,168 | $43,116 | $5,524 | $1,855 | $14,105 | $15,971 | $1,485 | $19,496 | $189,904 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Provision | 1,234 | 1,096 | (184) | 2,282 | 62 | (290) | 2,262 | 2,628 | 165 | 4,293 | 13,548 |
| Charge-offs | (562) | (134) | — | (2,494) | — | (160) | (352) | (2,116) | — | (6,243) | (12,061) |
| Recoveries | 209 | 755 | 154 | 1,004 | 180 | 350 | 61 | 245 | 3 | 2,101 | 5,062 |
| Balance at June 30 | $17,169 | $71,613 | $2,138 | $43,908 | $5,766 | $1,755 | $16,076 | $16,728 | $1,653 | $19,647 | $196,453 |

| | Six months ended June 30, 2015 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer | Total |
| Balance at January 1 | $11,961 | $85,189 | $732 | $30,727 | $4,286 | $3,184 | $10,661 | $18,650 | $892 | $16,555 | $182,837 |
| Provision | 1,191 | (5,557) | 231 | 12,093 | 419 | (2,042) | 1,975 | (431) | 192 | 9,579 | 17,650 |
| Charge-offs | (239) | (280) | (178) | (4,031) | (21) | — | (374) | (1,409) | (22) | (5,526) | (12,080) |
| Recoveries | 166 | 1,084 | 19 | 603 | 22 | 46 | 443 | 480 | 71 | 1,508 | 4,442 |
| Balance at June 30 | $13,079 | $80,436 | $804 | $39,392 | $4,706 | $1,188 | $12,705 | $17,290 | $1,133 | $22,116 | $192,849 |

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The following tables present the allowance for non-PCI loan losses and the recorded investment in loans, by loan class, based on impairment method as of June 30, 2016 and December 31, 2015:

| | June 30, 2016 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer |
| Allowance for loan and lease losses: | | | | | | | | | | |
| ALLL for loans and leases individually evaluated for impairment | $333 | $4,248 | $119 | $971 | $45 | $— | $1,992 | $868 | $— | $683 |
| ALLL for loans and leases collectively evaluated for impairment | 16,836 | 67,365 | 2,019 | 42,937 | 5,721 | 1,755 | 14,084 | 15,860 | 1,653 | 18,964 |
| Total allowance for loan and lease losses | $17,169 | $71,613 | $2,138 | $43,908 | $5,766 | $1,755 | $16,076 | $16,728 | $1,653 | $19,647 |
| Loans and leases: | | | | | | | | | | |
| Loans and leases individually evaluated for impairment | $3,299 | $77,620 | $1,551 | $10,220 | $1,233 | $695 | $26,780 | $7,113 | $411 | $1,471 |
| Loans and leases collectively evaluated for impairment | 621,507 | 8,427,639 | 336,067 | 2,375,939 | 783,628 | 364,574 | 2,751,083 | 2,526,415 | 225,911 | 1,277,948 |
| Total loan and leases | $624,806 | $8,505,259 | $337,618 | $2,386,159 | $784,861 | $365,269 | $2,777,863 | $2,533,528 | $226,322 | $1,279,419 |

| | December 31, 2015 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction and land | Commercial mortgage | Other commercial | Commercial and | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land | Consumer |

| | development - commercial | | real estate | industrial | | | | | development - non-commercial | |
|---|---|---|---|---|---|---|---|---|---|---|
| Allowance for loan and lease losses: | | | | | | | | | | |
| ALLL for loans and leases individually evaluated for impairment | $123 | $3,370 | $289 | $1,118 | $213 | $— | $1,212 | $299 | $49 | $527 |
| ALLL for loans and leases collectively evaluated for impairment | 16,165 | 66,526 | 1,879 | 41,998 | 5,311 | 1,855 | 12,893 | 15,672 | 1,436 | 18,969 |
| Total allowance for loan and lease losses | $16,288 | $69,896 | $2,168 | $43,116 | $5,524 | $1,855 | $14,105 | $15,971 | $1,485 | $19,496 |
| Loans and leases: | | | | | | | | | | |
| Loans and leases individually evaluated for impairment | $3,094 | $95,107 | $427 | $17,910 | $1,755 | $1,183 | $22,986 | $5,883 | $784 | $1,238 |
| Loans and leases collectively evaluated for impairment | 617,258 | 8,179,441 | 320,594 | 2,351,048 | 729,023 | 313,649 | 2,672,999 | 2,517,223 | 219,289 | 1,218,583 |
| Total loan and leases | $620,352 | $8,274,548 | $321,021 | $2,368,958 | $730,778 | $314,832 | $2,695,985 | $2,523,106 | $220,073 | $1,219,82 |

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The following tables show the activity in the allowance for PCI loan and lease losses by loan class for the three and six months ended June 30, 2016 and June 30, 2015.

| | Three months ended June 30, 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development - noncommercial | Consumer and other | Total |
| PCI Loans | | | | | | | | | |
| Allowance for loan and lease losses: | | | | | | | | | |
| Balance at April 1 | $733 | $6,750 | $770 | $225 | $4,680 | $415 | $ — | $184 | $13,757 |
| Provision | (453) | (935) | (154) | 60 | (382) | (177) | — | (105) | (2,146) |
| Charge-offs | — | (56) | — | — | — | — | — | — | (56) |
| Recoveries | — | — | — | — | — | — | — | — | — |
| Balance at June 30 | $280 | $5,759 | $616 | $285 | $4,298 | $238 | $ — | $79 | $11,555 |

| | Three months ended June 30, 2015 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development - noncommercial | Consumer and other | Total |
| Balance at April 1 | $341 | $8,876 | $194 | $11 | $4,872 | $3,271 | $ 31 | $23 | $17,619 |
| Provision | 325 | (2,065) | (125) | 399 | 1,165 | (1,112) | (31) | 169 | (1,275) |
| Charge-offs | (97) | (383) | — | (87) | (195) | (108) | — | (6) | (876) |
| Recoveries | — | — | — | — | — | — | — | — | — |
| Balance at June 30 | $569 | $6,428 | $69 | $323 | $5,842 | $2,051 | $ — | $186 | $15,468 |

| | Six months ended June 30, 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development - noncommercial | Consumer and other | Total |
| Balance at January 1 | $1,082 | $7,838 | $773 | $445 | $5,398 | $523 | $ — | $253 | $16,312 |
| Provision | (802) | (1,914) | (152) | (160) | (729) | (285) | — | (101) | (4,143) |
| Charge-offs | — | (165) | (5) | — | (371) | — | — | (73) | (614) |
| Recoveries | — | — | — | — | — | — | — | — | — |
| Balance at June 30 | $280 | $5,759 | $616 | $285 | $4,298 | $238 | $ — | $79 | $11,555 |

| | Six months ended June 30, 2015 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development - noncommercial | Consumer and other | Total |
| Balance at January 1 | $150 | $10,135 | $75 | $1,240 | $5,820 | $3,999 | $ 183 | $27 | $21,629 |
| Provision | 516 | (2,990) | (6) | (632) | 302 | (1,767) | (183) | 621 | (4,139) |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Charge-offs | (97 ) | (717 ) | — | (285 ) | (280 ) | (181 ) | — | (462 ) | (2,022 ) |
| Recoveries | — | — | — | — | — | — | — | — | — |
| Balance at June 30 | $569 | $6,428 | $ 69 | $ 323 | $ 5,842 | $ 2,051 | $ — | $ 186 | $15,468 |

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The following tables show the ending balances of PCI loans and leases and related allowance by class of loans as of June 30, 2016 and December 31, 2015:

| (Dollars in thousands) | June 30, 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development - noncommercial | Consumer and other | Total |
| ALLL for loans and leases acquired with deteriorated credit quality | $280 | $ 5,759 | $ 616 | $ 285 | $ 4,298 | $ 238 | $ — | $ 79 | $11,555 |
| Loans and leases acquired with deteriorated credit quality | 27,742 | 513,021 | 20,166 | 12,854 | 294,625 | 47,230 | 467 | 5,362 | 921,467 |

| (Dollars in thousands) | December 31, 2015 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development - noncommercial | Consumer and other | Total |
| ALLL for loans and leases acquired with deteriorated credit quality | $1,082 | $ 7,838 | $ 773 | $ 445 | $ 5,398 | $ 523 | $ — | $ 253 | $16,312 |
| Loans and leases acquired with deteriorated credit quality | 33,880 | 525,468 | 17,076 | 15,182 | 302,158 | 52,471 | — | 4,281 | 950,516 |

As of June 30, 2016, and December 31, 2015, $394.6 million and $469.3 million, respectively, in PCI loans experienced an adverse change in expected cash flows since the date of acquisition. The corresponding valuation reserve was $11.6 million and $16.3 million, respectively.

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The following tables provide information on non-PCI impaired loans and leases, exclusive of loans and leases evaluated collectively as a homogeneous group, as of June 30, 2016 and December 31, 2015 including interest income recognized in the period during which the loans and leases were considered impaired.

| | June 30, 2016 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | With a recorded allowance | With no recorded allowance | Total | Unpaid principal balance | Related allowance recorded |
| Non-PCI impaired loans and leases: | | | | | |
| Construction and land development - commercial | $2,164 | $ 1,135 | $3,299 | $3,800 | $ 333 |
| Commercial mortgage | 37,960 | 39,660 | 77,620 | 84,095 | 4,248 |
| Other commercial real estate | 578 | 973 | 1,551 | 1,875 | 119 |
| Commercial and industrial | 6,529 | 3,691 | 10,220 | 10,670 | 971 |
| Lease financing | 1,209 | 24 | 1,233 | 1,233 | 45 |
| Other | — | 695 | 695 | 783 | — |
| Residential mortgage | 14,734 | 12,046 | 26,780 | 27,772 | 1,992 |
| Revolving mortgage | 4,654 | 2,459 | 7,113 | 8,607 | 868 |
| Construction and land development - noncommercial | — | 411 | 411 | 411 | — |
| Consumer | 1,307 | 164 | 1,471 | 1,558 | 683 |
| Total non-PCI impaired loans and leases | $69,135 | $ 61,258 | $130,393 | $140,804 | $ 9,259 |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | With a recorded allowance | With no recorded allowance | Total | Unpaid principal balance | Related allowance recorded |
| Non-PCI impaired loans and leases: | | | | | |
| Construction and land development - commercial | $1,623 | $ 1,471 | $3,094 | $4,428 | $ 123 |
| Commercial mortgage | 41,793 | 53,314 | 95,107 | 103,763 | 3,370 |
| Other commercial real estate | 305 | 122 | 427 | 863 | 289 |
| Commercial and industrial | 8,544 | 9,366 | 17,910 | 21,455 | 1,118 |
| Lease financing | 1,651 | 104 | 1,755 | 1,956 | 213 |
| Other | — | 1,183 | 1,183 | 1,260 | — |
| Residential mortgage | 10,097 | 12,889 | 22,986 | 25,043 | 1,212 |
| Revolving mortgage | 1,105 | 4,778 | 5,883 | 7,120 | 299 |
| Construction and land development - noncommercial | 693 | 91 | 784 | 784 | 49 |
| Consumer | 1,050 | 188 | 1,238 | 1,294 | 527 |
| Total non-PCI impaired loans and leases | $66,861 | $ 83,506 | $150,367 | $167,966 | $ 7,200 |

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The following tables show the average non-PCI impaired loan balance and the interest income recognized by loan class for the three and six months ended June 30, 2016 and June 30, 2015:

| | Three months ended June 30, 2016 | | Three months ended June 30, 2015 | |
|---|---|---|---|---|
| (Dollars in thousands) | Average balance | Interest income recognized | Average balance | Interest income recognized |
| Non-PCI impaired loans and leases: | | | | |
| Construction and land development - commercial | $3,236 | $ 40 | $3,134 | $ 35 |
| Commercial mortgage | 79,442 | 616 | 86,253 | 840 |
| Other commercial real estate | 878 | 7 | 403 | — |
| Commercial and industrial | 9,938 | 84 | 14,088 | 146 |
| Lease financing | 1,214 | 15 | 1,463 | 16 |
| Other | 813 | 10 | 1,835 | — |
| Residential mortgage | 24,982 | 178 | 16,819 | 135 |
| Revolving mortgage | 6,421 | 40 | 4,015 | 23 |
| Construction and land development - noncommercial | 413 | 5 | 779 | 9 |
| Consumer | 1,422 | 20 | 1,154 | 20 |
| Total non-PCI impaired loans and leases | $128,759 | $ 1,015 | $129,943 | $ 1,224 |

| | Six months ended June 30, 2016 | | Six months ended June 30, 2015 | |
|---|---|---|---|---|
| (Dollars in thousands) | Average balance | Interest income recognized | Average balance | Interest income recognized |
| Non-PCI impaired loans and leases: | | | | |
| Construction and land development - commercial | $3,200 | $ 81 | $3,093 | $ 70 |
| Commercial mortgage | 86,193 | 1,382 | 83,115 | 1,602 |
| Other commercial real estate | 651 | 12 | 477 | 1 |
| Commercial and industrial | 12,744 | 235 | 12,220 | 249 |
| Lease financing | 1,436 | 35 | 1,527 | 34 |
| Other | 943 | 24 | 1,913 | — |
| Residential mortgage | 24,240 | 350 | 16,092 | 260 |
| Revolving mortgage | 6,365 | 72 | 3,501 | 39 |
| Construction and land development - noncommercial | 485 | 11 | 719 | 16 |
| Consumer | 1,344 | 38 | 1,088 | 39 |
| Total non-PCI impaired loans and leases | $137,601 | $ 2,240 | $123,745 | $ 2,310 |

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Troubled Debt Restructurings

BancShares accounts for certain loan modifications or restructurings as troubled debt restructurings (TDRs). In general, the modification or restructuring of a loan is considered a TDR if, for economic reasons or legal reasons related to a borrower's financial difficulties, a concession is granted to the borrower that creditors would not otherwise grant. Concessions may relate to the contractual interest rate, maturity date, payment structure or other actions. In accordance with GAAP, acquired loans accounted for under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, are not initially considered to be TDRs, but can be classified as such if a modification is made subsequent to acquisition. Subsequent modifications of a PCI loan accounted for in a pool that would otherwise meet the definition of a TDR is not reported, or accounted for, as a TDR since pooled PCI loans are excluded from the scope of TDR accounting.

The following table provides a summary of total TDRs by accrual status.

| | June 30, 2016 | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Accruing | Nonaccruing | Total | Accruing | Nonaccruing | Total |
| Commercial loans | | | | | | |
| Construction and land development - commercial | $3,444 | $ 451 | $3,895 | $3,624 | $ 257 | $3,881 |
| Commercial mortgage | 62,232 | 15,623 | 77,855 | 65,812 | 18,728 | 84,540 |
| Other commercial real estate | 2,747 | 93 | 2,840 | 1,751 | 89 | 1,840 |
| Commercial and industrial | 7,466 | 692 | 8,158 | 8,833 | 3,341 | 12,174 |
| Lease financing | 1,064 | 44 | 1,108 | 1,191 | 169 | 1,360 |
| Other | 610 | 85 | 695 | 1,183 | — | 1,183 |
| Total commercial TDRs | 77,563 | 16,988 | 94,551 | 82,394 | 22,584 | 104,978 |
| Noncommercial | | | | | | |
| Residential mortgage | 28,334 | 7,476 | 35,810 | 25,427 | 7,129 | 32,556 |
| Revolving mortgage | 5,593 | 1,469 | 7,062 | 3,600 | 1,705 | 5,305 |
| Construction and land development - noncommercial | 411 | — | 411 | 784 | — | 784 |
| Consumer and other | 1,268 | 204 | 1,472 | 1,091 | 129 | 1,220 |
| Total noncommercial TDRs | 35,606 | 9,149 | 44,755 | 30,902 | 8,963 | 39,865 |
| Total TDRs | $113,169 | $ 26,137 | $139,306 | $113,296 | $ 31,547 | $144,843 |

The majority of TDRs are included in the special mention, substandard or doubtful grading categories. When a restructured loan subsequently defaults, it is evaluated and downgraded if appropriate. The more severely graded the loan, the lower the estimated expected cash flows and the greater the allowance recorded. Further, TDRs over $500,000 and graded substandard or lower are evaluated individually for impairment through a review of collateral values or analysis of cash flows.

The following table shows the accrual status of non-PCI and PCI TDRs.

| (Dollars in thousands) | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Accruing TDRs: | | |
| PCI | $23,369 | $ 29,231 |
| Non-PCI | 89,800 | 84,065 |
| Total accruing TDRs | 113,169 | 113,296 |
| Nonaccruing TDRs: | | |
| PCI | 952 | 1,420 |
| Non-PCI | 25,185 | 30,127 |
| Total nonaccruing TDRs | 26,137 | 31,547 |
| All TDRs: | | |

| | | |
|---|---|---|
| PCI | 24,321 | 30,651 |
| Non-PCI | 114,985 | 114,192 |
| Total TDRs | $139,306 | $ 144,843 |

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The following tables provide the types of TDRs made during the three and six months ended June 30, 2016 and June 30, 2015, as well as a summary of loans that were modified as a TDR during the twelve months ended June 30, 2016 and June 30, 2015 that subsequently defaulted during the three and six months ended June 30, 2016 and June 30, 2015. BancShares defines payment default as movement of the TDR to nonaccrual status, which is generally 90 days past due for TDRs, foreclosure or charge-off, whichever occurs first.

| | Three months ended June 30, 2016 | | | | Three months ended June 30, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | All restructurings | | Restructurings with payment default | | All restructurings | | Restructurings with payment default | |
| (Dollars in thousands) | Number of Loans | Recorded investment at period end | Number of Loans | Recorded investment at period end | Number of Loans | Recorded investment at period end | Number of Loans | Recorded investment at period end |
| Non-PCI loans and leases | | | | | | | | |
| Interest only period provided | | | | | | | | |
| Commercial mortgage | — | $ — | — | $ — | 2 | $ 69 | — | $ — |
| Total interest only | — | — | — | — | 2 | 69 | — | — |
| | | | | | | | | |
| Loan term extension | | | | | | | | |
| Commercial mortgage | 2 | 808 | — | — | 2 | 840 | — | — |
| Other commercial real estate | 1 | 841 | — | — | — | — | — | — |
| Commercial and industrial | — | — | 1 | — | — | — | — | — |
| Residential mortgage | 5 | 678 | 1 | 52 | — | — | — | — |
| Total loan term extension | 8 | 2,327 | 2 | 52 | 2 | 840 | — | — |
| | | | | | | | | |
| Below market interest rate | | | | | | | | |
| Construction and land development - commercial | 4 | 317 | 2 | 209 | 3 | 251 | — | — |
| Commercial mortgage | 12 | 1,741 | 5 | 577 | 6 | 1,510 | — | — |
| Other commercial real estate | 1 | 498 | 1 | 12 | — | — | — | — |
| Commercial and industrial | 8 | 694 | 5 | 197 | 4 | 521 | 1 | 142 |
| Residential mortgage | 42 | 2,473 | 20 | 1,337 | 15 | 646 | 1 | 15 |
| Revolving mortgage | 2 | 59 | — | — | — | — | — | — |
| Consumer | 1 | 16 | 1 | — | 3 | 40 | — | — |
| Other | — | — | 1 | 85 | — | — | — | — |
| Total below market interest rate | 70 | 5,798 | 35 | 2,417 | 31 | 2,968 | 2 | 157 |
| | | | | | | | | |
| Discharged from bankruptcy | | | | | | | | |
| Commercial mortgage | 2 | 283 | — | — | — | — | — | — |
| Commercial and industrial | 2 | 49 | — | — | 1 | 17 | — | — |
| Residential mortgage | 5 | 147 | 7 | 506 | 2 | 35 | — | — |
| Revolving mortgage | 13 | 1,461 | 5 | 59 | 7 | 203 | 3 | 60 |
| Consumer | 10 | 144 | 7 | 79 | 3 | 45 | — | — |
| Total discharged from bankruptcy | 32 | 2,084 | 19 | 644 | 13 | 300 | 3 | 60 |
| | | | | | | | | |
| Total non-PCI restructurings | 110 | $ 10,209 | 56 | $ 3,113 | 48 | $ 4,177 | 5 | $ 217 |

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| (Dollars in thousands) | Six months ended June 30, 2016 | | | | Six months ended June 30, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | All restructurings | | Restructurings with payment default | | All restructurings | | Restructurings with payment default | |
| | Number of Loans | Recorded investment at period end | Number of Loans | Recorded investment at period end | Number of Loans | Recorded investment at period end | Number of Loans | Recorded investment at period end |
| Non-PCI loans and leases | | | | | | | | |
| Interest only period provided | | | | | | | | |
| Commercial mortgage | 1 | $ 249 | 1 | $ 249 | 2 | $ 69 | — | $ — |
| Commercial and industrial | — | — | — | — | 1 | 1,872 | 1 | 1,872 |
| Total interest only | 1 | 249 | 1 | 249 | 3 | 1,941 | 1 | 1,872 |
| Loan term extension | | | | | | | | |
| Construction and land development - commercial | 1 | 401 | — | — | 1 | 212 | 1 | 212 |
| Commercial mortgage | 4 | 1,096 | — | — | 5 | 1,371 | — | — |
| Other commercial real estate | 1 | 841 | — | — | — | — | — | — |
| Commercial and industrial | — | — | 1 | — | — | — | — | — |
| Residential mortgage | 7 | 978 | 1 | 52 | — | — | — | — |
| Revolving mortgage | — | — | — | — | 1 | 9 | — | — |
| Consumer | — | — | — | — | 1 | 5 | — | — |
| Total loan term extension | 13 | 3,316 | 2 | 52 | 8 | 1,597 | 1 | 212 |
| Below market interest rate | | | | | | | | |
| Construction and land development - commercial | 6 | 414 | 3 | 227 | 5 | 296 | — | — |
| Commercial mortgage | 22 | 2,866 | 9 | 1,078 | 16 | 5,226 | 1 | 498 |
| Other commercial real estate | 1 | 498 | 1 | 12 | — | — | — | — |
| Commercial and industrial | 11 | 704 | 5 | 197 | 7 | 673 | 1 | 142 |
| Residential mortgage | 94 | 5,998 | 32 | 2,107 | 42 | 1,698 | 3 | 58 |
| Revolving mortgage | 4 | 141 | — | — | 3 | 63 | — | — |
| Construction and land development - noncommercial | — | — | — | — | 2 | 253 | — | — |
| Consumer | 3 | 20 | 1 | — | 7 | 85 | — | — |
| Other | 1 | 85 | 1 | 85 | 1 | 1,732 | — | — |
| Total below market interest rate | 142 | 10,726 | 52 | 3,706 | 83 | 10,026 | 5 | 698 |
| Discharged from bankruptcy | | | | | | | | |
| Construction and land development - commercial | — | — | 1 | 14 | — | — | — | — |
| Commercial mortgage | 2 | 283 | — | — | 1 | 622 | — | — |
| Commercial and industrial | 2 | 49 | — | — | 1 | 17 | — | — |
| Residential mortgage | 11 | 721 | 7 | 506 | 8 | 434 | — | — |
| Revolving mortgage | 25 | 1,695 | 12 | 151 | 16 | 632 | 5 | 158 |
| Construction and land development - noncommercial | — | — | — | — | — | — | — | — |
| Consumer | 25 | 290 | 10 | 95 | 4 | 48 | — | — |
| Total discharged from bankruptcy | 65 | 3,038 | 30 | 766 | 30 | 1,753 | 5 | 158 |
| Total non-PCI restructurings | 221 | $ 17,329 | 85 | $ 4,773 | 124 | $ 15,317 | 12 | $ 2,940 |

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| | Three months ended June 30, 2016 | | | | Three months ended June 30, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | All restructurings | | Restructurings with payment default | | All restructurings | | Restructurings with payment default | |
| (Dollars in thousands) | Number of loans | Recorded investment at period end | Number of loans | Recorded investment at period end | Number of loans | Recorded investment at period end | Number of loans | Recorded investment at period end |
| PCI loans | | | | | | | | |
| Below market interest rate | | | | | | | | |
| Residential mortgage | 1 | $ 48 | 1 | $ 54 | 1 | $ 60 | — | $ — |
| Total below market interest rate | 1 | 48 | 1 | 54 | 1 | 60 | — | — |
| Total PCI restructurings | 1 | $ 48 | 1 | $ 54 | 1 | $ 60 | — | $ — |

| | Six months ended June 30, 2016 | | | | Six months ended June 30, 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | All restructurings | | Restructurings with payment default | | All restructurings | | Restructurings with payment default | |
| (Dollars in thousands) | Number of loans | Recorded investment at period end | Number of loans | Recorded investment at period end | Number of loans | Recorded investment at period end | Number of loans | Recorded investment at period end |
| PCI loans | | | | | | | | |
| Below market interest rate | | | | | | | | |
| Construction and land development - commercial | 1 | $ 55 | — | $ — | — | $ — | — | $ — |
| Commercial mortgage | 3 | 2,027 | — | — | — | — | — | — |
| Residential mortgage | 1 | 48 | 1 | 54 | 8 | 545 | — | — |
| Total below market interest rate | 5 | 2,130 | 1 | 54 | 8 | 545 | — | — |
| Discharged from bankruptcy | | | | | | | | |
| Residential mortgage | — | — | — | — | 1 | 78 | — | — |
| Total discharged from bankruptcy | — | — | — | — | 1 | 78 | — | — |
| Total PCI restructurings | 5 | $ 2,130 | 1 | $ 54 | 9 | $ 623 | — | $ — |

For the three and six months ended June 30, 2016 and June 30, 2015, the recorded investment in TDRs subsequent to modification was not materially impacted by the modification since forgiveness of principal is not a restructuring option frequently used by BancShares.

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NOTE F - OTHER REAL ESTATE OWNED (OREO)

The following table explains changes in other real estate owned during the six months ended June 30, 2016 and June 30, 2015.

| (Dollars in thousands) | Covered | Noncovered | Total |
|---|---|---|---|
| Balance at December 31, 2014 | $22,982 | $ 70,454 | $93,436 |
| Additions | 5,833 | 24,558 | 30,391 |
| Sales | (12,962 ) | (34,324 ) | (47,286 ) |
| Writedowns | (857 ) | (2,436 ) | (3,293 ) |
| Transfers [1] | (2,106 ) | 2,106 | — |
| Balance at June 30, 2015 | $12,890 | $ 60,358 | $73,248 |
| | | | |
| Balance at December 31, 2015 | $6,817 | $ 58,742 | $65,559 |
| Additions | 4,734 | 16,546 | 21,280 |
| Additions acquired in the First CornerStone Bank acquisition | — | 144 | 144 |
| Sales | (781 ) | (14,728 ) | (15,509 ) |
| Writedowns | (570 ) | (3,815 ) | (4,385 ) |
| Transfers [1] | (9,716 ) | 9,716 | — |
| Balance at June 30, 2016 | $484 | $ 66,605 | $67,089 |

[1] Transfers include OREO balances associated with expired or terminated loss share agreements.

At June 30, 2016 and December 31, 2015, BancShares had $13.1 million and $16.1 million, respectively, of foreclosed residential real estate property in OREO. The recorded investment in consumer mortgage loans collateralized by residential real estate property in the process of foreclosure was $21.1 million and $15.6 million at June 30, 2016 and December 31, 2015, respectively.

NOTE G - FDIC LOSS SHARE RECEIVABLE AND PAYABLE

BancShares completed six FDIC-assisted transactions with loss share agreements during the period beginning in 2009 through 2011. Prior to its merger into BancShares, First Citizens Bancorporation, Inc. (Bancorporation) completed three FDIC-assisted transactions with loss share agreements: Georgian Bank (acquired in 2009); Williamsburg First National Bank (acquired in 2010); and Atlantic Bank & Trust (acquired in 2011).

During the second quarter of 2016, FCB entered into an agreement with the FDIC to terminate five of FCB's nine loss share agreements, including Temecula Valley Bank, Sun American Bank (SAB), Williamsburg First National Bank, Atlantic Bank & Trust, and Colorado Capital Bank (CCB). Under the terms of the agreement, FCB made a net payment of $20.1 million to the FDIC as consideration for early termination of the loss share agreements. Also, FCB wrote-off $1.5 million of the FDIC loss share receivable and released $18.2 million of the FDIC loss share payable associated with the terminated agreements. As a result, FCB recognized a $3.4 million loss on the termination of the loss share agreements.

The early termination agreement eliminated FCB's FDIC loss share payable for SAB and CCB. The remaining FDIC loss share payable balance at June 30, 2016 was $94.3 million. In conjunction with the early termination, FCB adjusted the FDIC loss share payable under the two remaining loss share agreements with clawback provisions and released other related reserves. The clawback liabilities were adjusted in order to conform to the methodology used to determine the net termination payment. The adjustment to the clawback liabilities is accounted for by management as a change in estimate. The total one-time pre-tax benefit of these adjustments was $20.0 million. The resulting positive net impact to pre-tax earnings from the early termination of the FDIC loss share agreements was $16.6 million during the second quarter of 2016. See Note L for further information related to FCB's payable to the FDIC for loss share agreements.

The remaining receivable from the FDIC for the UWB, Venture Bank (VB) and Georgian Bank (GB) loss share agreements is measured separately from the related covered assets and is recorded at fair value at the acquisition date using projected cash flows based on the expected reimbursements for losses and the applicable loss share percentages. Amortization reflects changes in the FDIC loss share receivable due to improvements in expected cash flows that are being recognized over the remaining term of the loss share agreement. Cash payments to FDIC represent the net impact of loss share loan recoveries, charge-offs and related expenses as calculated and reported in FDIC loss share certificates. Post-acquisition adjustments represent the net change in loss estimates related to acquired loans and covered OREO as a result of changes in expected cash flows and the ALLL related to those covered loans. At the beginning of the second quarter of 2016, the loss share protection expired for non-

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single family residential loans acquired from UWB. As of June 30, 2016, loss share protection has expired or has been terminated for all non-single family residential loans. Loss share protection remains only for single family residential loans acquired from UWB, VB and GB.

The following table provides changes in the receivable from the FDIC for the three and six months ended June 30, 2016 and June 30, 2015.

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Beginning balance | $7,474 | $21,340 | $4,054 | $28,701 |
| Amortization | (867 ) | (1,461 ) | (3,242 ) | (6,492 ) |
| Net cash payments to FDIC | 3,631 | 5,128 | 13,502 | 10,890 |
| Post-acquisition adjustments | (3,495 ) | (19,199 ) | (7,571 ) | (27,291 ) |
| Termination of FDIC loss share agreements | (1,462 ) | — | (1,462 ) | — |
| Ending balance | $5,281 | $5,808 | $5,281 | $5,808 |

NOTE H - MORTGAGE SERVICING RIGHTS

Our portfolio of residential mortgage loans serviced for third parties was $2.24 billion and $2.15 billion as of June 30, 2016 and December 31, 2015, respectively. These loans were originated by BancShares and sold to third parties on a non-recourse basis with servicing rights retained. These retained servicing rights are recorded as a servicing asset on the Consolidated Balance Sheets and are initially recorded at fair value.

The activity of the servicing asset for the three and six months ended June 30, 2016 and 2015 is presented in the following table:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Beginning balance | $17,186 | $16,436 | $19,351 | $16,688 |
| Servicing rights originated | 1,351 | 1,927 | 2,328 | 2,589 |
| Amortization | (1,333 ) | (1,110 ) | (2,601 ) | (1,962 ) |
| Valuation allowance (provision) reversal | (380 ) | 909 | (2,254 ) | 847 |
| Ending balance | $16,824 | $18,162 | $16,824 | $18,162 |

The following table presents the activity in the servicing asset valuation allowance for the three and six months ended June 30, 2016 and 2015:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Beginning balance | $1,969 | $912 | $95 | $850 |
| Valuation allowance provision (reversal) | 380 | (909 ) | 2,254 | (847 ) |
| Ending balance | $2,349 | $3 | $2,349 | $3 |

As of June 30, 2016, the carrying value of BancShares' mortgage servicing rights was $16.8 million. Contractually specified mortgage servicing fees, late fees, and ancillary fees earned for the three months ended June 30, 2016 and 2015 were $1.5 million and $1.4 million, respectively. For the six months ended June 30, 2016 and 2015, contractually specified mortgage servicing fees, late fees, and ancillary fees earned were $2.9 million and $2.7 million, respectively, and are included in mortgage income in the Consolidated Statements of Income.
The amortization expense related to mortgage servicing rights, included as a reduction of mortgage income in the Consolidated Statements of Income, was $1.3 million and $1.1 million for the three months ended June 30, 2016 and

2015, respectively. For the six months ended June 30, 2016 and 2015, amortization expense related to mortgage servicing rights was $2.6 million and $2.0 million, respectively. Mortgage income included an impairment of $380 thousand and an impairment reversal of $909 thousand for the three months ended June 30, 2016 and 2015, respectively. For the six months ended June 30, 2016 and 2015, mortgage income included an impairment of $2.3 million and an impairment reversal of $847 thousand, respectively.

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Valuation of mortgage servicing rights is performed using a pooling methodology. Similar loans are pooled together and evaluated on a discounted earnings basis to determine the present value of future earnings. Key economic assumptions used to value mortgage servicing rights as of June 30, 2016 and December 31, 2015 were as follows:

| | June 30, 2016 | December 31, 2015 |
|---|---|---|
| Discount rate - conventional fixed loans | 8.47 % | 9.31 % |
| Discount rate - all loans excluding conventional fixed loans | 9.47 % | 10.31 % |
| Weighted average constant prepayment rate | 14.79 % | 11.01 % |
| Weighted average cost to service a loan | $62.75 | $ 56.61 |

NOTE I - REPURCHASE AGREEMENTS

BancShares utilizes securities sold under agreements to repurchase to facilitate the needs of customers and secure long-term funding needs. Repurchase agreements are transactions whereby BancShares offers to sell to a counterparty an undivided interest in an eligible security at an agreed upon purchase price, and which obligates BancShares to repurchase the security on an agreed upon date at an agreed upon repurchase price plus interest at an agreed upon rate. Securities sold under agreements to repurchase are recorded at the amount of cash received in connection with the transaction and are generally reflected as short-term borrowings on the Consolidated Balance Sheets.

BancShares monitors collateral levels on a continuous basis and maintains records of each transaction specifically describing the applicable security and the counterparty’s fractional interest in that security, and segregates the security from general assets in accordance with regulations governing custodial holdings of securities. The primary risk with repurchase agreements is market risk associated with the investments securing the transactions, as additional collateral may be required based on fair value changes of the underlying investments. Securities pledged as collateral under repurchase agreements are maintained with safekeeping agents. The carrying value of available for sale investment securities pledged as collateral under repurchase agreements was $846.9 million and $722.0 million at June 30, 2016 and December 31, 2015, respectively.

The remaining contractual maturity of the securities sold under agreements to repurchase by class of collateral pledged included in the Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015 is presented in the following tables.

| | June 30, 2016 | | | | |
|---|---|---|---|---|---|
| | Remaining Contractual Maturity of the Agreements | | | | |
| (Dollars in thousands) | Overnight and continuous | Up to 30 Days | 30-90 Days | Greater than 90 Days | Total |
| Repurchase agreements | | | | | |
| U.S. Treasury | $726,011 | $ — | $ — | $25,720 | $751,731 |
| Government agency | — | — | — | 4,280 | 4,280 |
| Total borrowings | $726,011 | $ — | $ — | $30,000 | $756,011 |
| Gross amount of recognized liabilities for repurchase agreements | | | | | $756,011 |

| | December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | Remaining Contractual Maturity of the Agreements | | | | |
| | Overnight and continuous | Up to 30 Days | 30-90 Days | Greater than 90 Days | Total |
| Repurchase agreements | | | | | |
| U.S. Treasury | $592,182 | $ — | $ — | $25,724 | $617,906 |

| | | | | | |
|---|---|---|---|---|---|
| Government agency | — | — | — | 4,276 | 4,276 |
| Total borrowings | $592,182 | $ — | $ — | $30,000 | $622,182 |
| Gross amount of recognized liabilities for repurchase agreements | | | | | $622,182 |

NOTE J - ESTIMATED FAIR VALUES

Fair value estimates are intended to represent the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. Where there is no active market for a financial instrument, BancShares has made estimates using discounted cash flows or other valuation techniques. Inputs to these valuation methods are subjective in nature, involve uncertainties and require significant judgment and therefore cannot be determined with precision. Accordingly, the derived fair value estimates presented below are not necessarily indicative of the amounts BancShares could realize in a current market exchange.

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ASC 820, Fair Value Measurements and Disclosures, indicates that assets and liabilities are recorded at fair value according to a fair value hierarchy comprised of three levels. The levels are based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The level within the fair value hierarchy for an asset or liability is based on the highest level of input that is significant to the fair value measurement (with level 1 considered highest and level 3 considered lowest). A brief description of each level follows:

- Level 1 values are based on quoted prices for identical instruments in active markets.
- Level 2 values are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 values are generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation techniques include the use of discounted cash flow models and similar techniques.

Valuation adjustments, such as those pertaining to counterparty and BancShares' own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing does not accurately reflect the counterparty's credit quality. As determined by BancShares management, liquidity valuation adjustments may be made to the fair value of certain assets to reflect the uncertainty in the pricing and trading of the instruments when recent market transactions for identical or similar instruments are not observed.

BancShares management reviews any changes to its valuation methodologies to ensure they are appropriate and justified, and refines valuation methodologies as more market-based data becomes available. Transfers between levels of the fair value hierarchy are recognized at the end of the reporting period.

The methodologies used to estimate the fair value of financial assets and financial liabilities are discussed below:
Investment securities available for sale. U.S.Treasury, government agency, mortgage-backed securities, municipal securities, corporate bonds and trust preferred securities are generally measured at fair value using a third party pricing service or recent comparable market transactions in similar or identical securities and are classified as level 2 instruments. Equity securities are measured at fair value using observable closing prices and the valuation also considers the amount of market activity by examining the trade volume of each security. Equity securities are classified as Level 1 if they are traded on a heavily active market and as Level 2 if the observable closing price is from a less than active market.

Loans held for sale. Certain residential real estate loans are originated to be sold to investors, which are carried at fair value as BancShares elected the fair value option on loans held for sale. The fair value is based on quoted market prices for similar types of loans. Accordingly, the inputs used to calculate fair value of residential real estate loans held for sale are classified as level 2 inputs.

Net loans and leases (PCI and Non-PCI). Fair value is estimated based on discounted future cash flows using the current interest rates at which loans with similar terms would be made to borrowers of similar credit quality. An additional valuation adjustment is made for liquidity. The inputs used in the fair value measurements for loans and leases are considered level 3 inputs.

FHLB stock. The carrying amount of FHLB stock is a reasonable estimate of fair value as these securities are not readily marketable and are evaluated for impairment based on the ultimate recoverability of the par value. BancShares considers positive and negative evidence, including the profitability and asset quality of the issuer, dividend payment history and recent redemption experience, when determining the ultimate recoverability of the par value. BancShares believes its investment in FHLB stock is ultimately recoverable at par. The inputs used in the fair value measurement

for the FHLB stock are considered level 2 inputs.

Mortgage servicing rights. Mortgage servicing rights are carried at the lower of amortized cost or market and are, therefore, carried at fair value only when fair value is less than the asset cost. The fair value of mortgage servicing rights is performed using a pooling methodology. Similar loans are pooled together and a model that relies on discount rates, estimates of prepayment rates and the weighted average cost to service the loans is used to determine the fair value. The inputs used in the fair value measurement for mortgage servicing rights are considered level 3 inputs.

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Deposits. For non-time deposits, carrying value is a reasonable estimate of fair value. The fair value of time deposits is estimated by discounting future cash flows using the interest rates currently offered for deposits of similar remaining maturities. The inputs used in the fair value measurement for deposits are considered level 2 inputs.

Long-term obligations. For fixed rate trust preferred securities, the fair values are determined based on recent trades of the actual security if available. For other long-term obligations, fair values are estimated by discounting future cash flows using current interest rates for similar financial instruments. The inputs used in the fair value measurement for long-term obligations are considered level 2 inputs.

Payable to the FDIC for loss share agreements. The fair value of the payable to the FDIC for loss share agreements is determined by the projected cash flows based on expected payments to the FDIC in accordance with the loss share agreements. Cash flows are discounted using current discount rates to reflect the timing of the estimated amounts due to the FDIC. The inputs used in the fair value measurement for the payable to the FDIC are considered level 3 inputs.

Interest rate swap. Under the terms of the previous cash flow hedge, BancShares paid a fixed payment to the counterparty in exchange for receipt of a variable payment that was determined based on the three-month LIBOR rate. The fair value of the cash flow hedge was, therefore, based on projected LIBOR rates for the duration of the hedge, values that, while observable in the market, were subject to adjustment due to pricing considerations for the specific instrument. The interest rate swap agreement expired in June 2016. The inputs used in the fair value measurement of the interest rate swap were considered level 2 inputs.

Off-balance-sheet commitments and contingencies. Carrying amounts are reasonable estimates of the fair values for such financial instruments. Carrying amounts include unamortized fee income and, in some cases, reserves for any credit losses from those financial instruments. These amounts are not material to BancShares' financial position.

For all other financial assets and financial liabilities, the carrying value is a reasonable estimate of the fair value as of June 30, 2016 and December 31, 2015. The carrying value and fair value for these assets and liabilities are equivalent because they are relatively short term in nature and there is no interest rate or credit risk that would cause the fair value to differ from the carrying value. Cash and due from banks is classified on the fair value hierarchy as level 1. Overnight investments, income earned not collected, short-term borrowings and accrued interest payable are considered level 2. Lastly, the receivable from the FDIC for loss share agreements is designated as level 3.

| | June 30, 2016 | | December 31, 2015 | |
|---|---|---|---|---|
| (Dollars in thousands) | Carrying value | Fair value | Carrying value | Fair value |
| Cash and due from banks | $507,569 | $ 507,569 | $534,086 | $ 534,086 |
| Overnight investments | 2,276,080 | 2,276,080 | 2,063,132 | 2,063,132 |
| Investment securities available for sale | 6,557,580 | 6,557,580 | 6,861,293 | 6,861,293 |
| Investment securities held to maturity | 156 | 165 | 255 | 265 |
| Loans held for sale | 84,795 | 84,795 | 59,766 | 59,766 |
| Net loans and leases | 20,534,563 | 20,089,558 | 20,033,774 | 19,353,325 |
| Receivable from the FDIC for loss share agreements | 5,281 | 5,281 | 4,054 | 4,054 |
| Income earned not collected | 71,916 | 71,916 | 70,036 | 70,036 |
| Federal Home Loan Bank stock | 43,495 | 43,495 | 37,511 | 37,511 |
| Mortgage servicing rights | 16,824 | 16,884 | 19,351 | 19,495 |
| Deposits | 27,257,774 | 26,819,080 | 26,930,755 | 26,164,472 |
| Short-term borrowings | 728,562 | 728,562 | 594,733 | 594,733 |
| Long-term obligations | 850,504 | 888,551 | 704,155 | 718,102 |
| Payable to the FDIC for loss share agreements | 94,252 | 100,339 | 126,453 | 131,894 |
| Accrued interest payable | 6,337 | 6,337 | 5,713 | 5,713 |

| | | | | |
|---|---|---|---|---|
| Interest rate swap [1] | — | — | 1,429 | 1,429 |

[1] The interest rate swap agreement expired in June 2016.

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Among BancShares' assets and liabilities, investment securities available for sale, loans held for sale and interest rates swaps accounted for as cash flow hedges are reported at their fair values on a recurring basis. For assets and liabilities carried at fair value on a recurring basis, the following table provides fair value information as of June 30, 2016 and December 31, 2015.

| | June 30, 2016 | | | |
|---|---|---|---|---|
| | | Fair value measurements using: | | |
| (Dollars in thousands) | Fair value | Level 1 inputs | Level 2 inputs | Level 3 inputs |
| Assets measured at fair value | | | | |
| Investment securities available for sale | | | | |
| U.S. Treasury | $1,541,479 | $— | $1,541,479 | $ — |
| Government agency | 355,545 | — | 355,545 | — |
| Mortgage-backed securities | 4,535,831 | — | 4,535,831 | — |
| Equity securities | 81,390 | 23,197 | 58,193 | — |
| Corporate bonds | 41,385 | — | 41,385 | — |
| Other | 1,950 | — | 1,950 | — |
| Total investment securities available for sale | $6,557,580 | $23,197 | $6,534,383 | $ — |
| Loans held for sale | $84,795 | $— | $84,795 | $ — |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | | Fair value measurements using: | | |
| | Fair value | Level 1 inputs | Level 2 inputs | Level 3 inputs |
| Assets measured at fair value | | | | |
| Investment securities available for sale | | | | |
| U.S. Treasury | $1,674,882 | $— | $1,674,882 | $ — |
| Government agency | 498,660 | — | 498,660 | — |
| Mortgage-backed securities | 4,668,198 | — | 4,668,198 | — |
| Equity securities | 8,893 | 1,668 | 7,225 | — |
| Corporate bonds | 8,500 | — | 8,500 | — |
| Other | 2,160 | — | 2,160 | — |
| Total investment securities available for sale | $6,861,293 | $1,668 | $6,859,625 | $ — |
| Loans held for sale | $59,766 | $— | $59,766 | $ — |
| Liabilities measured at fair value | | | | |
| Interest rate swaps accounted for as cash flow hedges | $1,429 | $— | $1,429 | $ — |

There were no transfers between levels during the three or six months ended June 30, 2016.

Fair Value Option

BancShares has elected the fair value option for residential real estate loans held for sale. This election reduces certain timing differences in the Consolidated Statement of Income and better aligns with the management of the portfolio from a business perspective.

The following table summarizes the difference between the aggregate fair value and the aggregate unpaid principal balance for residential real estate loans held for sale measured at fair value as of June 30, 2016 and December 31, 2015.

| | June 30, 2016 | |
|---|---|---|
| (Dollars in thousands) | | Difference |

| | Fair Value | Aggregate Unpaid Principal Balance | |
|---|---|---|---|
| Loans held for sale | $84,795 | $ 82,280 | $ 2,515 |

| | December 31, 2015 | | |
|---|---|---|---|
| | Fair Value | Aggregate Unpaid Principal Balance | Difference |
| Loans held for sale | $59,766 | $ 58,890 | $ 876 |

No loans held for sale were 90 or more days past due or on nonaccrual status as of June 30, 2016 or December 31, 2015.

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The changes in fair value for residential real estate loans held for sale for which we elected the fair value option are included in the table below for the three and six months ended June 30, 2016 and 2015.

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Gains (losses) from fair value changes on loans held for sale | $876 | $(461) | $1,639 | $(31) |

The changes in fair value in the table above are recorded as a component of mortgage income on the Consolidated Statements of Income.

Certain other assets are adjusted to their fair value on a nonrecurring basis, including impaired loans, OREO, goodwill, which are periodically tested for impairment, and mortgage servicing rights, which are carried at the lower of amortized cost or market. Non-impaired loans held for investment, deposits, short-term borrowings and long-term obligations are not reported at fair value.

Impaired loans are deemed to be at fair value if an associated allowance or current period charge-off has been recorded. The value of impaired loans is determined by either collateral valuations or discounted present value of the expected cash flow calculations. Collateral values are determined using appraisals or other third-party value estimates of the subject property with discounts generally between 10 and 14 percent applied for estimated holding and selling costs and other external factors that may impact the marketability of the property. Expected cash flows are determined using expected payment information at the individual loan level, discounted using the effective interest rate. The effective interest rate generally ranges between 2 and 16 percent.

OREO is measured and reported at fair value using collateral valuations. Collateral values are determined using appraisals or other third-party value estimates of the subject property with discounts generally between 10 and 14 percent applied for estimated holding and selling costs and other external factors that may impact the marketability of the property. Changes to the value of the assets between scheduled valuation dates are monitored through continued communication with brokers and monthly reviews by the asset manager assigned to each asset. If there are any significant changes in the market or the subject property, valuations are adjusted or new appraisals ordered to ensure the reported values reflect the most current information. OREO that has been acquired or written down in the current year is deemed to be at fair value and included in the table below.

Mortgage servicing rights are carried at the lower of cost or market and are, therefore, carried at fair value only when fair value is less than the amortized asset cost. The fair value of mortgage servicing rights is performed using a pooling methodology. Similar loans are pooled together and a discounted cash flow model, which takes into consideration discount rates, prepayment rates, and the weighted average cost to service the loans, is used to determine the fair value.

For financial assets and liabilities carried at fair value on a nonrecurring basis, the following table provides fair value information as of June 30, 2016 and December 31, 2015.

| | June 30, 2016 | | | |
|---|---|---|---|---|
| | | Fair value measurements using: | | |
| (Dollars in thousands) | Fair value | Level 1 inputs | Level 2 inputs | Level 3 inputs |
| Impaired loans | $60,459 | $— | $— | $60,459 |
| Other real estate not covered under loss share agreements remeasured during current year | 37,635 | — | — | 37,635 |
| Other real estate covered under loss share agreements remeasured during current year | 295 | — | — | 295 |
| Mortgage servicing rights | 16,473 | — | — | 16,473 |

December 31, 2015

| | Fair value | Fair value measurements using: Level 1 inputs | Level 2 inputs | Level 3 inputs |
|---|---|---|---|---|
| Impaired loans | $ 64,197 | $ — | $ — | $ 64,197 |
| Other real estate not covered under loss share agreements remeasured during current year | 44,571 | — | — | 44,571 |
| Other real estate covered under loss share agreements remeasured during current year | 4,403 | — | — | 4,403 |
| Mortgage servicing rights | 17,997 | — | — | 17,997 |

No financial liabilities were carried at fair value on a nonrecurring basis as of June 30, 2016 and December 31, 2015.

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NOTE K - EMPLOYEE BENEFIT PLANS

BancShares sponsors noncontributory defined benefit pension plans for its qualifying employees (BancShares Plan) and legacy Bancorporation employees (Bancorporation Plan). Net periodic benefit cost is a component of employee benefits expense.

BancShares Plan

For the three and six months ended June 30, 2016 and 2015, the components of net periodic benefit cost are as follows:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Service cost | $3,090 | $3,603 | $6,310 | $7,203 |
| Interest cost | 7,269 | 6,750 | 14,450 | 13,498 |
| Expected return on assets | (9,167 ) | (8,299 ) | (18,326) | (16,594) |
| Amortization of prior service cost | 52 | 52 | 104 | 105 |
| Amortization of net actuarial loss | 1,830 | 2,835 | 3,430 | 5,668 |
| Net periodic benefit cost | $3,074 | $4,941 | $5,968 | $9,880 |

Bancorporation Plan

For the three and six months ended June 30, 2016 and 2015, the components of net periodic benefit cost are as follows:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| (Dollars in thousands) | 2016 | 2015 | 2016 | 2015 |
| Service cost | $633 | $932 | $1,283 | $1,865 |
| Interest cost | 1,713 | 1,627 | 3,388 | 3,255 |
| Expected return on assets | (2,771) | (2,870) | (5,550 ) | (5,739 ) |
| Net periodic benefit cost | $(425) | $(311) | $(879 ) | $(619 ) |

No contributions were made during the three and six months ended June 30, 2016 to the BancShares or Bancorporation pension plans. BancShares does not expect to make any contributions to either of the defined benefit pension plans during 2016.

NOTE L - COMMITMENTS AND CONTINGENCIES

To meet the financing needs of its customers, BancShares and its subsidiaries have financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, standby letters of credit and recourse obligations on mortgage loans sold. These instruments involve elements of credit, interest rate or liquidity risk.

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. Established credit standards control the credit risk exposure associated with these commitments. In some cases, BancShares requires that collateral be pledged to secure the commitment, including cash deposits, securities and other assets. At June 30, 2016, BancShares had unused commitments that were $8.26 billion, compared to $7.95 billion at December 31, 2015. Total unfunded commitments relating to investments in affordable housing projects was $54.7 million and $41.8 million at June 30, 2016 and December 31, 2015, respectively, and are included in other liabilities on BancShares' Consolidated Balance Sheets. Affordable housing project investments were $107.4 million and $85.6 million at June 30, 2016 and December 31, 2015, respectively, and are included in other assets on the Consolidated Balance Sheets.

Standby letters of credit are commitments guaranteeing performance of a customer to a third party. Those commitments are primarily issued to support public and private borrowing arrangements. To mitigate its risk,

BancShares' follows its credit policies in the issuance of standby letters of credit. At June 30, 2016 and December 31, 2015, BancShares had standby letters of credit amounting to $82.3 million and $77.9 million, respectively. The credit risk related to the issuance of these letters of credit is essentially the same as that involved in extending loans to clients and, therefore, these letters of credit are collateralized when necessary.

Pursuant to standard representations and warranties relating to residential mortgage loan sales, contingent obligations exist for various events that may occur following the loan sale. If underwriting or documentation deficiencies are discovered at any point in the life of the loan or if the loan fails to perform per the terms of the loan purchase agreement, typically within 180 days from the date of sale, the investor may require BancShares to repurchase the loan or to repay a portion of the sale proceeds. Other liabilities included reserves of $3.0 million as of June 30, 2016 and December 31, 2015 for estimated losses arising from these standard representation and warranty provisions.

BancShares recorded a receivable from the FDIC totaling $5.3 million and $4.1 million as of June 30, 2016 and December 31, 2015, respectively, for the expected reimbursement of losses on assets covered under various loss share agreements. These loss share agreements impose certain obligations on us that, in the event of noncompliance, could result in the delay or disallowance of some or all of our rights under those agreements. Requests for reimbursement are subject to FDIC review and may be delayed or disallowed for noncompliance. The loss share agreements are subject to interpretation by both the FDIC and BancShares, and disagreements may arise regarding coverage of losses, expenses and contingencies. See Note G for additional information on the receivable from the FDIC regarding the early termination of five loss share agreements during the second quarter of 2016.

The loss share agreements for two FDIC-assisted transactions include provisions related to payments that may be owed to the FDIC at the termination of the agreements (clawback liability). The clawback liability represents a payment by BancShares to the FDIC if actual cumulative losses on acquired covered assets are lower than the cumulative losses originally estimated by the FDIC at the time of acquisition. The clawback liability is estimated by discounting estimated future payments and is recorded in the Consolidated Balance Sheets as a payable to the FDIC under the relevant loss share agreements. As of June 30, 2016 and December 31, 2015, the estimated clawback liability was $94.3 million and $126.5 million, respectively. See Note G for additional information on the clawback liability regarding the early termination of the five loss share agreements during the second quarter of 2016.

BancShares entered into forward-starting advances with the FHLB of Atlanta in June 2016 to receive $200.0 million of fixed rate long-term funding. There are two advances of $100.0 million each scheduled to fund in June 2018 with maturity dates of June 2026 and 2028.

BancShares and various subsidiaries have been named as defendants in legal actions arising from their normal business activities in which damages in various amounts are claimed. Although the amount of any ultimate liability with respect to such matters cannot be determined, in the opinion of management, any such liability will not have a material effect on BancShares' consolidated financial statements.

NOTE M - DERIVATIVES

BancShares had an interest rate swap entered into during 2011 that qualified as a cash flow hedge under GAAP. BancShares' interest rate swap agreement expired in June 2016. At December 31, 2015, the fair value of the outstanding derivative was included in other liabilities in the consolidated balance sheet, and the net change in fair value is included in the consolidated statements of cash flows under the caption net change in other liabilities.

The following table provides the notional amount of the interest rate swap and the fair value of the liability as of December 31, 2015.

| | December 31, 2015 | |
|---|---|---|
| (Dollars in thousands) | Notional amount | Estimated fair value of liability |
| 2011 interest rate swap hedging variable rate exposure on trust preferred securities 2011-2016 | $93,500 | $ 1,429 |

The interest rate swap was used for interest rate risk management purposes and converted variable-rate exposure on outstanding debt to a fixed rate. The interest rate swap had a notional amount of $93.5 million, representing the amount of variable rate trust preferred capital securities issued during 2006 and still outstanding at the swap inception date. The interest rate swap hedged interest payments through June 2016 and required fixed-rate payments by BancShares at 5.50 percent in exchange for variable-rate payments of 175 basis points above the three-month LIBOR, which was equal to the interest paid to the holders of the trust preferred capital securities. Settlement of the swap occurred quarterly. At December 31, 2015, collateral with a fair value of $2.0 million was pledged to secure the existing obligation under the interest rate swap.

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, representing the excess of the cumulative change in the fair value of the derivative over the cumulative change in expected future discounted cash flows on the hedged transaction, is recorded in the consolidated statement of income. BancShares' interest rate swap was fully effective since inception. Therefore, changes in the fair value of the interest rate swap had no impact on net income. For the three months ended June 30, 2016 and 2015, BancShares recognized interest expense of $745 thousand and $830 thousand, and for the six months ended June 30, 2016 and 2015, BancShares recognized interest expense of $1.5 million and $1.7 million, respectively, resulting from incremental interest paid to the interest rate swap counterparty, none of which related to ineffectiveness.

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NOTE N - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) included the following as of June 30, 2016 and December 31, 2015:

| | June 30, 2016 | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Accumulated other comprehensive income (loss) | Deferred tax expense (benefit) | Accumulated other comprehensive income (loss), net of tax | Accumulated other comprehensive loss | Deferred tax benefit | Accumulated other comprehensive loss, net of tax |
| Unrealized gains (losses) on investment securities available for sale, net | $50,548 | $19,335 | $ 31,213 | $(24,504 ) | $(9,379 ) | $ (15,125 ) |
| Unrealized loss on cash flow hedge | — | — | — | (1,429 ) | (537 ) | (892 ) |
| Funded status of defined benefit plans | (74,885 ) | (28,645 ) | (46,240 ) | (78,419 ) | (29,996 ) | (48,423 ) |
| Total | $(24,337) | $(9,310 ) | $ (15,027 ) | $(104,352) | $(39,912) | $ (64,440 ) |

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The following table highlights changes in accumulated other comprehensive income (loss) by component for the three and six months ended June 30, 2016 and June 30, 2015:

| | Three months ended June 30, 2016 | | | |
|---|---|---|---|---|
| (Dollars in thousands) | Unrealized gains (losses) on available for sale securities[1] | Gains (losses) on cash flow hedges[1] | Defined benefit pension items[1] | Total |
| Beginning balance | $24,034 | $(455) | $(47,403) | $(23,824) |
| Other comprehensive income before reclassifications | 14,915 | 455 | — | 15,370 |
| Amounts reclassified from accumulated other comprehensive income (loss) | (7,736) | — | 1,163 | (6,573) |
| Net current period other comprehensive income | 7,179 | 455 | 1,163 | 8,797 |
| Ending balance | $31,213 | $— | $(46,240) | $(15,027) |

| | Three months ended June 30, 2015 | | | |
|---|---|---|---|---|
| | Unrealized gains (losses) on available for sale securities[1] | Gains (losses) on cash flow hedges[1] | Defined benefit pension items[1] | Total |
| Beginning balance | $20,551 | $(2,310) | $(53,652) | $(35,411) |
| Other comprehensive (loss) income before reclassifications | (17,874) | 435 | — | (17,439) |
| Amounts reclassified from accumulated other comprehensive income (loss) | (73) | — | 1,764 | 1,691 |
| Net current period other comprehensive (loss) income | (17,947) | 435 | 1,764 | (15,748) |
| Ending balance | $2,604 | $(1,875) | $(51,888) | $(51,159) |

| | Six months ended June 30, 2016 | | | |
|---|---|---|---|---|
| | Unrealized gains (losses) on available for sale securities[1] | Gains (losses) on cash flow hedges[1] | Defined benefit pension items[1] | Total |
| Beginning balance | $(15,125) | $(892) | $(48,423) | $(64,440) |
| Other comprehensive income before reclassifications | 56,932 | 892 | — | 57,824 |
| Amounts reclassified from accumulated other comprehensive (loss) income | (10,594) | — | 2,183 | (8,411) |
| Net current period other comprehensive income | 46,338 | 892 | 2,183 | 49,413 |
| Ending balance | $31,213 | $— | $(46,240) | $(15,027) |

| | Six months ended June 30, 2015 | | | |
|---|---|---|---|---|
| | Unrealized gains (losses) on | Gains (losses) on cash flow | Defined benefit pension items[1] | Total |

| | available for sale securities[1] | hedges[1] | | |
|---|---|---|---|---|
| Beginning balance | $5,098 | $(2,664) | $(55,415) | $(52,981) |
| Other comprehensive income before reclassifications | 728 | 789 | — | 1,517 |
| Amounts reclassified from accumulated other comprehensive income (loss) | (3,222) | — | 3,527 | 305 |
| Net current period other comprehensive (loss) income | (2,494) | 789 | 3,527 | 1,822 |
| Ending balance | $2,604 | $(1,875) | $(51,888) | $(51,159) |

[1] All amounts are net of tax. Amounts in parentheses indicate debits.

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The following table presents the amounts reclassified from accumulated other comprehensive (loss) income and the line item affected in the statement where net income is presented for the three and six months ended June 30, 2016 and June 30, 2015:

| (Dollars in thousands) | Three months ended June 30, 2016 | |
|---|---|---|
| Details about accumulated other comprehensive income (loss) | Amounts reclassified from accumulated other comprehensive income (loss)[1] | Affected line item in the statement where net income is presented |
| Unrealized gains and losses on available for sale securities | $12,529 | Securities gains |
| | (4,793 ) | Income taxes |
| | $7,736 | Net income |
| Amortization of defined benefit pension items | | |
| Prior service costs | $(52 ) | Employee benefits |
| Actuarial losses | (1,830 ) | Employee benefits |
| | (1,882 ) | Employee benefits |
| | 719 | Income taxes |
| | $(1,163 ) | Net income |
| Total reclassifications for the period | $6,573 | |

| | Three months ended June 30, 2015 | |
|---|---|---|
| Details about accumulated other comprehensive income (loss) | Amounts reclassified from accumulated other comprehensive income (loss)[1] | Affected line item in the statement where net income is presented |
| Unrealized gains and losses on available for sale securities | $147 | Securities gains |
| | (74 ) | Income taxes |
| | $73 | Net income |
| Amortization of defined benefit pension items | | |
| Prior service costs | $(52 ) | Employee benefits |
| Actuarial losses | (2,835 ) | Employee benefits |
| | (2,887 ) | Employee benefits |
| | 1,123 | Income taxes |
| | $(1,764 ) | Net income |
| Total reclassifications for the period | $(1,691 ) | |

| | Six months ended June 30, 2016 | |
|---|---|---|
| Details about accumulated other comprehensive income (loss) | Amount reclassified from | Affected line item in the statement where net income is presented |

| | accumulated other comprehensive income (loss)[1] | |
|---|---|---|
| Unrealized gains and losses on available for sale securities | $17,157 | Securities gains |
| | (6,563 ) | Income taxes |
| | $10,594 | Net income |
| Amortization of defined benefit pension items | | |
| Prior service costs | $(104 ) | Employee benefits |
| Actuarial losses | (3,430 ) | Employee benefits |
| | (3,534 ) | Employee benefits |
| | 1,351 | Income taxes |
| | $(2,183 ) | Net income |
| Total reclassifications for the period | $8,411 | |

| | Six months ended June 30, 2015 | |
|---|---|---|
| Details about accumulated other comprehensive income (loss) | Amount reclassified from accumulated other comprehensive income (loss)[1] | Affected line item in the statement where net income is presented |
| Unrealized gains and losses on available for sale securities | $5,273 | Securities gains |
| | (2,051 ) | Income taxes |
| | $3,222 | Net income |
| Amortization of defined benefit pension items | | |
| Prior service costs | $(105 ) | Employee benefits |
| Actuarial losses | (5,668 ) | Employee benefits |
| | (5,773 ) | Employee benefits |
| | 2,246 | Income taxes |
| | $(3,527 ) | Net income |
| Total reclassifications for the period | $(305 ) | |

[1] Amounts in parentheses indicate debits to profit/loss.

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

Management’s discussion and analysis (MD&A) of earnings and related financial data are presented to assist in understanding the financial condition and results of operations of First Citizens BancShares, Inc. and Subsidiaries (BancShares). This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and related notes presented within this report along with our financial statements and related MD&A of financial condition and results of operations included in our 2015 Annual Report on Form 10-K. Intercompany accounts and transactions have been eliminated. Although certain amounts for prior years have been reclassified to conform to statement presentations for 2016, the reclassifications had no material effect on shareholders’ equity or net income as previously reported. Unless otherwise noted, the terms "we," "us" and "BancShares" refer to the consolidated financial position and consolidated results of operations for BancShares.

### EXECUTIVE OVERVIEW

BancShares’ earnings and cash flows are primarily derived from commercial and retail banking activities. We gather deposits from retail and commercial customers and also secure funding through various non-deposit sources. We invest the liquidity generated from these funding sources in interest-earning assets, including loans and leases, investment securities and overnight investments. We also invest in bank premises, hardware, software, furniture and equipment used to conduct our commercial and retail banking business. We provide treasury services products, cardholder and merchant services, wealth management services and various other products and services typically offered by commercial banks.

BancShares conducts its banking operations through its wholly-owned subsidiary First-Citizens Bank & Trust Company (FCB), a state-chartered bank organized under the laws of the state of North Carolina.

Management has embarked on several strategic initiatives to better position the company to counter challenges to generate earnings and shareholder value presented by the interest rate environment. The initiatives focus on core revenue growth through broader products and services, control of noninterest expenses, optimization of our branch network, and further enhancements to our technology. Additionally, we continue to pursue strategic acquisitions and mergers to expand our customer base and increase efficiency and productivity. Refer to our Form 10-K for the year ended December 31, 2015 for further discussion of our strategy.

### Significant Events in 2016

On June 14, 2016, FCB entered into an agreement with the FDIC to terminate five of FCB's nine loss share agreements with the FDIC, including Temecula Valley Bank (TVB), Sun American Bank (SAB), Williamsburg First National Bank (WFNB), Atlantic Bank & Trust (ABT), and Colorado Capital Bank (CCB). Under the terms of the agreement, FCB made a net payment of $20.1 million to the FDIC as consideration for early termination of the loss share agreements. The early termination resulted in a one-time expense of $3.4 million during the second quarter of 2016. In conjunction with the early termination, FCB adjusted its clawback liabilities under the two remaining loss share agreements with clawback provisions and released other related reserves. The clawback liabilities were adjusted in order to conform to the methodology used to determine the net termination payment. The total one-time pre-tax benefit of these adjustments was $20.0 million. The resulting positive net impact to pre-tax earnings from the early termination of the FDIC loss share agreements was $16.6 million during the second quarter of 2016.

On May 19, 2016, FCB entered into a definitive merger agreement with Cordia Bancorp Inc. (Cordia). Cordia had total assets of $347.8 million at March 31, 2016. The agreement provides for the acquisition by FCB of Midlothian, Virginia-based Cordia and its bank subsidiary, Bank of Virginia. Under the terms of the agreement, cash consideration of $5.15 will be paid to Cordia's shareholders in exchange for each of their shares of Cordia's common stock. Total consideration is estimated to be $35.0 million based on Cordia's common stock outstanding at March 31, 2016. The agreement has been approved by the Board of Directors of both companies. The transaction is expected to close no later than the fourth quarter of 2016, subject to the receipt of regulatory approvals and the approval of Cordia's shareholders.

On May 6, 2016, FCB entered into an agreement with the Federal Deposit Insurance Corporation (FDIC) to purchase certain assets and assume certain liabilities of First CornerStone Bank (FCSB) of King of Prussia, Pennsylvania. As a

result of the transaction, FCB recorded loans with a fair value of $43.2 million and investment securities with a fair value of $4.6 million. The fair value of deposits assumed was $96.9 million. In accordance with the acquisition method of accounting, all assets and liabilities were recorded at their fair value as of the acquisition date. As a result, FCB recorded a gain on the acquisition of $2.1 million which is included in noninterest income in the Consolidated Statements of Income. Per the acquisition method of accounting, these fair values are preliminary and subject to refinement for up to one year after the acquisition date as additional information relative to closing date fair values become available.

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In March 2016, FCB entered into an agreement with the FDIC to purchase certain assets and assume certain liabilities of North Milwaukee State Bank of Milwaukee, Wisconsin (NMSB). As a result of the NMSB transaction, FCB recorded loans with a fair value of $36.9 million and investment securities with a fair value of $9.4 million. The fair value of deposits assumed was $59.2 million. In accordance with the acquisition method of accounting, all assets and liabilities were recorded at their fair value as of the acquisition date. As a result, an acquisition gain of $1.7 million was recorded in the first quarter of 2016. In the second quarter of 2016, refinements were made to the initial fair values primarily based upon updated collateral valuations resulting in an increase of $1.2 million to the gain on acquisition recognized in the three months ended June 30, 2016. These adjustments brought the total gain on the transaction to $2.9 million recognized in noninterest income for the six months ended June 30, 2016. Per the acquisition method of accounting, these fair values are preliminary and subject to refinement for up to one year after the acquisition date as additional information relative to closing date fair values become available.

## RECENT ECONOMIC AND INDUSTRY DEVELOPMENTS

Various external factors influence the focus of our business efforts, and the results of our operations can change significantly based on those external factors. In June 2016, the United Kingdom held its referendum on continued membership in the European Union and voted to leave, causing economic uncertainty and heightened market volatility. Interest rates are expected to remain low given the uncertainty in the global economy; however, the market volatility improved trading conditions at the end of June 2016. Second quarter 2016 results indicate relatively stable labor conditions, despite the global economic instability, as the unemployment rate dropped to 4.9 percent. According to the U.S. Department of Labor, the economy added approximately 442,000 new nonfarm payroll jobs during the second quarter of 2016 and labor force participation increased. The U.S. housing market remains solid as a result of strong housing demand fueled by low mortgage interest rates, economic growth and job creation.

The Federal Reserve’s Federal Open Market Committee (FOMC) indicated in the second quarter that growth in economic activity has increased, while the pace of improvement in the labor market has slowed. Although the unemployment rate has declined, job gains have diminished. Household spending growth has strengthened. The FOMC decided to maintain the target range for the federal funds rate and will continue to assess realized and expected economic conditions relative to its objectives of maximum employment and 2.0 percent inflation in determining the timing and size of future adjustments to the target range. The FOMC continues to closely monitor inflation indicators and global economic and financial developments.

The trends in the banking industry are similar to those of the broader economy as shown in the latest national banking results from the first quarter of 2016. FDIC-insured institutions reported a 1.9 percent decrease in net income compared to the first quarter of 2015 as a result of higher expenses for loan losses and lower noninterest income from trading and asset servicing. Interest-earning assets contributed to an increase in net interest income compared to a year earlier and bank average net interest margin was 3.10 percent in the first quarter of 2016, up slightly from 3.02 percent in the first quarter of 2015. The first quarter of 2016 was the second consecutive quarter that net charge-offs posted a year-over-year increase, following 21 quarters in a row when net charge-offs decreased.

## EARNINGS PERFORMANCE SUMMARY

BancShares' consolidated net income for the second quarter of 2016 was $69.3 million, or $5.77 per share, compared to $52.1 million, or $4.34 per share, for the first quarter of 2016, and $44.5 million, or $3.71 per share, for the corresponding period of 2015. BancShares’ current quarter results generated an annualized return on average assets of 0.87 percent and an annualized return on average equity of 9.33 percent, compared to respective returns of 0.66 percent and 7.17 percent for the first quarter of 2016, and 0.58 percent and 6.42 percent for the second quarter of 2015. Net interest margin for the second quarter of 2016 was 3.13 percent, compared to 3.18 percent for the first quarter of 2016 and 3.31 percent for the second quarter of the prior year.

Earnings for the second quarter of 2016 included a gain of $2.1 million recognized in connection with the FCSB acquisition which contributed $42.0 million in loans and $82.7 million in deposit balances at June 30, 2016. Earnings for the second quarter of 2016 also included an additional $1.2 million gain on the NMSB acquisition due to a refinement of initial fair value estimates, a $16.6 million pre-tax impact from the early termination of the FDIC loss share agreements as previously discussed and securities gains of $12.5 million.

For the six months ended June 30, 2016, net income was $121.4 million, or $10.11 per share, compared to $111.7 million, or $9.30 per share, reported for the same period of 2015. Annualized returns on average assets and average equity were 0.76 percent and 8.26 percent, respectively, through June 30, 2016, compared to 0.74 percent and 8.19 percent, respectively, for the same period a year earlier. Year-to-date 2016 earnings included acquisition gains of $5.0 million recognized in connection with the NMSB and FCSB acquisitions. Year-to-date 2015 earnings included a $42.9 million gain on the February 13, 2015 acquisition of Capitol City Bank & Trust (CCBT). Net interest margin for the six months ended June 30, 2016 was 3.16 percent, compared to 3.24 percent for the same period of 2015.

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Key highlights in the second quarter of 2016 include:

- The early termination of the FDIC loss share agreements resulted in a net impact to pre-tax earnings of $16.6 million during the second quarter of 2016.
- Loans grew by $324.9 million to $20.74 billion during the second quarter of 2016, reflecting originated portfolio growth and the FCSB acquisition.
- Net charge-offs were $3.3 million, or 0.06 percent of average loans and leases on an annualized basis, compared to $4.3 million, or 0.08 percent, during the first quarter of 2016.
- Total noninterest income was $140.3 million in the second quarter of 2016, up $35.0 million from the first quarter of 2016. The increase was driven primarily by the $16.6 million impact of the early termination of the FDIC loss share agreements, higher investment securities gains of $12.5 million and the $3.3 million gain on the acquisitions of FCSB and NMSB recognized in the current quarter.
- BancShares remained well-capitalized under Basel III capital requirements with a Tier 1 risk-based capital ratio of 12.63 percent, common equity Tier 1 ratio of 12.63 percent, total risk-based capital ratio of 14.10 percent and leverage capital ratio of 9.09 percent at June 30, 2016.

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Table 1
Selected Quarterly Data

| | 2016 | | 2015 | | | Six months ended June 30 | |
|---|---|---|---|---|---|---|---|
| | Second | First | Fourth | Third | Second | | |
| (Dollars in thousands, except share data) | Quarter | Quarter | Quarter | Quarter | Quarter | 2016 | 2015 |
| SUMMARY OF OPERATIONS | | | | | | | |
| Interest income | $243,369 | $243,112 | $241,861 | $249,825 | $246,013 | $486,481 | $477,523 |
| Interest expense | 11,180 | 10,392 | 11,142 | 10,454 | 11,363 | 21,572 | 22,708 |
| Net interest income | 232,189 | 232,720 | 230,719 | 239,371 | 234,650 | 464,909 | 454,815 |
| Provision for loan and lease losses | 4,562 | 4,843 | 7,046 | 107 | 7,719 | 9,405 | 13,511 |
| Net interest income after provision for loan and lease losses | 227,627 | 227,877 | 223,673 | 239,264 | 226,931 | 455,504 | 441,304 |
| Gain on acquisitions | 3,290 | 1,704 | — | — | — | 4,994 | 42,930 |
| Noninterest income excluding gain on acquisitions | 136,960 | 103,578 | 99,135 | 109,750 | 107,450 | 240,538 | 215,273 |
| Noninterest expense | 258,303 | 251,671 | 255,886 | 260,172 | 264,691 | 509,974 | 522,857 |
| Income before income taxes | 109,574 | 81,488 | 66,922 | 88,842 | 69,690 | 191,062 | 176,650 |
| Income taxes | 40,258 | 29,416 | 24,174 | 32,884 | 25,168 | 69,674 | 64,970 |
| Net income | $69,316 | $52,072 | $42,748 | $55,958 | $44,522 | $121,388 | $111,680 |
| Net interest income, taxable equivalent | $233,496 | $234,187 | $232,147 | $240,930 | $236,456 | $467,683 | $457,907 |
| PER SHARE DATA | | | | | | | |
| Net income | $5.77 | $4.34 | $3.56 | $4.66 | $3.71 | $10.11 | $9.30 |
| Cash dividends | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.60 | 0.60 |
| Market price at period end (Class A) | 258.91 | 251.07 | 258.17 | 226.00 | 263.04 | 258.91 | 263.04 |
| Book value at period end | 252.76 | 246.55 | 239.14 | 238.34 | 232.62 | 252.76 | 232.62 |
| SELECTED QUARTERLY AVERAGE BALANCES | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total assets | $32,161,905 | $31,705,658 | $31,753,223 | $31,268,774 | $30,835,749 | $31,933,782 | $30,626,200 |
| Investment securities | 6,786,463 | 6,510,248 | 6,731,183 | 7,275,290 | 7,149,691 | 6,648,355 | 7,020,440 |
| Loans and leases [1] | 20,657,094 | 20,349,091 | 20,059,556 | 19,761,145 | 19,354,823 | 20,503,093 | 19,139,621 |
| Interest-earning assets | 29,976,629 | 29,558,629 | 29,565,715 | 29,097,839 | 28,660,246 | 29,767,629 | 28,447,268 |
| Deposits | 27,212,814 | 26,998,026 | 27,029,650 | 26,719,713 | 26,342,821 | 27,105,420 | 26,089,355 |
| Long-term obligations | 817,750 | 750,446 | 704,465 | 548,214 | 473,434 | 784,098 | 467,109 |
| Interest-bearing liabilities | 19,092,287 | 19,067,251 | 18,933,443 | 18,911,455 | 18,933,611 | 19,079,769 | 19,052,128 |
| Shareholders' equity | $2,989,097 | $2,920,611 | $2,867,177 | $2,823,967 | $2,781,648 | $2,953,948 | $2,750,964 |
| Shares outstanding | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 |
| SELECTED QUARTER-END BALANCES | | | | | | | |
| Total assets | $32,230,403 | $32,195,657 | $31,475,934 | $31,449,824 | $30,896,855 | $32,230,403 | $30,896,855 |
| Investment securities | 6,557,736 | 6,687,483 | 6,861,548 | 6,690,879 | 7,350,545 | 6,557,736 | 7,350,545 |
| Loans and leases: | | | | | | | |
| PCI | 921,467 | 945,887 | 950,516 | 1,044,064 | 1,123,239 | 921,467 | 1,123,239 |
| Non-PCI | 19,821,104 | 19,471,802 | 19,289,474 | 18,811,742 | 18,396,946 | 19,821,104 | 18,396,946 |
| Deposits | 27,257,774 | 27,365,245 | 26,930,755 | 26,719,375 | 26,511,896 | 27,257,774 | 26,511,896 |
| Long-term obligations | 850,504 | 779,087 | 704,155 | 705,418 | 475,568 | 850,504 | 475,568 |
| Shareholders' equity | $3,035,704 | $2,961,194 | $2,872,109 | $2,862,528 | $2,793,890 | $3,035,704 | $2,793,890 |
| Shares outstanding | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 | 12,010,405 |
| SELECTED RATIOS AND OTHER DATA | | | | | | | |
| Rate of return on average assets (annualized) | 0.87 % | 0.66 % | 0.53 % | 0.71 % | 0.58 % | 0.76 % | 0.74 % |
| Rate of return on average shareholders' equity (annualized) | 9.33 | 7.17 | 5.92 | 7.86 | 6.42 | 8.26 | 8.19 |
| Net yield on interest-earning assets (taxable equivalent) | 3.13 | 3.18 | 3.12 | 3.29 | 3.31 | 3.16 | 3.24 |
| Allowance for loan and lease losses to total | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| loans and leases: | | | | | | | |
| PCI | 1.25 | 1.45 | 1.72 | 1.68 | 1.38 | 1.25 | 1.38 |
| Non-PCI | 0.99 | 0.99 | 0.98 | 1.00 | 1.05 | 0.99 | 1.05 |
| Total | 1.00 | 1.01 | 1.02 | 1.03 | 1.07 | 1.00 | 1.07 |
| Nonperforming assets to total loans and leases and other real estate at period end: | | | | | | | |
| Covered | 1.17 | 4.74 | 3.51 | 3.72 | 4.70 | 1.17 | 4.70 |
| Noncovered | 0.77 | 0.74 | 0.79 | 0.77 | 0.73 | 0.77 | 0.73 |
| Total | 0.77 | 0.80 | 0.83 | 0.82 | 0.79 | 0.77 | 0.79 |
| Tier 1 risk-based capital ratio | 12.63 | 12.58 | 12.65 | 12.77 | 12.66 | 12.63 | 12.66 |
| Common equity Tier 1 ratio | 12.63 | 12.58 | 12.51 | 12.63 | 12.52 | 12.63 | 12.52 |
| Total risk-based capital ratio | 14.10 | 14.09 | 14.03 | 14.18 | 14.10 | 14.10 | 14.10 |
| Leverage capital ratio | 9.09 | 9.00 | 8.96 | 8.97 | 8.92 | 9.09 | 8.92 |
| Dividend payout ratio | 5.20 | 6.91 | 8.43 | 6.44 | 8.09 | 5.93 | 6.45 |
| Average loans and leases to average deposits | 75.91 | 75.37 | 74.21 | 73.96 | 73.47 | 75.64 | 73.36 |

(1) Loans and leases include PCI loans, non-PCI loans, nonaccrual loans and loans held for sale.

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BUSINESS COMBINATIONS

Cordia Bancorp Inc.

On May 19, 2016, FCB entered into a definitive merger agreement with Cordia Bancorp Inc. (Cordia). Cordia had total assets of $347.8 million at March 31, 2016. The agreement provides for the acquisition by FCB of Midlothian, Virginia-based Cordia and its bank subsidiary, Bank of Virginia. Under the terms of the agreement, cash consideration of $5.15 will be paid to Cordia's shareholders in exchange for each of their shares of Cordia's common stock. Total consideration is estimated to be $35.0 million based on Cordia's common stock outstanding at March 31, 2016. The agreement has been approved by the Board of Directors of each company. Subject to the receipt of regulatory approvals and the approval of Cordia's shareholders, the merger is expected to close no later than the fourth quarter of 2016.

First CornerStone Bank

In May 2016, FCB entered into an agreement with the FDIC to purchase certain assets and assume certain liabilities of FCSB. The acquisition provided FCB with value enhancement from expanded banking relationships in Pennsylvania as FCSB operated six branch locations in Chadds Ford, King of Prussia, Malvern, Media, Phoenixville and Ridley, Pennsylvania. This is an FDIC-assisted transaction; however, it has no loss share agreement.

The FCSB transaction was accounted for under the acquisition method of accounting and, accordingly, assets acquired and liabilities assumed were recorded at their estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding closing date fair values becomes available.

The following table provides the identifiable assets acquired and liabilities assumed at their estimated fair values as of the acquisition date.

Table 2

First CornerStone Bank

| (Dollars in thousands) | As recorded by FCB |
|---|---|
| Assets | |
| Cash and cash equivalents | $ 748 |
| Overnight investments | 37,540 |
| Investment securities | 4,564 |
| Loans | 43,170 |
| Other real estate owned | 144 |
| Income earned not collected | 8 |
| Intangible assets | 390 |
| Other assets | 13 |
| Total assets acquired | 86,577 |
| Liabilities | |
| Deposits | 96,882 |
| Other liabilities | 23 |
| Total liabilities assumed | 96,905 |
| Fair value of net liabilities assumed | (10,328 ) |
| Cash received from FDIC | 12,450 |
| Gain on acquisition of FCSB | $ 2,122 |

Merger-related expenses of $793 thousand were recorded in the Consolidated Statements of Income for the three and six months ended June 30, 2016. Loan-related interest income generated from FCSB was approximately $324

thousand since the acquisition date.
All loans resulting from the FCSB transaction were recognized upon acquisition date with a discount attributable, at least in part, to credit quality, and are therefore accounted for as PCI loans.

North Milwaukee State Bank
In March 2016, FCB entered into an agreement with the FDIC to purchase certain assets and assume certain liabilities of NMSB. The acquisition provided FCB with value enhancement from expanded banking relationships. This was an FDIC-assisted transaction; however, it has no loss share agreement.

During the second quarter of 2016, refinements were made to initial fair values primarily based upon updated collateral valuations resulting in an increase of $1.2 million to the gain on acquisition. These adjustments brought the total gain on the transaction to $2.9 million which is included in noninterest income on the Consolidated Statement of Income.

The NMSB transaction was accounted for under the acquisition method of accounting and, accordingly, assets acquired and liabilities assumed were recorded at their estimated fair values on the acquisition date. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding closing date fair values becomes available.

The following table provides the identifiable assets acquired and liabilities assumed at their estimated fair values as of the acquisition date.

Table 3
North Milwaukee State Bank

| (Dollars in thousands) | As recorded by FCB |
|---|---|
| Assets | |
| Cash and cash equivalents | $ 4,545 |
| Overnight investments | 2,274 |
| Investment securities | 9,425 |
| Loans | 36,914 |
| Intangible assets | 240 |
| Other assets | 216 |
| Total assets acquired | 53,614 |
| Liabilities | |
| Deposits | 59,206 |
| Short-term borrowings | 1,662 |
| Other liabilities | 74 |
| Total liabilities assumed | 60,942 |
| Fair value of net liabilities assumed | (7,328 ) |
| Cash received from FDIC | 10,200 |
| Gain on acquisition of NMSB | $ 2,872 |

Merger-related expenses of $438 thousand and $476 thousand were recorded in the Consolidated Statements of Income for the three and six months ended June 30, 2016, respectively. Loan-related interest income generated from NMSB was approximately $676 thousand for the second quarter of 2016 and $799 thousand since the acquisition date. All loans resulting from the NMSB transaction were recognized upon acquisition date with a discount attributable, at least in part, to credit quality, and are therefore accounted for as PCI loans.

FDIC-Assisted Transactions

BancShares completed seven FDIC-assisted transactions during the period beginning in 2009 through 2015, and it acquired NMSB and FCSB in its eighth and ninth such transaction during 2016. These transactions provided us significant growth opportunities, have continued to provide significant contributions to our results of operations and have allowed us to increase our presence in existing markets and expand our banking presence to adjacent markets. Prior to its merger into BancShares, First Citizens Bancorporation, Inc. (Bancorporation) completed three FDIC-assisted transactions: Georgian Bank of Atlanta, Georgia (acquired in 2009); Williamsburg First National Bank of Williamsburg, South Carolina (acquired in 2010); and Atlantic Bank & Trust of Charleston, South Carolina (acquired in 2011). Nine of the twelve FDIC-assisted transactions (including the three completed by Bancorporation) included loss share agreements that, for their terms, protected us from a portion of the credit and asset quality risk we

would otherwise incur. The CCBT, NMSB and FCSB transactions did not include a loss share agreement.

During the second quarter of 2016, FCB entered into an agreement with the FDIC to terminate five of FCB's nine loss share agreements with the FDIC, including Temecula Valley Bank (TVB), Sun American Bank (SAB), Williamsburg First National Bank (WFNB), Atlantic Bank & Trust (ABT), and Colorado Capital Bank (CCB). All rights and obligations of FCB and the FDIC under the loss share agreements, including the clawback provisions and the settlement of outstanding loss share claims, have been resolved and terminated under the termination agreement. The termination of the FDIC loss share agreements had no impact on the yields of the loans that were previously covered under these agreements. FCB will recognize all future recoveries, losses and expenses related to the previously covered assets since the FDIC will no longer share in those amounts.

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Under the terms of the agreement, FCB made a net payment of $20.1 million to the FDIC as consideration for early termination of the loss share agreements. Also, FCB wrote-off $1.5 million of the FDIC loss share receivable and $18.2 million of the FDIC loss share payable associated with the terminated agreements. As a result, FCB recognized a $3.4 million loss on the termination of the loss share agreements. In conjunction with the early termination, FCB adjusted its clawback liabilities under the two remaining loss share agreements with clawback provisions and released other related reserves. The clawback liabilities were adjusted in order to conform to the methodology used to determine the net termination payment. The adjustment to the clawback liabilities is accounted for by management as a change in estimate. The total one-time pre-tax benefit of these adjustments was $20.0 million. The resulting positive net impact to pre-tax earnings from the early termination of the FDIC loss share agreements was $16.6 million during the second quarter of 2016.

As a result of executing the loss share termination agreement with the FDIC, loans of $43.5 million that were previously covered by the loss share agreements are classified as non-covered at June 30, 2016. For those acquired loans with loss share agreements remaining, generally, losses on single family residential loans are covered for ten years. All other loans are generally covered for five years. At June 30, 2016, $95.5 million of total loans and leases remain covered under loss share agreements.

During the second quarter of 2016, loss share protection expired for non-single family residential loans acquired from United Western Bank (UWB). The loan balance for the expired agreements from UWB was $107.0 million at June 30, 2016. At June 30, 2016, loss share protection expired or was terminated for all non-single family residential loans and loss share protection remains only for single family residential loans within the United Western Bank, Venture Bank and Georgian Bank loss share transactions which were not terminated. We will process all necessary filings in accordance with the agreements before expiration to collect the earned loss share receivables. Going forward, we will continue to manage these loans and loan relationships for which loss share has expired in accordance with our standard credit administration policies and procedures.

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Table 4
Consolidated Quarter-to-Date Average Taxable-Equivalent Balance Sheets

| | Three months ended June 30, 2016 | | | March 31, 2016 | | | June 30, 2015 | | |
|---|---|---|---|---|---|---|---|---|---|
| (Dollars in thousands) | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate |
| Assets | | | | | | | | | |
| Loans and leases | $20,657,094 | $216,612 | 4.22 % | $20,349,091 | $217,732 | 4.30 % | $19,354,823 | $224,235 | 4.65 % |
| Investment securities: | | | | | | | | | |
| U. S. Treasury | 1,540,669 | 2,993 | 0.78 | 1,533,028 | 2,880 | 0.76 | 2,224,933 | 4,346 | 0.78 |
| Government agency | 373,006 | 844 | 0.91 | 463,597 | 1,031 | 0.89 | 915,976 | 2,195 | 0.96 |
| Mortgage-backed securities | 4,787,719 | 20,554 | 1.72 | 4,467,186 | 19,012 | 1.70 | 4,008,782 | 15,518 | 1.55 |
| Corporate bonds | 12,533 | 197 | 6.27 | 10,659 | 166 | 6.23 | — | — | — |
| State, county and municipal | — | — | — | 196 | 1 | 2.73 | — | — | — |
| Other | 72,536 | 251 | 1.40 | 35,582 | 91 | 1.02 | — | — | — |
| Total investment securities | 6,786,463 | 24,839 | 1.47 | 6,510,248 | 23,181 | 1.43 | 7,149,691 | 22,059 | 1.23 |
| Overnight investments | 2,533,072 | 3,225 | 0.51 | 2,699,290 | 3,666 | 0.54 | 2,155,732 | 1,525 | 0.28 |
| Total interest-earning assets | 29,976,629 | $244,676 | 3.28 % | 29,558,629 | $244,579 | 3.32 % | 28,660,246 | $247,819 | 3.47 % |
| Cash and due from banks | 455,394 | | | 470,159 | | | 453,347 | | |
| Premises and equipment | 1,123,042 | | | 1,131,235 | | | 1,121,776 | | |
| FDIC loss share receivable | 8,396 | | | 8,742 | | | 20,779 | | |
| Allowance for loan and lease losses | (206,518 ) | | | (206,338 ) | | | (206,463 ) | | |
| Other real estate owned | 66,300 | | | 65,616 | | | 84,057 | | |
| Other assets | 738,662 | | | 677,615 | | | 702,007 | | |
| Total assets | $32,161,905 | | | $31,705,658 | | | $30,835,749 | | |
| | | | | | | | | | |
| Liabilities | | | | | | | | | |
| Interest-bearing deposits: | | | | | | | | | |
| Checking with interest | $4,446,454 | $218 | 0.02 % | $4,317,299 | $200 | 0.02 % | $4,712,074 | $428 | 0.04 % |
| Savings | 2,016,387 | 151 | 0.03 | 1,944,805 | 145 | 0.03 | 1,833,259 | 98 | 0.02 |
| | 8,084,829 | 1,644 | 0.08 | 8,335,030 | 1,642 | 0.08 | 7,666,121 | 1,629 | 0.09 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Money market accounts | | | | | | | | | |
| Time deposits | 2,986,103 | 2,588 | 0.35 | 3,061,333 | 2,672 | 0.35 | 3,414,991 | 3,379 | 0.40 |
| Total interest-bearing deposits | 17,533,773 | 4,601 | 0.11 | 17,658,467 | 4,659 | 0.11 | 17,626,445 | 5,534 | 0.13 |
| Repurchase agreements | 738,191 | 453 | 0.25 | 655,787 | 433 | 0.27 | 622,547 | 387 | 0.25 |
| Other short-term borrowings | 2,573 | 1 | 0.13 | 2,551 | 1 | 0.12 | 211,185 | 1,271 | 2.41 |
| Long-term obligations | 817,750 | 6,125 | 3.00 | 750,446 | 5,299 | 2.82 | 473,434 | 4,171 | 3.52 |
| Total interest-bearing liabilities | 19,092,287 | 11,180 | 0.23 | 19,067,251 | 10,392 | 0.22 | 18,933,611 | 11,363 | 0.24 |
| Demand deposits | 9,679,041 | | | 9,339,559 | | | 8,716,376 | | |
| Other liabilities | 401,480 | | | 378,237 | | | 404,114 | | |
| Shareholders' equity | 2,989,097 | | | 2,920,611 | | | 2,781,648 | | |
| Total liabilities and shareholders' equity | $32,161,905 | | | $31,705,658 | | | $30,835,749 | | |
| Interest rate spread | | | 3.05 % | | | 3.10 % | | | 3.23 % |
| Net interest income and net yield on interest-earning assets | | $233,496 | 3.13 % | | $234,187 | 3.18 % | | $236,456 | 3.31 % |

Loans and leases include PCI loans, non-PCI loans, nonaccrual loans and loans held for sale. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only are stated on a taxable-equivalent basis assuming statutory federal income tax rates of 35.0 percent for each period and state income tax rates of 5.5 percent, 5.5 percent and 6.0 percent for the three months ended June 30, 2016, March 31, 2016 and June 30, 2015, respectively. The taxable-equivalent adjustment was $1,307, $1,467 and $1,806 for the three months ended June 30, 2016, March 31, 2016 and June 30, 2015, respectively.

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Table 5
Consolidated Year-to-Date Average Taxable-Equivalent Balance Sheets

| | Six months ended June 30, 2016 | | | June 30, 2015 | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Average Balance | Interest Income/ Expense | Yield/ Rate | Average Balance | Interest Income/ Expense | Yield/ Rate |
| Assets | | | | | | |
| Loans and leases | $20,503,093 | $434,344 | 4.26 % | $19,139,621 | $436,120 | 4.59 % |
| Investment securities: | | | | | | |
| U.S. Treasury | 1,536,848 | 5,873 | 0.77 | 2,289,724 | 8,938 | 0.79 |
| Government agency | 418,301 | 1,875 | 0.90 | 927,104 | 3,903 | 0.84 |
| Mortgage-backed securities | 4,627,453 | 39,566 | 1.71 | 3,801,791 | 28,738 | 1.51 |
| Corporate bonds | 11,596 | 363 | 6.26 | — | — | — |
| State, county and municipal | 98 | 1 | 2.73 | 1,821 | 53 | 5.81 |
| Other | 54,059 | 342 | 1.27 | — | — | — |
| Total investment securities | 6,648,355 | 48,020 | 1.45 | 7,020,440 | 41,632 | 1.19 |
| Overnight investments | 2,616,181 | 6,891 | 0.53 | 2,287,207 | 2,863 | 0.25 |
| Total interest-earning assets | 29,767,629 | $489,255 | 3.30 % | 28,447,268 | $480,615 | 3.40 % |
| Cash and due from banks | 462,777 | | | 458,537 | | |
| Premises and equipment | 1,127,139 | | | 1,122,545 | | |
| FDIC loss share receivable | 8,569 | | | 24,584 | | |
| Allowance for loan and lease losses | (206,428) | | | (204,935) | | |
| Other real estate owned | 65,958 | | | 87,872 | | |
| Other assets | 708,138 | | | 690,329 | | |
| Total assets | $31,933,782 | | | $30,626,200 | | |
| | | | | | | |
| Liabilities | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Checking with interest | $4,381,877 | $418 | 0.02 % | $4,660,349 | $842 | 0.04 % |
| Savings | 1,980,596 | 296 | 0.03 | 1,799,587 | 190 | 0.02 |
| Money market accounts | 8,209,929 | 3,285 | 0.08 | 7,743,351 | 3,270 | 0.09 |
| Time deposits | 3,023,718 | 5,261 | 0.35 | 3,464,981 | 6,861 | 0.40 |
| Total interest-bearing deposits | 17,596,120 | 9,260 | 0.11 | 17,668,268 | 11,163 | 0.13 |
| Repurchase agreements | 696,989 | 886 | 0.26 | 465,107 | 508 | 0.22 |
| Other short-term borrowings | 2,562 | 2 | 0.12 | 451,644 | 3,084 | 1.37 |
| Long-term obligations | 784,098 | 11,424 | 2.91 | 467,109 | 7,953 | 3.41 |
| Total interest-bearing liabilities | 19,079,769 | 21,572 | 0.23 | 19,052,128 | 22,708 | 0.24 |
| Demand deposits | 9,509,300 | | | 8,421,087 | | |
| Other liabilities | 390,765 | | | 402,021 | | |
| Shareholders' equity | 2,953,948 | | | 2,750,964 | | |
| Total liabilities and shareholders' equity | $31,933,782 | | | $30,626,200 | | |
| Interest rate spread | | | 3.07 % | | | 3.16 % |
| | | | | | | |
| Net interest income and net yield on interest-earning assets | | $467,683 | 3.16 % | | $457,907 | 3.24 % |

Loans and leases include PCI loans, non-PCI loans, nonaccrual loans and loans held for sale. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only are stated on a taxable-equivalent basis assuming statutory federal income tax rates of 35.0 percent for each

period and state income tax rates of 5.5 percent and 6.0 percent for the six months ended June 30, 2016 and 2015, respectively. The taxable-equivalent adjustment was $2,774 and $3,092 for the six months ended June 30, 2016 and 2015, respectively.

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Table 6
Changes in Consolidated Taxable Equivalent Net Interest Income

| | Three months ended June 30, 2016 | | | Six months ended June 30, 2016 | | |
|---|---|---|---|---|---|---|
| | Change from prior year period due to: | | | Change from prior year period due to: | | |
| (Dollars in thousands) | Volume | Yield/Rate | Total Change | Volume | Yield/Rate | Total Change |
| Assets | | | | | | |
| Loans and leases | $14,063 | $(21,686) | $(7,623) | $30,376 | $(32,152) | $(1,776) |
| Investment securities: | | | | | | |
| U. S. Treasury | (1,340) | (13) | (1,353) | (2,897) | (168) | (3,065) |
| Government agency | (1,270) | (81) | (1,351) | (2,222) | 194 | (2,028) |
| Mortgage-backed securities | 3,175 | 1,861 | 5,036 | 6,630 | 4,198 | 10,828 |
| Corporate bonds | 197 | — | 197 | 363 | — | 363 |
| State, county and municipal | — | — | — | (37) | (15) | (52) |
| Other | 251 | — | 251 | 342 | — | 342 |
| Total investment securities | 1,013 | 1,767 | 2,780 | 2,179 | 4,209 | 6,388 |
| Overnight investments | 365 | 1,335 | 1,700 | 626 | 3,402 | 4,028 |
| Total interest-earning assets | $15,441 | $(18,584) | $(3,143) | $33,181 | $(24,541) | $8,640 |
| Liabilities | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Checking with interest | $(1) | $(209) | $(210) | $(8) | $(416) | $(424) |
| Savings | 8 | 45 | 53 | 17 | 89 | 106 |
| Money market accounts | 150 | (135) | 15 | 304 | (289) | 15 |
| Time deposits | (397) | (394) | (791) | (808) | (792) | (1,600) |
| Total interest-bearing deposits | (240) | (693) | (933) | (495) | (1,408) | (1,903) |
| Repurchase agreements | 69 | (3) | 66 | 270 | 108 | 378 |
| Other short-term borrowings | (661) | (609) | (1,270) | (1,667) | (1,415) | (3,082) |
| Long-term obligations | 2,800 | (846) | 1,954 | 5,022 | (1,551) | 3,471 |
| Total interest-bearing liabilities | 1,968 | (2,151) | (183) | 3,130 | (4,266) | (1,136) |
| Change in net interest income | $13,473 | $(16,433) | $(2,960) | $30,051 | $(20,275) | $9,776 |

The rate/volume variance is allocated equally between the changes in volume and rate.

RESULTS OF OPERATIONS

Net Interest Income and Margin

Second Quarter 2016

Net interest income decreased $531 thousand, or by 0.2 percent, to $232.2 million from the first quarter of 2016. On a taxable-equivalent basis, net interest income decreased $691 thousand, or by 0.3 percent, from $234.2 million during the first quarter of 2016. The decrease was primarily due to lower PCI loan income as a result of PCI loan portfolio runoff and an increase in interest expense of $788 thousand primarily due to additional Federal Home Loan Bank (FHLB) borrowings used to mitigate interest rate risk from long-term fixed rate loans. Accretion income on PCI loans was $20.4 million, compared to $21.4 million during the first quarter of 2016. These unfavorable impacts were offset by higher investment securities interest income of $1.7 million as proceeds from maturities and sales were reinvested into higher yielding investments and an increase in non-PCI loan interest income of $666 thousand related to originated loan volume.

Net interest income was $232.2 million, a decrease of $2.5 million, or 1.0 percent, from the second quarter of 2015. On a taxable-equivalent basis, net interest income was $233.5 million, a decrease of $3.0 million, or 1.3 percent, from the second quarter of 2015. Loan interest income was down $7.2 million primarily due to lower PCI loan income as a result of PCI loan portfolio runoff. Accretion income on PCI loans was $20.4 million, compared to $34.1 million

during the second quarter of 2015. This decrease in net interest income was offset by a $6.5 million increase in non-PCI loan interest income due to originated loan volume, a $2.9 million improvement in investment securities interest income as proceeds from maturities and sales were reinvested into higher yielding investments and a $1.7 million increase in interest income earned on excess cash held in overnight investments. The December 2015 increase in the federal funds rate of 25 basis points contributed to higher interest income earned on overnight investments in the current quarter.

The taxable-equivalent net interest margin was 3.13 percent for the second quarter of 2016, a decrease of 5 basis points from the first quarter of 2016 and a decrease of 18 basis points from the same quarter in the prior year. The margin compression for

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both periods was primarily due to continued PCI loan portfolio runoff, offset by originated loan growth and an improvement in investment yields. Higher FHLB borrowings also contributed to the margin decline from the first quarter of 2016.

Average quarter-to-date interest earning assets increased by $418.0 million since the first quarter of 2016, reflecting a a $308.0 million increase in average outstanding loans, due to originated loan growth and loans acquired in the NMSB and FCSB acquisitions, and a $276.2 million increase in average investment securities, partially offset by a reduction in average overnight investments of $166.2 million. Average investment securities increased primarily due to purchases throughout the quarter, offset by sales in June 2016. Average quarter-to-date interest earning assets increased by $1.32 billion compared to the same quarter in the prior year. Growth in average interest-earning assets was primarily funded by growth in deposits. Within interest-earning assets, loans experienced the most significant increase, primarily due to originated loan growth of $1.42 billion.

Average interest-bearing liabilities increased by $25.0 million compared to the first quarter of 2016, due to a $82.4 million increase in average short-term borrowings and a $67.3 million increase in average long-term obligations, partially offset by a $124.7 million decrease in average interest-bearing deposits due to a shift to low-cost demand deposit accounts. The increase in short-term borrowings was due to higher average repurchase obligations and the increase in long-term obligations was due to the addition of $75.0 million FHLB advances during the second quarter of 2016 to mitigate interest rate risk from long-term fixed rate loans. When compared to the same quarter in the prior year, average interest-bearing liabilities increased $158.7 million and the rate on interest-bearing liabilities decreased 1 basis point to 0.23 percent. The decline in the rate on interest-bearing liabilities was the result of lower deposit funding costs in the second quarter of 2016.

Year-to-date 2016

Net interest income for the first six months of 2016 was $464.9 million, an increase of $10.1 million, or 2.2 percent, compared to the same period of 2015. On a taxable-equivalent basis, net interest income was $467.7 million, an increase of $9.8 million, or 2.1 percent, from the same period of 2015. Loan interest income decreased $1.7 million from the same period of 2015 as a result of a $16.9 million decline in PCI loan interest income due to PCI loan runoff, offset by an increase in non-PCI loan interest income of $15.2 million due to originated loan growth. Net interest income benefited from a $6.6 million improvement in investment securities interest income, higher income earned on overnight investments and lower interest expense due to reduced interest-bearing deposit costs. Investment securities interest income improved as proceeds from sales and maturities were reinvested into higher yielding investments and overnight investments benefited as a result of the December 2015 increase in the federal funds rate.

The taxable-equivalent net interest margin decreased 8 basis points to 3.16 percent in the first six months of 2016, compared to the same period of 2015. The margin compression was due to PCI loan portfolio runoff, offset by continued originated loan growth, improvement in investment yields and lower funding costs. The December 2015 increase in federal funds rate of 25 basis points contributed to higher interest income earned on overnight investments.

Average year-to-date interest earning assets increased by $1.32 billion in the first six months of 2016 compared to the same period of 2015, primarily due to a $1.36 billion increase in average outstanding loans due to originated loan growth and the $58.5 million net impact of the CCBT, NMSB and FCSB acquisitions. Average year-to-date interest earning assets also increased due to higher average overnight investments of $329.0 million, partially offset by a $372.1 million decline in average investment securities as sales, maturities and paydowns exceeded purchases during the period.

Average year-to-date interest-bearing liabilities increased by $27.6 million compared to the first six months of 2015, due to a $317.0 million increase in average long-term obligations, partially offset by a $217.2 million decline in average short-term borrowings and a $72.1 million decrease in average interest-bearing deposits. The increase in long-term obligations was primarily due to the addition of $150.0 million FHLB advances during 2016 to mitigate interest rate risk from long-term fixed rate loans, while the decline in short-term borrowings was due to maturities of FHLB borrowings of $70.0 million and subordinated debt of $199.9 million.

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Noninterest Income

Noninterest income is an essential component of our total revenue and is critical to our ability to sustain adequate profitability levels. The primary sources of noninterest income have traditionally consisted of cardholder services income, merchant services income, service charges on deposit accounts and revenues derived from wealth management services. Recoveries on PCI loans that have been previously charged-off are additional sources of noninterest income. BancShares records the portion of recoveries not covered under loss share agreements as noninterest income rather than as an adjustment to the allowance for loan losses. Charge-offs on PCI loans are recorded against the discount recognized on the date of acquisition versus through the allowance for loan losses.

Table 7
Noninterest Income

| | Three months ended | | | Six months ended | |
|---|---|---|---|---|---|
| (Dollars in thousands) | June 30, 2016 | March 31, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| Gain on acquisitions | $3,290 | $1,704 | $— | $4,994 | $42,930 |
| Cardholder services | 21,054 | 19,358 | 19,214 | 40,412 | 37,615 |
| Merchant services | 24,236 | 21,977 | 22,070 | 46,213 | 40,950 |
| Service charges on deposit accounts | 21,884 | 21,850 | 22,361 | 43,734 | 44,419 |
| Wealth management services | 21,291 | 19,634 | 21,555 | 40,925 | 42,435 |
| Securities gains | 12,529 | 4,628 | 147 | 17,157 | 5,273 |
| Other service charges and fees | 7,137 | 6,989 | 5,730 | 14,126 | 11,235 |
| Mortgage income | 4,537 | 1,311 | 5,571 | 5,848 | 10,120 |
| Insurance commissions | 2,265 | 3,178 | 2,456 | 5,443 | 5,753 |
| ATM income | 1,845 | 1,765 | 1,825 | 3,610 | 3,489 |
| Adjustments to FDIC receivable for loss share agreements | (2,367) | (2,533) | (4,553) | (4,900) | (5,600) |
| Net impact from FDIC loss share termination | 16,559 | — | — | 16,559 | — |
| Recoveries of PCI loans previously charged off | 4,219 | 2,884 | 7,918 | 7,103 | 13,416 |
| Other | 1,771 | 2,537 | 3,156 | 4,308 | 6,168 |
| Total noninterest income | $140,250 | $105,282 | $107,450 | $245,532 | $258,203 |

In the second quarter of 2016, noninterest income was $140.3 million, an increase of $35.0 million from the first quarter of 2016. The increase was attributable to the following drivers:

- The $16.6 million impact of the early termination of the FDIC loss share agreements.
- Higher gains on sales of investment securities of $7.9 million in response to changing market conditions.
- The $3.3 million gain on acquisitions of FCSB and NMSB recognized in the current quarter.
- Merchant and cardholder services increased $4.0 million as a result of higher sales volume.
- Mortgage income increased $3.2 million due to lower impairment charges on mortgage servicing assets and increased production and sales of loans.

Noninterest income excluding acquisition gains was $137.0 million and $240.5 million for the second quarter of 2016 and the first six months of 2016, respectively, compared to $107.5 million and $215.3 million for the same periods of 2015. The increase for both periods was primarily driven by the impact from the early termination of the FDIC loss share agreements, increases in securities gains, and higher merchant and cardholder income due to increased sales volume. These increases were partially offset by declines in recoveries of PCI loans previously charged off and mortgage income.

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Noninterest Expense

The primary components of noninterest expense are salaries and related employee benefits, occupancy costs, facilities and equipment expense and merchant processing expenses.

Table 8
Noninterest Expense

| (Dollars in thousands) | Three months ended June 30, 2016 | March 31, 2016 | June 30, 2015 | Six months ended June 30, 2016 | June 30, 2015 |
|---|---|---|---|---|---|
| Salaries and wages | $104,059 | $103,899 | $109,895 | $207,958 | $215,366 |
| Employee benefits | 25,661 | 27,350 | 28,002 | 53,011 | 59,220 |
| Occupancy expense | 24,955 | 25,012 | 25,532 | 49,967 | 51,152 |
| Equipment expense | 22,715 | 22,345 | 23,296 | 45,060 | 46,837 |
| FDIC insurance expense | 4,588 | 4,789 | 4,551 | 9,377 | 8,822 |
| Foreclosure-related expenses | (1,116) | 1,731 | 1,019 | 615 | 3,576 |
| Merger-related expenses | 1,385 | 38 | 4,573 | 1,423 | 7,570 |
| Merchant processing expense | 16,517 | 15,087 | 15,132 | 31,604 | 28,988 |
| Processing fees paid to third parties | 4,634 | 4,102 | 4,777 | 8,736 | 10,172 |
| Card processing expense | 6,321 | 6,084 | 5,480 | 12,405 | 10,421 |
| Consultant expense | 2,741 | 1,771 | 2,248 | 4,215 | 4,376 |
| Collection expense | 2,497 | 2,581 | 2,585 | 5,078 | 4,885 |
| Advertising expense | 2,813 | 2,055 | 2,324 | 4,868 | 4,237 |
| Core deposit intangible amortization | 4,216 | 4,318 | 4,821 | 8,534 | 9,776 |
| Other | 36,317 | 30,509 | 30,456 | 67,123 | 57,459 |
| Total noninterest expense | $258,303 | $251,671 | $264,691 | $509,974 | $522,857 |

Noninterest expense was $258.3 million in the second quarter of 2016, an increase of $6.6 million from the first quarter of 2016. The following items impacted various noninterest expense categories:

- Merger-related expenses increased $1.3 million due to the NMSB and FCSB acquisitions.
- Merchant and card processing expenses increased $1.7 million aligned with increased sales volume.
- Consulting expenses increased 1.0 million primarily due to enterprise risk management initiatives.
- Advertising costs increased by $758 thousand as a result of increased media spending and internet marketing.
- Other expense increased primarily as a result of certain litigation related costs of $2.3 million.
- Foreclosure-related expenses decreased $2.8 million primarily due to higher reimbursements on Small Business Administration (SBA) guaranteed loans.

Noninterest expense for the second quarter of 2016 and the first six months of 2016 was $258.3 million and $510.0 million, respectively, compared to $264.7 million and $522.9 million for the same periods of 2015. The decrease for both periods was primarily driven by respective declines in personnel expenses of $8.2 million and $13.6 million related to lower pension and higher deferrals of salary costs related to loan origination activity and $3.2 million and $6.1 million respective decreases in merger-related expenses. These declines were partially offset by increases in merchant and card processing expenses of $2.2 million and $4.6 million, respectively, due to higher sales volumes and an increase in other expense primarily as a result of certain litigation related costs of $2.3 million.

Income Taxes

Income tax expense was $40.3 million, $29.4 million and $25.2 million for the second quarter of 2016, first quarter of 2016 and second quarter of 2015, representing effective tax rates of 36.7 percent, 36.1 percent and 36.1 percent during the respective periods. Income tax expense was $69.7 million and $65.0 million for the six months ended June 30, 2016 and 2015, respectively, representing effective tax rates of 36.5 percent and 36.8 percent for the respective six month periods.

We monitor and evaluate the potential impact of current events on the estimates used to establish income tax expenses and income tax liabilities. On a periodic basis, we evaluate our income tax positions based on current tax law, positions taken by various tax auditors within the jurisdictions where BancShares is required to file income tax returns, as well as potential or pending audits or assessments by tax auditors.

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## INTEREST-EARNING ASSETS

Interest-earning assets include loans and leases, investment securities, and overnight investments, all of which reflect varying interest rates based on the risk level and repricing characteristics of the underlying asset. Riskier investments typically carry a higher interest rate but expose us to higher levels of market risk.

We have historically focused on maintaining high-asset quality, which results in a loan and lease portfolio subjected to strenuous underwriting and monitoring procedures. We avoid high-risk industry concentrations, but we do maintain a concentration of owner-occupied real estate loans to borrowers in medical and medical-related fields. Our focus on asset quality also influences the composition of our investment securities portfolio.

Interest-earning assets averaged $29.98 billion and $29.56 billion for the quarter ended June 30, 2016 and March 31, 2016, respectively. The $418.0 million increase from March 31, 2016 was due to a $308.0 million increase in loans and leases primarily as a result of originated loan growth and a $110.0 million increase in investment securities and overnight investments.

### Investment Securities

Investment securities were $6.56 billion at June 30, 2016, compared to $6.86 billion and $7.35 billion at December 31, 2015 and June 30, 2015, respectively. The $303.7 million and $792.6 million decrease in the portfolio from December 31, 2015 and June 30, 2015, respectively, was attributable to reinvesting a portion of the proceeds from sales, maturities and calls into overnight investments pending reinvestment. The yield on overnight investments benefited from the December 2015 increase in the federal funds rate of 25 basis points.

Available for sale securities are reported at fair value and unrealized gains and losses are included as a component of other comprehensive income, net of deferred taxes. As of June 30, 2016, investment securities available for sale had a net pre-tax unrealized gain of $50.5 million, compared to a net pre-tax unrealized loss of $24.5 million as of December 31, 2015 and a net unrealized gain of $4.3 million as of June 30, 2015. After evaluating the securities with unrealized losses, management concluded that no other than temporary impairment existed as of June 30, 2016.

Sales of investment securities for the three months ended June 30, 2016 were $727.7 million resulting in a net realized gain of $12.5 million compared to sales of $40.2 million and a net gain of $147 thousand for same period of 2015. During the six months ended June 30, 2016 we generated $17.2 million in net realized gains on sales of investment securities of $1.70 billion compared to $5.2 million in net realized gains and investment securities sales of $482.5 million for the corresponding period of 2015.

At June 30, 2016, mortgage-backed securities represented 69.2 percent of investment securities available for sale, compared to U.S. Treasury, government agency securities, equity securities, corporate bonds and other, which represented 23.5 percent, 5.4 percent, 1.2 percent, 0.6 percent and 0.1 percent of the portfolio, respectively. Overnight investments are with the Federal Reserve Bank and other financial institutions.

Since December 31, 2015, cash flows from sales, maturities and calls of U.S. Treasury, government agency securities, and mortgage-backed securities have largely been reinvested into similar securities. Remaining proceeds from sales that are included in overnight investments are expected to be deployed back into the securities portfolio over the remainder of 2016. Additionally, purchases of equities have been made largely under a long term earnings optimization strategy. The carrying value of equity securities and corporate bonds increased by $72.5 million and $32.9 million, respectively, while U.S. Treasury, government agency and mortgage-backed securities declined $133.4 million, $143.1 million and $132.4 million, respectively.

The primary objective of the investment portfolio is to generate incremental income by deploying excess funds into securities that have minimal liquidity and credit risk and low to moderate interest rate risk. Other objectives include acting as a stable source of liquidity, serving as a tool for asset and liability management and maintaining an interest rate risk profile compatible with BancShares' objectives. Changes in the total balance of our investment securities portfolio result from trends among loans and leases, deposits and short-term borrowings. Generally, when inflows arising from deposit and treasury services products exceed loan and lease demand, we invest excess funds into the securities portfolio or into overnight investments. Conversely, when loan demand exceeds growth in deposits and short-term borrowings, we allow any overnight investments to decline and use proceeds from maturing securities and prepayments to fund loan demand.

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Table 9
Investment Securities

| | June 30, 2016 | | December 31, 2015 | | June 30, 2015 | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Cost | Fair value | Cost | Fair value | Cost | Fair Value |
| Investment securities available for sale: | | | | | | |
| U.S. Treasury | $1,538,211 | $1,541,479 | $1,675,996 | $1,674,882 | $2,198,027 | $2,206,859 |
| Government agency | 355,014 | 355,545 | 498,804 | 498,660 | 774,962 | 776,244 |
| Mortgage-backed securities | 4,489,218 | 4,535,831 | 4,692,447 | 4,668,198 | 4,372,946 | 4,367,091 |
| Equity securities | 81,114 | 81,390 | 7,935 | 8,893 | — | — |
| Corporate bonds | 41,360 | 41,385 | 8,500 | 8,500 | — | — |
| Other | 2,115 | 1,950 | 2,115 | 2,160 | — | — |
| Total investment securities available for sale | 6,507,032 | 6,557,580 | 6,885,797 | 6,861,293 | 7,345,935 | 7,350,194 |
| Investment securities held to maturity: | | | | | | |
| Mortgage-backed securities | 156 | 165 | 255 | 265 | 351 | 365 |
| Total investment securities | $6,507,188 | $6,557,745 | $6,886,052 | $6,861,558 | $7,346,286 | $7,350,559 |

Loans and Leases
Loans at June 30, 2016, were $20.74 billion, a net increase of $502.6 million compared to December 31, 2015, representing growth of 5.0 percent on an annualized basis. Originated loan growth was $531.6 million primarily due to continued growth in the commercial portfolio. PCI loans decreased by $29.0 million, reflecting loan runoff of $105.6 million, offset by net loans acquired from NMSB of $34.6 million and FCSB of $42.0 million at June 30, 2016.
Non-PCI loans increased by $1.42 billion, compared to June 30, 2015, reflecting originated loan growth. PCI loans decreased by $201.8 million from June 30, 2015, due to continued pay downs in the PCI loan portfolio, offset by the contributions from the NMSB and FCSB acquisitions with loan balances of $34.6 million and $42.0 million, respectively, at June 30, 2016.

BancShares reports PCI and non-PCI loan portfolios separately and each portfolio is further divided into commercial and non-commercial. Additionally, loans are assigned to loan classes, which further disaggregate loans based upon common risk characteristics, such as commercial real estate, commercial and industrial or residential mortgage. Table 10 provides the composition of PCI and non-PCI loans and leases.

PCI Loans
The PCI portfolio includes loans acquired in a transfer, including business combinations, where there is evidence of credit
deterioration since origination and it is probable at the date of acquisition that we will not collect all contractually required
principal and interest payments. All nonrevolving loans are evaluated at acquisition and where a discount is required at least in part due to credit quality, the loans are accounted for under the guidance in ASC Topic 310-30. PCI loans and leases are valued at fair value at the date of acquisition.

PCI loans at June 30, 2016 were $921.5 million, representing 4.4 percent of total loans and leases, compared to $950.5 million and $1.12 billion at December 31, 2015 and June 30, 2015, respectively.

PCI commercial loans were $576.9 million at June 30, 2016, a decrease of $16.7 million since December 31, 2015 and a decrease of $120.1 million since June 30, 2015. At June 30, 2016, PCI noncommercial loans were $344.5 million, a decrease of $12.4 million and $81.7 million since December 31, 2015 and June 30, 2015, respectively. The runoff in the PCI loan portfolio was offset by the contributions from the NMSB and FCSB acquisitions.

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Non-PCI Loans and Leases

The non-PCI portfolio includes loans that management has the intent and ability to hold and is reported at the principal balance
outstanding, net of deferred loan fees, including unearned income and unamortized costs, fees, premiums and discounts. Non-PCI loans include originated commercial loans and leases, originated noncommercial loans, purchased non-impaired loans, purchased leases and certain purchased revolving credit. For purchased non-impaired loans to be included as non-PCI, it must be determined that the loans do not have a discount at least in part due to credit quality at the time of acquisition. Purchased non-impaired loans are initially recorded at their fair value at the date of acquisition.

Non-PCI loans at June 30, 2016 were $19.82 billion, representing 95.6 percent of total loans and leases, compared to $19.29 billion and $18.40 billion at December 31, 2015 and June 30, 2015, respectively.

The non-PCI commercial loan portfolio is composed of Commercial Mortgage, Commercial and Industrial, Construction and Land Development, Lease Financing, Other Commercial Real Estate and Other Commercial loans. Non-PCI commercial loans were $13.00 billion at June 30, 2016, an increase of $373.5 million and $1.13 billion, compared to December 31, 2015 and June 30, 2015, respectively, resulting from continued loan growth.

The non-PCI noncommercial loan portfolio is composed of Residential Mortgage, Revolving Mortgage, Consumer and Construction and Land Development loans. Non-PCI noncommercial loans were $6.82 billion at June 30, 2016, an increase of $158.1 million and $298.6 million compared to December 31, 2015 and June 30, 2015, respectively.

Table 10
Loans and Leases

| (Dollars in thousands) | June 30, 2016 | December 31, 2015 | June 30, 2015 |
|---|---|---|---|
| Non-PCI loans and leases: | | | |
| Commercial: | | | |
| Construction and land development | $624,806 | $620,352 | $547,151 |
| Commercial mortgage | 8,505,259 | 8,274,548 | 7,861,590 |
| Other commercial real estate | 337,618 | 321,021 | 288,214 |
| Commercial and industrial | 2,386,159 | 2,368,958 | 2,199,591 |
| Lease financing | 784,861 | 730,778 | 643,508 |
| Other | 365,269 | 314,832 | 338,389 |
| Total commercial loans | 13,003,972 | 12,630,489 | 11,878,443 |
| Noncommercial: | | | |
| Residential mortgage | 2,777,863 | 2,695,985 | 2,597,064 |
| Revolving mortgage | 2,533,528 | 2,523,106 | 2,529,936 |
| Construction and land development | 226,322 | 220,073 | 227,280 |
| Consumer | 1,279,419 | 1,219,821 | 1,164,223 |
| Total noncommercial loans | 6,817,132 | 6,658,985 | 6,518,503 |
| Total non-PCI loans and leases | 19,821,104 | 19,289,474 | 18,396,946 |
| PCI loans: | | | |
| Commercial: | | | |
| Construction and land development | 27,742 | 33,880 | 48,208 |
| Commercial mortgage | 513,021 | 525,468 | 611,505 |
| Other commercial real estate | 20,166 | 17,076 | 14,353 |
| Commercial and industrial | 12,854 | 15,182 | 20,382 |
| Other | 3,159 | 2,008 | 2,597 |

| | | | |
|---|---|---|---|
| Total commercial loans | 576,942 | 593,614 | 697,045 |
| Noncommercial: | | | |
| Residential mortgage | 294,625 | 302,158 | 358,307 |
| Revolving mortgage | 47,230 | 52,471 | 64,340 |
| Construction and land development | 467 | — | 345 |
| Consumer | 2,203 | 2,273 | 3,202 |
| Total noncommercial loans | 344,525 | 356,902 | 426,194 |
| Total PCI loans | 921,467 | 950,516 | 1,123,239 |
| Total loans and leases | $20,742,571 | $20,239,990 | $19,520,185 |

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Allowance for Loan and Lease Losses (ALLL)

The ALLL was $208.0 million at June 30, 2016, representing an increase of $1.8 million and a decline of $309 thousand since December 31, 2015 and June 30, 2015, respectively. BancShares continues to experience improvement in credit quality indicators which have reduced the ALLL ratio since June 30, 2015. The ALLL as a percentage of total loans and leases was 1.00 percent at June 30, 2016, compared to 1.02 percent and 1.07 percent at December 31, 2015 and June 30, 2015, respectively. The decline in the ALLL ratio from both periods was primarily due to lower reserves on PCI loans due to runoff in the portfolio.

At June 30, 2016, the ALLL allocated to non-PCI loans and leases was $196.5 million, or 0.99 percent of non-PCI loans and leases, compared to $189.9 million, or 0.98 percent, at December 31, 2015 and $192.8 million, or 1.05 percent, at June 30, 2015. The ALLL for non-PCI loans and leases increased from both December 31, 2015 and June 30, 2015 primarily due to loan growth. An additional ALLL of $11.6 million relates to PCI loans at June 30, 2016, compared to $16.3 million and $15.5 million at December 31, 2015 and June 30, 2015, respectively. The ALLL on the PCI loan portfolio declined from both periods due to the runoff of this portfolio.

The ALLL allocated to originated non-PCI loans and leases was 1.12 percent of originated non-PCI loans and leases at June 30, 2016, compared to 1.14 percent and 1.27 percent at December 31, 2015 and June 30, 2015, respectively. Originated non-PCI loans were $17.53 billion, $16.60 billion and $15.21 billion at June 30, 2016, December 31, 2015 and June 30, 2015, respectively, and do not include purchased revolving, purchased non-PCI loans or PCI loans. In the commercial non-PCI loan portfolio, credit quality improvements included low net charge-off ratios and migration of loans with higher credit risk ratings to lower ratings. The noncommercial non-PCI loan portfolio also experienced lower delinquency trends.

BancShares recorded $4.6 million net provision expense for loan and lease losses during the second quarter of 2016, compared to net provision expense of $4.8 million in the first quarter of 2016. The decline of $281 thousand was due to continued credit quality improvements and lower net charge-offs on loans and leases, offset by higher originated loan growth. Compared to the second quarter of 2015, provision expense decreased $3.2 million due primarily to less originated loan growth in 2016. On an annualized basis, total net charge-offs as a percentage of total average loans and leases decreased during the second quarter of 2016 to 0.06 percent, compared to 0.08 percent in the first quarter of 2016 and 0.10 percent in the second quarter of 2015.

Net provision expense for the six months ended June 30, 2016 was $9.4 million, compared to net provision expense of $13.5 million for the same period of 2015. The decline in provision expense was primarily due to lower loan growth in the non-PCI portfolio for the six months ended June 30, 2016 compared to the same period in 2015.

Provision expense for non-PCI loan and leases was $6.7 million during the second quarter of 2016, compared to $6.8 million in the first quarter of 2016 and $9.0 million in the second quarter of 2015. The decline in provision expense from 2015 was due to lower originated loan growth. Net charge-offs for non-PCI loans and leases were $3.3 million during the second quarter of 2016, compared to $3.7 million and $4.1 million during the first quarter of 2016 and second quarter of 2015, respectively. On an annualized basis, non-PCI net charge-offs as a percentage of non-PCI average loans and leases during the second quarter of 2016 were 0.07 percent, down from 0.08 percent during the first quarter of 2016 and 0.09 percent from the second quarter of 2015.

The PCI loan net provision credit was $2.1 million during the second quarter of 2016, compared to net provision credits of $2.0 million and $1.3 million for the first quarter of 2016 and second quarter of 2015, respectively.

Management considers the ALLL adequate to absorb estimated inherent losses that relate to loans and leases outstanding at June 30, 2016, although future adjustments may be necessary based on changes in economic conditions

and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the ALLL. Such agencies may require adjustments to the ALLL based on information available to them at the time of their examination.

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Table 11
Allowance for Loan and Lease Losses Components by Loan Class

| (Dollars in thousands) | 2016 Second Quarter | First Quarter | 2015 Fourth Quarter | Third Quarter | Second Quarter | Six months ended June 30 2016 | 2015 |
|---|---|---|---|---|---|---|---|
| Allowance for loan and lease losses at beginning of period | $206,783 | $206,216 | $205,463 | $208,317 | $205,553 | $206,216 | $204,466 |
| Non-PCI provision for loan and lease losses: | | | | | | | |
| Commercial: | | | | | | | |
| Construction and land development | 291 | 943 | 2,393 | 1,189 | 88 | 1,234 | 1,191 |
| Commercial mortgage | 701 | 394 | (4,600) | (5,664) | (1,878) | 1,096 | (5,557) |
| Other commercial real estate | (79) | (104) | 1,047 | 291 | (227) | (184) | 231 |
| Commercial and industrial | 81 | 2,201 | 6,137 | (799) | 4,547 | 2,282 | 12,093 |
| Lease financing | 343 | (282) | 759 | 424 | 408 | 62 | 419 |
| Other | 37 | (328) | 680 | (58) | (1,824) | (290) | (2,042) |
| Total commercial loans | 1,374 | 2,824 | 6,416 | (4,617) | 1,114 | 4,200 | 6,335 |
| Noncommercial: | | | | | | | |
| Residential mortgage | 1,487 | 776 | 1,707 | 520 | 1,162 | 2,262 | 1,975 |
| Revolving mortgage | 1,470 | 1,158 | (1,366) | 871 | 31 | 2,628 | (431) |
| Construction and land development | 78 | 87 | 235 | 114 | 74 | 165 | 192 |
| Consumer | 2,299 | 1,995 | 957 | 450 | 6,613 | 4,293 | 9,579 |
| Total noncommercial loans | 5,334 | 4,016 | 1,533 | 1,955 | 7,880 | 9,348 | 11,315 |
| Total non-PCI provision | 6,708 | 6,840 | 7,949 | (2,662) | 8,994 | 13,548 | 17,650 |
| PCI provision for loan losses | (2,146) | (1,997) | (903) | 2,769 | (1,275) | (4,143) | (4,139) |
| Non-PCI Charge-offs: | | | | | | | |
| Commercial: | | | | | | | |
| Construction and land development | (136) | (426) | (437) | (336) | (221) | (562) | (239) |
| Commercial mortgage | (44) | (90) | (809) | (411) | (47) | (134) | (280) |
| Other commercial real estate | — | — | — | — | (9) | — | (178) |
| Commercial and industrial | (1,177) | (1,317) | (1,137) | (784) | (2,318) | (2,494) | (4,031) |
| Lease financing | — | — | (374) | (7) | (6) | — | (21) |
| Other | (88) | (71) | — | — | — | (160) | — |
| Total commercial loans | (1,445) | (1,904) | (2,757) | (1,538) | (2,601) | (3,350) | (4,749) |
| Noncommercial: | | | | | | | |
| Residential mortgage | (179) | (174) | (851) | (394) | (90) | (352) | (374) |
| Revolving mortgage | (1,081) | (1,036) | (840) | (677) | (616) | (2,116) | (1,409) |
| Construction and land development | — | — | — | — | — | — | (22) |
| Consumer | (3,136) | (3,108) | (3,761) | (2,409) | (2,743) | (6,243) | (5,526) |
| Total noncommercial loans | (4,396) | (4,318) | (5,452) | (3,480) | (3,449) | (8,711) | (7,331) |
| Total non-PCI charge-offs | (5,841) | (6,222) | (8,209) | (5,018) | (6,050) | (12,061) | (12,080) |
| Non-PCI Recoveries: | | | | | | | |
| Commercial: | | | | | | | |
| Construction and land development | 129 | 80 | 271 | 129 | 104 | 209 | 166 |
| Commercial mortgage | 500 | 256 | 150 | 794 | 323 | 755 | 1,084 |
| Other commercial real estate | 10 | 143 | 11 | 15 | 9 | 154 | 19 |
| Commercial and industrial | 525 | 479 | 11 | 296 | 209 | 1,004 | 603 |
| Lease financing | 1 | 180 | — | 16 | 11 | 180 | 22 |
| Other | 29 | 321 | — | 45 | 31 | 350 | 46 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total commercial loans | 1,194 | 1,459 | 443 | 1,295 | 687 | 2,652 | 1,940 |
| Noncommercial: | | | | | | | |
| Residential mortgage | 41 | 20 | 104 | 314 | 305 | 61 | 443 |
| Revolving mortgage | 214 | 32 | 330 | 363 | 346 | 245 | 480 |
| Construction and land development | — | 3 | — | 3 | 3 | 3 | 71 |
| Consumer | 1,111 | 990 | 1,381 | 762 | 630 | 2,101 | 1,508 |
| Total noncommercial loans | 1,366 | 1,045 | 1,815 | 1,442 | 1,284 | 2,410 | 2,502 |
| Total non-PCI recoveries | 2,560 | 2,504 | 2,258 | 2,737 | 1,971 | 5,062 | 4,442 |
| Non-PCI loans and leases charged off, net | (3,281) | (3,718) | (5,951) | (2,281) | (4,079) | (6,999) | (7,638) |
| PCI loans charged off, net | (56) | (558) | (342) | (680) | (876) | (614) | (2,022) |
| Allowance for loan and lease losses at end of period | $208,008 | $206,783 | $206,216 | $205,463 | $208,317 | $208,008 | $208,317 |
| Reserve for unfunded commitments | $399 | $407 | $379 | $411 | $389 | $399 | $389 |

The provision expense for commercial mortgage non-PCI loans and leases was $701 thousand and $1.1 million for the three and six months ended June 30, 2016, compared to net provision credits of $1.9 million and $5.6 million for the same periods of 2015. The increase in provision expense was primarily due to originated loan growth for the three and six months ended June 30, 2016, compared to the same periods of 2015.

The provision expense for commercial and industrial non-PCI loans and leases was $81 thousand and $2.3 million for the three and six months ended June 30, 2016, compared to provision expense of $4.5 million and $12.1 million for the same periods of 2015. The decrease in provision expense was due to lower net charge-offs, lower loan growth and a provision release in the current quarter related to a large loan payoff.

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Other non-PCI loans and leases had provision expense of $37 thousand and a net provision credit of $290 thousand for the three and six months ended June 30, 2016, compared to net provision credits of $1.8 million and $2.0 million for the same periods of 2015. The increase in provision expense during 2016 was due to higher originated loan growth. The provision credit in 2015 resulted from reclassifying one large loan from other non-PCI loans to commercial mortgage non-PCI loans.

Revolving mortgage non-PCI loans and leases had provision expense of $1.5 million and $2.6 million for the three and six months ended June 30, 2016, compared to provision expense of $31 thousand and a net provision credit of $431 thousand for the same periods of 2015. The increase in provision expense was due to higher originated loan growth.

The provision expense for consumer non-PCI loans and leases was $2.3 million and $4.3 million for the three and six months ended June 30, 2016, compared to $6.6 million and $9.6 million for the same periods of 2015. The decrease in provision expense was due to an adjustment to the loss rate for certain consumer loans in 2015.

Table 12

Allowance for Loan and Lease Losses Metrics and Ratios

| (Dollars in thousands) | 2016 Second Quarter | 2016 First Quarter | 2015 Fourth Quarter | 2015 Third Quarter | 2015 Second Quarter | Six months ended June 30 2016 | Six months ended June 30 2015 |
|---|---|---|---|---|---|---|---|
| Average loans and leases: | | | | | | | |
| PCI | $931,820 | $939,839 | $996,637 | $1,081,497 | $1,173,105 | $935,830 | $1,186,719 |
| Non-PCI | 19,725,274 | 19,409,252 | 19,062,919 | 18,679,648 | 18,181,718 | 19,567,263 | 17,952,902 |
| Loans and leases at period-end: | | | | | | | |
| PCI | 921,467 | 945,887 | 950,516 | 1,044,064 | 1,123,239 | 921,467 | 1,123,239 |
| Non-PCI | 19,821,104 | 19,471,802 | 19,289,474 | 18,811,742 | 18,396,946 | 19,821,104 | 18,396,946 |
| Allowance for loan and lease losses allocated to loans and leases: | | | | | | | |
| PCI | 11,555 | 13,757 | 16,312 | 17,557 | 15,468 | 11,555 | 15,468 |
| Non-PCI | 196,453 | 193,026 | 189,904 | 187,906 | 192,849 | 196,453 | 192,849 |
| Total | $208,008 | $206,783 | $206,216 | $205,463 | $208,317 | $208,008 | $208,317 |
| Net charge-offs (annualized) to average loans and leases: | | | | | | | |
| PCI | 0.02 % | 0.24 % | 0.14 % | 0.25 % | 0.30 % | 0.13 % | 0.34 % |
| Non-PCI | 0.07 | 0.08 | 0.12 | 0.05 | 0.09 | 0.07 | 0.09 |
| Total | 0.06 | 0.08 | 0.12 | 0.06 | 0.10 | 0.07 | 0.10 |
| ALLL to total loans and leases: | | | | | | | |
| PCI | 1.25 | 1.45 | 1.72 | 1.68 | 1.38 | 1.25 | 1.38 |
| Non-PCI | 0.99 | 0.99 | 0.98 | 1.00 | 1.05 | 0.99 | 1.05 |
| Total | 1.00 | 1.01 | 1.02 | 1.03 | 1.07 | 1.00 | 1.07 |

The ALLL as a percentage of total loans and leases at June 30, 2016 was 1.00 percent, compared to 1.02 percent at December 31, 2015 and 1.07 percent at June 30, 2015.

The non-GAAP reconciliation in Table 13 provides a calculation of the adjusted ALLL and the related adjusted ALLL as a percentage of total loans and leases for the periods presented. Management uses these non-GAAP financial measures to monitor performance and believes this measure provides meaningful information as the remaining unamortized discounts provide coverage for losses similar to the ALLL. Non-GAAP financial measures have limitations as analytical tools, and should not be considered in isolation or as a substitute for analysis of BancShares' results or financial condition as reported under GAAP.

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Table 13
Adjusted Allowance for Loan and Lease Losses (Non-GAAP)

| | 2016 | | 2015 | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Second Quarter | First Quarter | Fourth Quarter | Third Quarter | Second Quarter |
| ALLL on non-PCI loans and leases (GAAP) | $196,453 | $193,026 | $189,904 | $187,906 | $192,849 |
| Unamortized discount related to non-PCI loans and leases (GAAP) | 34,991 | 37,878 | 41,124 | 45,068 | 49,309 |
| Adjusted ALLL on non-PCI loans and leases (non-GAAP) | 231,444 | 230,904 | 231,028 | 232,974 | 242,158 |
| | | | | | |
| ALLL on PCI loans (GAAP) | 11,555 | 13,757 | 16,312 | 17,557 | 15,468 |
| Unamortized discount related to PCI loans (GAAP) | 136,516 | 140,379 | 137,819 | 154,624 | 172,962 |
| Adjusted ALLL on PCI loans (non-GAAP) | 148,071 | 154,136 | 154,131 | 172,181 | 188,430 |
| | | | | | |
| Total ALLL (GAAP) | 208,008 | 206,783 | 206,216 | 205,463 | 208,317 |
| Net acquisition accounting fair value discounts on loans and leases (GAAP) | 171,507 | 178,257 | 178,943 | 199,692 | 222,271 |
| Adjusted ALLL (non-GAAP) | $379,515 | $385,040 | $385,159 | $405,155 | $430,588 |
| | | | | | |
| Adjusted ALLL to total loans and leases (non-GAAP): | | | | | |
| Non-PCI | 1.17 % | 1.19 % | 1.20 % | 1.24 % | 1.32 % |
| PCI | 16.07 | 16.30 | 16.22 | 16.49 | 16.78 |
| Total | 1.83 % | 1.89 % | 1.90 % | 2.04 % | 2.21 % |

The adjusted ALLL (non-GAAP), which includes the ALLL as well as remaining net acquisition fair value adjustments for acquired loans, declined to 1.83 percent of total loans and leases at June 30, 2016, from 1.90 percent and 2.21 percent of total loans and leases at December 31, 2015 and June 30, 2015, respectively. The reduction in the adjusted ALLL resulted primarily from credit quality improvements and continued accretion of acquisition accounting fair value adjustments.

Nonperforming Assets

Nonperforming assets include nonaccrual loans and leases and OREO resulting from both PCI and non-PCI loans. At June 30, 2016, BancShares' nonperforming assets were $159.9 million, a decline of $9.1 million from December 31, 2015 primarily due to reductions in commercial nonaccrual loans and leases. Nonperforming assets increased $4.5 million from June 30, 2015, related to an increase in nonaccrual loans and leases, offset by reductions in OREO balances.

OREO balances increased $1.5 million since December 31, 2015 and declined $6.2 million since June 30, 2015. Nonaccrual PCI loans at June 30, 2016 are down $3.8 million and $4.9 million from December 31, 2015 and June 30, 2015, respectively, due to resolutions of impaired loans. Nonaccrual non-PCI loans and leases at June 30, 2016 declined $6.8 million from December 31, 2015 as a result of problem asset resolutions primarily in the commercial loan portfolio, while nonaccrual non-PCI loans and leases increased $15.6 million from June 30, 2015 due to the downgrade of a few large commercial mortgage relationships and an increase in residential mortgage loans being placed on nonaccrual status.

Of the $159.9 million in nonperforming assets at June 30, 2016, $1.1 million related to loans and OREO covered by loss share agreements. Covered nonperforming assets continue to decline due to the expiration of FDIC loss share agreements, loan resolutions and the termination of five of FCB's nine loss share agreements with the FDIC during the second quarter of 2016 as previously discussed.

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Table 14
Nonperforming Assets

| | 2016 | | 2015 | | |
|---|---|---|---|---|---|
| (Dollars in thousands) | Second Quarter | First Quarter | Fourth Quarter | Third Quarter | Second Quarter |
| Nonaccrual loans and leases: | | | | | |
| Non-PCI | $89,006 | $90,455 | $95,854 | $87,276 | $73,435 |
| PCI | 3,759 | 7,319 | 7,579 | 5,329 | 8,672 |
| Other real estate | 67,089 | 65,068 | 65,559 | 69,859 | 73,248 |
| Total nonperforming assets | $159,854 | $162,842 | $168,992 | $162,464 | $155,355 |
| | | | | | |
| Nonaccrual loans and leases: | | | | | |
| Covered under loss share agreements | $637 | $2,968 | $2,992 | $3,171 | $2,732 |
| Not covered under loss share agreements | 92,128 | 94,806 | 100,441 | 89,434 | 79,375 |
| Other real estate: | | | | | |
| Covered | 484 | 9,734 | 6,817 | 8,152 | 12,890 |
| Noncovered | 66,605 | 55,334 | 58,742 | 61,707 | 60,358 |
| Total nonperforming assets | $159,854 | $162,842 | $168,992 | $162,464 | $155,355 |
| | | | | | |
| Loans and leases: | | | | | |
| Covered | $95,534 | $258,179 | $272,554 | $296,476 | $319,665 |
| Noncovered | 20,647,037 | 20,159,510 | 19,967,436 | 19,559,330 | 19,200,520 |
| | | | | | |
| Accruing loans and leases 90 days or more past due | | | | | |
| Non-PCI | 3,017 | 4,882 | 3,315 | 6,277 | 4,960 |
| PCI | 76,807 | 70,398 | 73,751 | 73,539 | 81,055 |
| | | | | | |
| Ratio of nonperforming assets to total loans, leases and other real estate owned: | | | | | |
| Covered | 1.17 % | 4.74 % | 3.51 % | 3.72 % | 4.70 % |
| Noncovered | 0.77 | 0.74 | 0.79 | 0.77 | 0.73 |
| Total | 0.77 % | 0.80 % | 0.83 % | 0.82 % | 0.79 % |

Troubled Debt Restructurings

Troubled debt restructurings (TDRs) are selectively made to provide relief to customers experiencing liquidity challenges or other circumstances that could affect their ability to meet their debt obligations. Typical modifications include short-term deferral of interest or modification of payment terms. Nonperforming TDRs are not accruing interest and are included as nonperforming assets within nonaccrual loans and leases. TDRs which are accruing at the time of restructure and continue to perform based on the restructured terms are considered performing.

Total PCI and non-PCI loans and leases classified as TDRs at June 30, 2016 were $139.3 million, compared to $144.8 million at December 31, 2015 and $151.6 million at June 30, 2015. Accruing TDRs were $113.2 million, decreases of $127 thousand and $14.4 million from December 31, 2015 and June 30, 2015, respectively. At June 30, 2016, nonaccruing TDRs were $26.1 million, a decrease of $5.4 million and an increase of $2.1 million from December 31, 2015 and June 30, 2015, respectively. The decrease in nonaccruing TDRs from December 31, 2015 was primarily related to large payoffs in the commercial loan portfolio.

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Table 15
Troubled Debt Restructurings

| (Dollars in thousands) | June 30, 2016 | December 31, 2015 | June 30, 2015 |
|---|---|---|---|
| Accruing TDRs: | | | |
| PCI | $23,369 | $ 29,231 | $41,355 |
| Non-PCI | 89,800 | 84,065 | 86,227 |
| Total accruing TDRs | 113,169 | 113,296 | 127,582 |
| Nonaccruing TDRs: | | | |
| PCI | 952 | 1,420 | 1,975 |
| Non-PCI | 25,185 | 30,127 | 22,020 |
| Total nonaccruing TDRs | 26,137 | 31,547 | 23,995 |
| All TDRs: | | | |
| PCI | 24,321 | 30,651 | 43,330 |
| Non-PCI | 114,985 | 114,192 | 108,247 |
| Total TDRs | $139,306 | $ 144,843 | $151,577 |

INTEREST-BEARING LIABILITIES

Interest-bearing liabilities include interest-bearing deposits, short-term borrowings and long-term obligations. Interest-bearing liabilities were $19.06 billion and $18.96 billion at June 30, 2016 and December 31, 2015, respectively. The $101.7 million increase from December 31, 2015 was primarily due to $150.0 million of new Federal Home Loan Bank (FHLB) borrowings in 2016 and a $133.8 million increase in customer repurchase agreements, offset by a decline in interest-bearing deposits of $178.4 million. Interest-bearing liabilities increased $316.3 million from June 30, 2015 primarily due to $380.0 million in additional FHLB borrowings, offset by a $64.0 million reduction in interest-bearing deposits.

Deposits

At June 30, 2016, total deposits were $27.26 billion, an increase of $327.0 million, or 1.2 percent, when compared to December 31, 2015 as a result of organic growth in demand and savings deposit accounts and the contributions from the NMSB and FCSB acquisitions, offset by runoff in time deposits and money market accounts. Deposits increased $745.9 million, or by 2.8 percent, when compared to June 30, 2015, primarily the result of organic growth in demand deposit, checking with interest and savings accounts and the contributions from the NMSB and FCSB acquisitions.
Due to our focus on maintaining a strong liquidity position, core deposit retention remains a key business objective. We believe that traditional bank deposit products remain an attractive option for many customers, but as economic conditions improve, we recognize that our liquidity position could be adversely affected as bank deposits are withdrawn and invested elsewhere. Our ability to fund future loan growth is dependent on our success at retaining existing deposits and generating new deposits at a reasonable cost.

Short-Term Borrowings

At June 30, 2016, short-term borrowings were $728.6 million compared to $594.7 million and $723.2 million at December 31, 2015 and June 30, 2015, respectively. The $133.8 million increase from December 31, 2015 was due to higher activity in customer repurchase agreements. The $5.3 million increase from June 30, 2015 was due to a $15.3 million increase in customer repurchase agreements, offset by maturities of FHLB borrowings of $10.0 million.

Long-Term Obligations

Long-term obligations were $850.5 million at June 30, 2016, up $146.3 million from December 31, 2015 primarily the result of incremental FHLB borrowings of $150.0 million during 2016 used to mitigate interest rate risk from long-term fixed rate loans. Long-term obligations were up $374.9 million from June 30, 2015 primarily due to new FHLB borrowings of $380.0 million since June 30, 2015.

At June 30, 2016, December 31, 2015 and June 30, 2015, long-term obligations included $132.5 million in junior subordinated debentures representing obligations to FCB/NC Capital Trust III, FCB/SC Capital Trust II, and SCB Capital Trust I, special purpose entities and grantor trusts for $128.5 million of trust preferred securities. FCB/NC

Capital Trust III, FCB/SC Capital Trust II, and SCB Capital Trust I's (the Trusts) trust preferred securities mature in 2036, 2034, and 2034, respectively, and may be redeemed at par in whole or in part at any time. BancShares has guaranteed all obligations of the Trusts.

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Shareholders' Equity and Capital Adequacy

BancShares and FCB are required to meet minimum capital requirements imposed by regulatory authorities. Failure to meet certain capital requirements may result in actions by regulatory agencies that could have a material impact on our consolidated financial statements.

In accordance with accounting principles generally accepted in the United States of America (GAAP), unrealized gains and losses on certain assets and liabilities, net of deferred taxes, are included in accumulated other comprehensive income (AOCI)within shareholders' equity. These amounts are excluded from shareholders' equity in the calculation of our capital ratios. In the aggregate, these items represented a net reduction in shareholders' equity of $15.0 million at June 30, 2016, compared to a net reduction of $64.4 million at December 31, 2015 and $51.2 million at June 30, 2015. The $49.4 million and $36.2 million changes in AOCI from December 31, 2015 and June 30, 2015, respectively, were primarily driven by an increase in unrealized gains on investment securities available for sale as a result of lower market interest rates over the periods.

Table 16
Analysis of Capital Adequacy

| | June 30, 2016 | | December 31, 2015 | | June 30, 2015 | | Regulatory minimum | | Well-capitalized requirement | |
|---|---|---|---|---|---|---|---|---|---|---|
| BancShares | | | | | | | | | | |
| Risk-based capital ratios | | | | | | | | | | |
| Tier 1 risk-based capital | 12.63 | % | 12.65 | % | 12.66 | % | 6.00 | % | 8.00 | % |
| Common equity Tier 1 | 12.63 | | 12.51 | | 12.52 | | 4.50 | | 6.50 | |
| Total risk-based capital | 14.10 | | 14.03 | | 14.10 | | 8.00 | | 10.00 | |
| Tier 1 leverage ratio | 9.09 | | 8.96 | | 8.92 | | 4.00 | | 5.00 | |
| | | | | | | | | | | |
| Bank | | | | | | | | | | |
| Risk-based capital ratios | | | | | | | | | | |
| Tier 1 risk-based capital | 12.44 | % | 12.64 | % | 12.61 | % | 6.00 | % | 8.00 | % |
| Common equity Tier 1 | 12.44 | | 12.64 | | 12.61 | | 4.50 | | 6.50 | |
| Total risk-based capital | 13.39 | | 13.61 | | 13.62 | | 8.00 | | 10.00 | |
| Tier 1 leverage ratio | 8.96 | | 8.95 | | 8.90 | | 4.00 | | 5.00 | |

Bank regulatory agencies approved regulatory capital guidelines (Basel III) aimed at strengthening existing capital requirements for banking organizations. The final rules set new minimum requirements for both the quantity and quality of capital held by BancShares and included a new common equity Tier 1 capital to risk-weighted assets ratio. A new capital conservation buffer was also established and was phased in beginning January 1, 2016 at 0.625 percent of risk-weighted assets and will increase each subsequent year by an additional 0.625 percent until reaching its final level of 2.50 percent on January 1, 2019. BancShares and FCB had capital conservation buffers above minimum risk-based capital requirements of 6.10 percent and 5.39 percent, respectively, at June 30, 2016. The buffers exceed the 0.625 percent requirement and, therefore, result in no limit on distributions.

As of June 30, 2016, BancShares continues to exceed minimum capital standards and FCB remains well-capitalized under the new rules. BancShares remained well-capitalized with a leverage capital ratio of 9.09 percent, Tier 1 risk-based capital ratio of 12.63 percent, common equity Tier 1 ratio of 12.63 and total risk-based capital ratio of 14.10 percent under Basel III guidelines at June 30, 2016.

BancShares had no trust preferred capital securities included in Tier 1 capital at June 30, 2016, compared to $32.1 million at December 31, 2015. The decrease during 2016 was due to the implementation of Basel III. Effective January 1, 2015, 75 percent of our trust preferred capital securities were excluded from Tier 1 capital and the remaining 25 percent were phased out on January 1, 2016 under Basel III requirements. Trust preferred capital securities continue to be a component of total risk-based capital.

RISK MANAGEMENT

Risk is inherent in any business and, as is the case with other management functions, senior management has primary responsibility for day-to-day management of the risks we face. The Board of Directors strive to ensure that risk management is part of the business culture and that policies and procedures for assessing, monitoring, and limiting risk are part of the daily decision-making process. The Board of Director’s role in risk oversight is an integral part of our overall enterprise risk

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management framework. The Board of Directors administers its risk oversight function primarily through the Board Risk Committee.
The Board Risk Committee structure is designed to allow for information flow and escalation of risk related issues. Among the duties and responsibilities as may be assigned from time to time by the Board of Directors, the Board Risk Committee is directed to monitor and advise the board regarding risk exposures, including credit, market, liquidity, operational, compliance, legal, strategic and reputational risks; review, approve and monitor adherence to risk appetite and supporting risk tolerance levels; evaluate, monitor and oversee the adequacy and effectiveness of the risk management framework; and review reports of examination by and communications from regulatory agencies, and the results of internal and third party testing, analyses and reviews, related to risks, risk management, and any other matters within the scope of the Board Risk Committee's oversight responsibilities, and monitor and review management's response to any noted issues. In addition, the Board Risk Committee may coordinate with the Audit Committee for the review of financial statements and related risks and other areas of joint responsibility.
The Dodd-Frank Act mandated that stress tests be developed and performed to ensure that financial institutions have sufficient capital to absorb losses and support operations during multiple economic and bank scenarios. Bank holding companies with total consolidated assets between $10 billion and $50 billion, including BancShares, will undergo annual company-run stress tests. As directed by the Federal Reserve, summaries of BancShares' results in the severely adverse stress tests are available to the public. In combination with other risk management and monitoring practices, the results of stress testing activities will be considered as part of our risk management program.

Credit risk management. Credit risk is the risk of not collecting payments pursuant to the contractual terms of loans, leases and investment securities. Loans and leases, other than acquired loans, were underwritten in accordance with our credit policies and procedures and are subject to periodic ongoing reviews. Acquired loans were recorded at fair value as of the acquisition date and are subject to periodic reviews to identify any further credit deterioration. Our independent credit review function conducts risk reviews and analyses of both acquired and originated loans to ensure compliance with credit policies and to monitor asset quality trends. The risk reviews include portfolio analysis by geographic location, industry, collateral type and product. We strive to identify potential problem loans as early as possible, to record charge-offs or write-downs as appropriate and to maintain an adequate ALLL that accounts for losses inherent in the loan and lease portfolio.

Interest rate risk management. Interest rate risk (IRR) results principally from assets and liabilities maturing or repricing at different points in time, from assets and liabilities repricing at the same point in time but in different amounts and from short-term and long-term interest rates changing in different magnitudes.

We assess our short term IRR by forecasting net interest income over 24 months under various interest rate scenarios and comparing those results to forecast net interest income assuming stable rates. Rate shock scenarios represent an instantaneous and parallel shift in rates, up or down, from a base yield curve. Due to the current low level of interest rates and competitive pressures that constrain our ability to further reduce deposit interest rates, it is unlikely that the rates on most interest-bearing liabilities can decline materially from current levels. Our shock projections incorporate assumptions of likely customer migration of low rate deposit instruments to intermediate term fixed rate instruments, such as certificates of deposit, as rates rise. Various other IRR scenarios are modeled to supplement shock scenarios. This may include interest rate ramps, changes in the shape of the yield curve and changes in the relationships of FCB rates to market rates.

Table 17
Net Interest Income Sensitivity Simulation Analysis

This table provides the impact on net interest income over 24 months resulting from various instantaneous interest rate shock scenarios as of June 30, 2016 and December 31, 2015.

| Change in interest rate (basis point) | Estimated increase (decrease) in net interest income | |
|---|---|---|
| | June 30, 2016 | December 31, 2015 |
| +100 | 5.01% | 2.78% |
| +200 | 6.56 | 2.80 |
| +300 | 3.79 | (0.75) |

The change in net interest income sensitivity metrics at June 30, 2016 compared to December 31, 2015 was primarily due to a shift in the earning asset mix with an increase in floating rate overnight investments and a reduction in fixed rate securities, and a decrease in intermediate and long-term treasury and swap rates which resulted in a change to the expected deposit mix.

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Table 18
Economic Value of Equity Modeling Analysis

Long-term interest rate risk exposure is measured using the economic value of equity (EVE) sensitivity analysis to study the impact of long-term cash flows on earnings and capital. EVE represents the difference between the sum of the present value of all asset cash flows and the sum of the present value of the liability cash flows. EVE sensitivity analysis involves discounting cash flows of balance sheet items under different interest rate scenarios. Cash flows will vary by interest rate scenario, resulting in variations in EVE. The base-case measurement and its sensitivity to shifts in the yield curve allow management to measure longer-term repricing and option risk in the balance sheet. This table presents the EVE profile as of June 30, 2016 and December 31, 2015.

| | Estimated increase (decrease) in EVE | |
|---|---|---|
| Change in interest rate (basis point) | June 30, 2016 | December 31, 2015 |
| +100 | 6.62 % | 3.18 % |
| +200 | 7.26 | 1.53 |
| +300 | 2.96 | (3.92 ) |

The improvement in the economic value of equity metrics at June 30, 2016 compared to December 31, 2015 was primarily due to balance sheet changes including a decrease in fixed rate securities and an increase in demand deposits, and a decrease in intermediate and long-term treasury and swap rates which had a favorable impact on deposits and EVE risk.

We do not typically utilize interest rate swaps, floors, collars or other derivative financial instruments to attempt to hedge our overall balance sheet rate sensitivity and interest rate risk. However, we had an interest rate swap agreement that expired in June 2016 that synthetically converted the variable rate on $93.5 million of junior subordinated debentures to a fixed rate of 5.50 percent through June 2016. See Note M to the Consolidated Financial Statements for additional discussion of this interest rate swap.

Liquidity risk management. Liquidity risk is the risk that an institution will be unable to generate or obtain sufficient cash or its equivalents on a cost-effective basis to meet commitments as they fall due. The most common sources of liquidity risk arise from mismatches in the timing and value of on-balance sheet and off-balance sheet cash inflows and outflows. In general, on-balance sheet mismatches generate liquidity risk when the effective maturity of assets exceeds the effective maturity of liabilities. A commonly cited example of a balance sheet liquidity mismatch is when long-term loans (assets) are funded with short-term deposits (liabilities). Other forms of liquidity risk include market constraints on the ability to convert assets into cash at expected levels, an inability to access funding sources at sufficient levels at a reasonable cost, and changes in economic conditions or exposure to credit, market, operation, legal and reputation risks that can affect an institution’s liquidity risk profile.

We utilize various limit-based measures to monitor, measure and control liquidity risk across three different types of liquidity:

- Tactical liquidity measures the risk of a negative cash flow position whereby cash outflows exceed cash inflows over a short-term horizon out to nine weeks;
- Structural liquidity measures the amount by which illiquid assets are supported by long-term funding; and
- Contingent liquidity utilizes cash flow stress testing across three crisis scenarios to determine the adequacy of our liquidity.

We aim to maintain a diverse mix of liquidity sources to support the liquidity management function, while aiming to avoid funding concentrations by diversifying our external funding with respect to maturities, counterparties and

nature. Our primary sources of liquidity are our retail deposit book due to the generally stable balances and low cost it offers, cash in excess of our reserve requirement at the Federal Reserve Bank and various other corresponding bank accounts and unencumbered securities, all of which were $4.03 billion at June 30, 2016 compared to $3.96 billion at December 31, 2015. Another source of available funds is advances from the FHLB of Atlanta. Outstanding FHLB advances were $670.2 million as of June 30, 2016, and we had sufficient collateral pledged to secure $5.34 billion of additional borrowings. We also maintain Federal Funds lines and other borrowing facilities which had $690.0 million of available capacity at June 30, 2016.

We entered into forward-starting advances with the FHLB of Atlanta in June 2016 to receive $200.0 million of fixed rate long-term funding. There are two advances of $100.0 million each scheduled to fund in June 2018 with maturity dates of June 2026 and 2028.

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## CRITICAL ACCOUNTING POLICIES

There have been no significant changes in our Critical Accounting Policies as described in our 2015 Annual Report on Form 10-K.

## FORWARD-LOOKING STATEMENTS

Statements in this Report and exhibits relating to plans, strategies, economic performance and trends, projections of results of specific activities or investments, expectations or beliefs about future events or results and other statements that are not descriptions of historical facts may be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Forward-looking information is inherently subject to risks and uncertainties, and actual results could differ materially from those currently anticipated due to a number of factors which include, but are not limited to, factors discussed in our Annual Report on Form 10-K and in other documents filed by us from time to time with the Securities and Exchange Commission.

Forward-looking statements may be identified by terms such as “may,” “will,” “should,” “could,” “expects,” “plans,” “intends, “anticipates,” “believes,” “estimates,” “predicts,” “forecasts,” “projects,” “potential” or “continue,” or similar terms or the neg these terms, or other statements concerning opinions or judgments of BancShares’ management about future events.

Factors that could influence the accuracy of those forward-looking statements include, but are not limited to, the financial success or changing strategies of our customers, customer acceptance of our services, products and fee structure, the competitive nature of the financial services industry, our ability to compete effectively against other financial institutions in our banking markets, actions of government regulators, the level of market interest rates and our ability to manage our interest rate risk, changes in general economic conditions that affect our loan and lease portfolio, the abilities of our borrowers to repay their loans and leases, the values of real estate and other collateral, the impact of the FDIC-assisted transactions and other developments or changes in our business that we do not expect. Actual results may differ materially from those expressed in or implied by any forward-looking statements. Except to the extent required by applicable law or regulation, BancShares undertakes no obligation to revise or update publicly any forward-looking statements for any reason.

## Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the potential economic loss resulting from changes in market prices and interest rates. This risk can either result in diminished current fair values of financial instruments or reduced net interest income in future periods. As of June 30, 2016, BancShares’ market risk profile has not changed significantly from December 31, 2015, as discussed in the Form 10-K. Changes in fair value that result from movement in market rates cannot be predicted with any degree of certainty. Therefore, the impact that future changes in market rates will have on the fair values of financial instruments is uncertain.

## Item 4. Controls and Procedures

BancShares' management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of BancShares' disclosure controls and procedures as of the end of the period covered by this Quarterly Report, in accordance with Rule 13a-15 of the Securities Exchange Act of 1934 (Exchange Act). Based upon that evaluation, as of the end of the period covered by this report, the Chief Executive Officer and the Chief Financial Officer concluded that BancShares' disclosure controls and procedures were effective to provide reasonable assurance that it is able to record, process, summarize and report in a timely manner the information required to be disclosed in the reports it files under the Exchange Act.

No change in BancShares' internal control over financial reporting occurred during the second quarter of 2016 that had materially affected, or is reasonably likely to materially affect, BancShares' internal control over financial reporting.

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PART II

Item 1. Legal Proceedings

BancShares and various subsidiaries have been named as defendants in various legal actions arising from our normal business activities in which damages in various amounts are claimed. Although the amount of any ultimate liability with respect to those other matters cannot be determined, in the opinion of management, any such liability will not have a material effect on BancShares’ consolidated financial statements.

Additional information relating to legal proceedings is set forth in Note L of BancShares' Notes to Unaudited Consolidated Financial Statements.

Item 1A. Risk Factors

The risks described below, as well as the risks described in our annual Form 10-K for the year ended December 31, 2015 should be carefully considered. The risks described may not be the only risks facing us. Additional risks and uncertainties not currently known to us or that are currently considered to not be material also may materially adversely affect our business, financial condition and/or operating results.

We may be adversely affected by risks associated with completed, pending or any potential future acquisitions.

We plan to continue to grow our business organically. However, we have pursued and expect to pursue additional acquisition opportunities that we believe support our business strategies and may enhance our profitability. We must generally satisfy a number of material conditions prior to consummating any acquisition, including, in many cases, federal and state regulatory approval. We may fail to complete strategic and competitively significant business opportunities as a result of our inability to obtain any required regulatory approvals in a timely manner or at all. Acquisitions of financial institutions involve operational risks and uncertainties, and acquired companies may have unknown or contingent liabilities, exposure to unexpected asset quality problems that require write downs or write-offs, difficulty retaining key employees and customers and other issues that could negatively affect our results of operations and financial condition.

We may not be able to realize projected cost savings, synergies or other benefits associated with any such acquisition. Failure to efficiently integrate any acquired entities into our existing operations could increase our operating costs significantly and have material adverse effects on our financial condition and results of operations. There can be no assurance that we will be successful in identifying or consummating any potential acquisitions.

The performance of equity securities and corporate bonds in the investment portfolio could be adversely impacted by the soundness and fluctuations in the market values of other financial institutions.

Our investment securities portfolio contains certain equity securities and corporate bonds of other financial institutions. As a result, a portion of our investment securities portfolio is subject to fluctuation due to changes in the financial stability and market value of other financial institutions. Such fluctuations could have an adverse effect on our results of operations.

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

On October 27, 2015, the Board of Directors approved a stock trading plan that provides for the purchase of up to 200,000 shares of Registrant's Class A common stock. The shares may be purchased from time to time from November 1, 2015 through October 31, 2016. The board's action approving share purchases does not obligate BancShares to acquire any particular amount of shares and purchases may be suspended or discontinued at any time. Any shares of stock that are purchased will be canceled.

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Item 6. Exhibits

| | |
|---|---|
| 31.1 | Certification of Chief Executive Officer (filed herewith) |
| 31.2 | Certification of Chief Financial Officer (filed herewith) |
| 32.1 | Certification of Chief Executive Officer (filed herewith) |
| 32.2 | Certification of Chief Financial Officer (filed herewith) |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

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SIGNATURES

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

| | |
|---|---|
| Date: August 4, 2016 | FIRST CITIZENS BANCSHARES, INC.<br>(Registrant) |
| By: | /s/ CRAIG L. NIX<br>Craig L. Nix<br>Chief Financial Officer |