CULLEN/FROST BANKERS, INC.
Form 10-Q
October 30, 2013
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United States
Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: September 30, 2013
Or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number: 001-13221
Cullen/Frost Bankers, Inc.
(Exact name of registrant as specified in its charter)

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

(210) 220-4011
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No ý
As of October 24, 2013, there were 60,497,866 shares of the registrant's Common Stock, $.01 par value, outstanding.

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Part I. Financial Information
Item 1. Financial Statements (Unaudited)
Cullen/Frost Bankers, Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share amounts)

	September 30, 2013	December 31, 2012
Assets:		
Cash and due from banks	$679,301	$790,106
Interest-bearing deposits	3,635,487	2,650,425
Federal funds sold and resell agreements	5,273	84,448
Total cash and cash equivalents	4,320,061	3,524,979
Securities held to maturity, at amortized cost	3,156,146	2,956,381
Securities available for sale, at estimated fair value	5,569,791	6,203,299
Trading account securities	15,289	30,074
Loans, net of unearned discounts	9,306,454	9,223,848
Less: Allowance for loan losses	(93,147)	(104,453)
Net loans	9,213,307	9,119,395
Premises and equipment, net	306,638	315,934
Goodwill	535,509	535,509
Other intangible assets, net	5,759	8,147
Cash surrender value of life insurance policies	140,404	138,005
Accrued interest receivable and other assets	266,856	292,346
Total assets	$23,529,760	$23,124,069
Liabilities:		
Deposits:		
Non-interest-bearing demand deposits	$8,101,773	$8,096,937
Interest-bearing deposits	11,877,121	11,400,429
Total deposits	19,978,894	19,497,366
Federal funds purchased and repurchase agreements	587,137	561,061
Junior subordinated deferrable interest debentures	123,712	123,712
Other long-term borrowings	100,000	100,007
Accrued interest payable and other liabilities	258,849	424,441
Total liabilities	21,048,592	20,706,587
Shareholders' Equity:		
Preferred stock, par value $0.01 per share; 10,000,000 shares authorized; 6,000,000 Series A shares ($25 liquidation preference) issued at September 30, 2013, none issued at December 31, 2012	144,486	—
Common stock, par value $0.01 per share; 210,000,000 shares authorized; 60,492,315 shares issued at September 30, 2013 and 61,479,189 shares issued at December 31, 2012	617	615
Additional paid-in capital	719,972	702,968
Retained earnings	1,546,101	1,475,851
Accumulated other comprehensive income, net of tax	145,727	238,048
Treasury stock, at cost; 1,140,149 shares at September 30, 2013, none at December 31, 2012	(75,735)	—
Total shareholders' equity	2,481,168	2,417,482

Total liabilities and shareholders' equity	$23,529,760	$23,124,069

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Income
(Dollars in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest income:				
Loans, including fees	$104,349	$101,643	$309,721	$297,330
Securities:				
Taxable	23,007	32,091	75,869	102,556
Tax-exempt	31,402	23,283	88,046	67,911
Interest-bearing deposits	2,077	1,115	4,928	2,948
Federal funds sold and resell agreements	16	27	67	75
Total interest income	160,851	158,159	478,631	470,820
Interest expense:				
Deposits	3,522	4,598	11,412	13,717
Federal funds purchased and repurchase agreements	30	37	89	105
Junior subordinated deferrable interest debentures	1,710	1,711	5,073	5,096
Other long-term borrowings	236	281	710	1,446
Total interest expense	5,498	6,627	17,284	20,364
Net interest income	155,353	151,532	461,347	450,456
Provision for loan losses	5,108	2,500	14,683	5,955
Net interest income after provision for loan losses	150,245	149,032	446,664	444,501
Non-interest income:				
Trust and investment management fees	22,692	20,843	67,138	62,774
Service charges on deposit accounts	20,742	20,797	60,830	62,230
Insurance commissions and fees	10,371	9,964	32,707	31,512
Interchange and debit card transaction fees	4,376	4,194	12,655	12,603
Other charges, commissions and fees	9,266	7,265	25,599	22,440
Net gain (loss) on securities transactions	(14)	—	(3)	(121)
Other	6,558	8,095	25,354	21,462
Total non-interest income	73,991	71,158	224,280	212,900
Non-interest expense:				
Salaries and wages	68,524	64,984	201,491	191,310
Employee benefits	14,989	14,019	47,609	44,768
Net occupancy	13,094	13,193	37,718	37,203
Furniture and equipment	14,629	14,193	43,800	41,347
Deposit insurance	2,921	2,593	8,645	7,928
Intangible amortization	780	973	2,388	2,978
Other	36,886	34,495	115,744	103,492
Total non-interest expense	151,823	144,450	457,395	429,026
Income before income taxes	72,413	75,740	213,549	228,375
Income taxes	11,969	17,071	38,254	50,611
Net Income	60,444	58,669	175,295	177,764
Preferred stock dividends	2,015	—	4,703	—
Net income available to common shareholders	$58,429	$58,669	$170,592	$177,764
Earnings per common share:				
Basic	$0.96	$0.95	$2.82	$2.89

Diluted	0.96	0.95	2.81	2.88

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Comprehensive Income
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$60,444	$58,669	$175,295	$177,764
Other comprehensive income (loss), before tax:				
Securities available for sale and transferred securities:				
Change in net unrealized gain/loss during the period	(551)	40,122	(95,920)	62,972
Change in net unrealized gain on securities transferred to held to maturity	(8,054)	—	(26,258)	—
Reclassification adjustment for net (gains) losses included in net income	14	—	3	121
Total securities available for sale and transferred securities	(8,591)	40,122	(122,175)	63,093
Defined-benefit post-retirement benefit plans:				
Change in the net actuarial gain/loss	1,640	1,427	4,919	4,084
Derivatives:				
Change in the accumulated gain/loss on effective cash flow hedge derivatives	(15)	(269)	(48)	(760)
Reclassification adjustments for (gains) losses included in net income:				
Interest rate swaps on variable-rate loans	(9,345)	(9,345)	(28,035)	(28,035)
Interest rate swap on junior subordinated deferrable interest debentures	1,120	1,063	3,308	3,140
Total derivatives	(8,240)	(8,551)	(24,775)	(25,655)
Other comprehensive income (loss), before tax	(15,191)	32,998	(142,031)	41,522
Deferred tax expense (benefit) related to other comprehensive income	(5,316)	11,550	(49,710)	14,533
Other comprehensive income (loss), net of tax	(9,875)	21,448	(92,321)	26,989
Comprehensive income	$50,569	$80,117	$82,974	$204,753

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Changes in Shareholders' Equity
(Dollars in thousands, except per share amounts)

	Nine Months Ended September 30,	
	2013	2012
Total shareholders' equity at beginning of period	$2,417,482	$2,283,537
Net income	175,295	177,764
Other comprehensive income (loss)	(92,321)	26,989
Stock option exercises (1,249,874 shares in 2013 and 197,961 shares in 2012)	65,026	10,092
Stock compensation expense recognized in earnings	7,310	7,942
Tax benefits (deficiencies) related to stock compensation	1,854	(425)
Issuance of preferred stock (6,000,000 shares in 2013)	144,486	—
Purchase of treasury stock (2,236,748 shares in 2013)	(144,000)	—
Cash dividends – preferred stock (approximately $0.78 per share in 2013)	(4,703)	—
Cash dividends – common stock ($1.48 per share in 2013 and $1.42 per share in 2012)	(89,261)	(87,282)
Total shareholders' equity at end of period	$2,481,168	$2,418,617

See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands)

	Nine Months Ended September 30,	
	2013	2012
Operating Activities:		
Net income	$175,295	$177,764
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	14,683	5,955
Deferred tax expense (benefit)	271	(5,020)
Accretion of loan discounts	(9,423)	(8,321)
Securities premium amortization (discount accretion), net	30,054	14,952
Net (gain) loss on securities transactions	3	121
Depreciation and amortization	28,835	28,374
Net loss on sale/write-down of assets/foreclosed assets	2,958	4,182
Stock-based compensation	7,310	7,942
Net tax benefit (deficiency) from stock-based compensation	(396)	(535)
Excess tax benefits from stock-based compensation	(2,250)	(110)
Earnings on life insurance policies	(2,399)	(3,042)
Net change in:		
Trading account securities	14,785	(1,214)
Accrued interest receivable and other assets	11,556	53,120
Accrued interest payable and other liabilities	(170,982)	(4,945)
Net cash from operating activities	100,300	269,223
Investing Activities:		
Securities held to maturity:		
Purchases	(257,571)	—
Maturities, calls and principal repayments	13,561	766
Securities available for sale:		
Purchases	(9,128,340)	(17,484,661)
Sales	8,497,061	15,987,480
Maturities, calls and principal repayments	1,192,979	617,489
Net change in loans	(102,195)	(823,627)
Net cash paid in acquisitions	—	(7,199)
Proceeds from sales of premises and equipment	16,312	3,765
Purchases of premises and equipment	(24,783)	(19,724)
Proceeds from sales of repossessed properties	6,363	10,715
Net cash from investing activities	213,387	(1,714,996)
Financing Activities:		
Net change in deposits	481,528	1,488,449
Net change in short-term borrowings	26,076	(120,998)
Principal payments on long-term borrowings	(7)	(14)
Proceeds from stock option exercises	65,026	10,092
Excess tax benefits from stock-based compensation	2,250	110
Proceeds from issuance of preferred stock	144,486	—
Purchase of treasury stock	(144,000)	—

Cash dividends paid on preferred stock	(4,703)	—
Cash dividends paid on common stock	(89,261)	(87,282)
Net cash from financing activities	481,395	1,290,357
Net change in cash and cash equivalents	795,082	(155,416)
Cash and equivalents at beginning of period	3,524,979	2,907,592
Cash and equivalents at end of period	$4,320,061	$2,752,176

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements
(Table amounts in thousands, except for share and per share amounts)
Note 1 - Significant Accounting Policies
Nature of Operations. Cullen/Frost Bankers, Inc. (Cullen/Frost) is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout numerous Texas markets. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, investment banking, insurance, brokerage, leasing, asset-based lending, treasury management and item processing.
Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest (collectively referred to as the “Corporation”). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies the Corporation follows conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.
The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Corporation’s financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (SEC). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with the Corporation’s consolidated financial statements, and notes thereto, for the year ended December 31, 2012, included in the Corporation’s Annual Report on Form 10-K filed with the SEC on February 8, 2013 (the “2012 Form 10-K”). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period.
Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. The allowance for loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly subject to change.
Cash Flow Reporting. Additional cash flow information was as follows:

	Nine Months Ended September 30,	
	2013	2012
Cash paid for interest	$17,681	$22,913
Cash paid for income tax	42,944	38,761
Significant non-cash transactions:		
Loans foreclosed and transferred to other real estate owned and foreclosed assets	3,251	5,336
Loans to facilitate the sale of other real estate owned	228	—
Deferred gain on sale of building and parking garage	922	—

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Note 2 - Securities

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

	September 30, 2013				December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held to Maturity								
U.S. Treasury	$248,488	$22,039	$—	$270,527	$248,188	$29,859	$—	$278,047
Residential mortgage-backed securities	9,868	101	57	9,912	10,725	300	—	11,025
States and political subdivisions	2,896,790	8,130	133,446	2,771,474	2,696,468	15,397	4,993	2,706,872
Other	1,000	—	1	999	1,000	—	—	1,000
Total	$3,156,146	$30,270	$133,504	$3,052,912	$2,956,381	$45,556	$4,993	$2,996,944
Available for Sale								
U.S. Treasury	$2,521,612	$22,449	$—	$2,544,061	$3,020,115	$37,806	$—	$3,057,921
Residential mortgage-backed securities	1,828,500	78,336	1,026	1,905,810	2,382,514	135,514	25	2,518,003
States and political subdivisions	1,066,966	22,151	5,105	1,084,012	552,056	39,427	—	591,483
Other	35,908	—	—	35,908	35,892	—	—	35,892
Total	$5,452,986	$122,936	$6,131	$5,569,791	$5,990,577	$212,747	$25	$6,203,299

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At September 30, 2013, approximately 96.1% of the securities in the Corporation's municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately 76.4% are either guaranteed by the Texas Permanent School Fund, which has a "triple A" insurer financial strength, or secured by U.S. Treasury securities via defeasance of the debt by the issuers. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities in the above table. The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law was $2.5 billion at September 30, 2013 and $2.7 billion and December 31, 2012.

During the fourth quarter of 2012, the Corporation reclassified certain securities from available for sale to held to maturity. The securities had an aggregate fair value of $2.3 billion with an aggregate net unrealized gain of $165.7 million ($107.7 million, net of tax) on the date of the transfer. The net unamortized, unrealized gain on the transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of September 30, 2013 totaled $138.8 million ($90.2 million, net of tax). This amount will be amortized out of accumulated other comprehensive income over the remaining life of the underlying securities as an adjustment of the yield on those securities.

As of September 30, 2013, securities, with unrealized losses segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
Residential mortgage-backed securities	$7,063	$57	$—	$—	$7,063	$57
States and political subdivisions	2,342,235	133,446	—	—	2,342,235	133,446

Other	999	1	—	—	999	1
Total	$2,350,297	$133,504	$—	$—	$2,350,297	$133,504
Available for Sale						
Residential mortgage-backed securities	$18,244	$1,025	$46	$1	$18,290	$1,026
States and political subdivisions	340,154	5,105	—	—	340,154	5,105
Total	$358,398	$6,130	$46	$1	$358,444	$6,131

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

Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time the Corporation will receive full value for the securities. Furthermore, as of September 30, 2013, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Corporation will not have to sell any such securities before a recovery of cost. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2013, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation's consolidated income statement.

The amortized cost and estimated fair value of securities, excluding trading securities, at September 30, 2013 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Residential mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$30,674	$31,223	$1,014,141	$1,015,777
Due after one year through five years	381,844	409,840	1,573,827	1,597,207
Due after five years through ten years	178,783	175,708	669,101	670,434
Due after ten years	2,554,977	2,426,229	331,509	344,655
Residential mortgage-backed securities	9,868	9,912	1,828,500	1,905,810
Equity securities	—	—	35,908	35,908
Total	$3,156,146	$3,052,912	$5,452,986	$5,569,791

Sales of securities available for sale were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Proceeds from sales	$1,474	$—	$8,497,061	$15,987,480
Gross realized gains	—	—	11	2,508
Gross realized losses	(14)	—	(14)	(2,629)
Tax (expense) benefit of securities gains/losses	5	—	1	42

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

	September 30, 2013	December 31, 2012
U.S. Treasury	$15,289	$14,038
States and political subdivisions	—	16,036
Total	$15,289	$30,074

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012

Net gain on sales transactions	$108	$310	$684	$932
Net mark-to-market gains (losses)	(29)	22	(409)	(57)
Net gain (loss) on trading account securities	$79	$332	$275	$875

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Note 3 - Loans

Loans were as follows:

	September 30, 2013	Percentage of Total	December 31, 2012	Percentage of Total
Commercial and industrial:				
Commercial	$4,357,696	46.8 %	$4,357,100	47.2 %
Leases	306,649	3.3	278,535	3.0
Asset-based	144,327	1.6	192,977	2.1
Total commercial and industrial	4,808,672	51.7	4,828,612	52.3
Commercial real estate:				
Commercial mortgages	2,746,821	29.5	2,495,481	27.1
Construction	412,529	4.4	608,306	6.6
Land	211,619	2.3	216,008	2.3
Total commercial real estate	3,370,969	36.2	3,319,795	36.0
Consumer real estate:				
Home equity loans	331,349	3.5	310,675	3.4
Home equity lines of credit	193,449	2.1	186,522	2.0
1-4 family residential mortgages	33,568	0.3	38,323	0.4
Construction	9,884	0.1	17,621	0.2
Other	231,577	2.5	224,206	2.4
Total consumer real estate	799,827	8.5	777,347	8.4
Total real estate	4,170,796	44.7	4,097,142	44.4
Consumer and other:				
Consumer installment	333,885	3.6	311,310	3.4
Other	16,227	0.2	8,435	0.1
Total consumer and other	350,112	3.8	319,745	3.5
Unearned discounts	(23,126)	(0.2)	(21,651)	(0.2)
Total loans	$9,306,454	100.0 %	$9,223,848	100.0 %

Loan Origination/Risk Management. The Corporation has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial and industrial loans are underwritten after evaluating and understanding the borrower’s ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower’s management possesses sound ethics and solid business acumen, the Corporation’s management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the

repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Corporation's exposure to adverse economic events that affect any single

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market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Corporation also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At September 30, 2013, approximately 58% of the outstanding principal balance of the Corporation's commercial real estate loans were secured by owner-occupied properties.

With respect to loans to developers and builders that are secured by non-owner occupied properties that the Corporation may originate from time to time, the Corporation generally requires the borrower to have had an existing relationship with the Corporation and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Corporation until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

The Corporation originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.

The Corporation maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Corporation's policies and procedures.

Concentrations of Credit. Most of the Corporation's lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of the Corporation's loan portfolio consists of commercial and industrial and commercial real estate loans. Other than energy loans, as of September 30, 2013 there were no concentrations of loans related to any single industry in excess of 10% of total loans.

Foreign Loans. The Corporation has U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant at September 30, 2013 or December 31, 2012.

Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Corporation considers the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Corporation's collateral position. Regulatory provisions would typically require the placement of a loan on non-accrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on non-accrual loans is recognized only to the extent that cash payments

are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

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

	September 30, 2013	December 31, 2012
Commercial and industrial:		
Energy	$766	$1,150
Other commercial	34,695	45,158
Commercial real estate:		
Buildings, land and other	40,541	38,631
Construction	—	1,100
Consumer real estate	2,298	2,773
Consumer and other	781	932
Total	$79,081	$89,744

As of September 30, 2013, non-accrual loans reported in the table above included $4.4 million related to loans that were restructured as "troubled debt restructurings" during 2013. Had non-accrual loans performed in accordance with their original contract terms, the Corporation would have recognized additional interest income, net of tax, of approximately $568 thousand and $1.8 million for the three and nine months ended September 30, 2013, compared to $646 thousand and $1.9 million for the same periods in 2012.

An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of September 30, 2013 was as follows:

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and industrial:						
Energy	$532	$228	$760	$1,078,139	$1,078,899	$—
Other commercial	18,105	16,838	34,943	3,694,830	3,729,773	6,606
Commercial real estate:						
Buildings, land and other	11,019	33,578	44,597	2,913,843	2,958,440	1,683
Construction	—	—	—	412,529	412,529	—
Consumer real estate	6,248	2,848	9,096	790,731	799,827	2,480
Consumer and other	4,182	653	4,835	345,277	350,112	452
Unearned discounts	—	—	—	(23,126)	(23,126)	—
Total	$40,086	$54,145	$94,231	$9,212,223	$9,306,454	$11,221

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

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

dependent construction loans is based on an “as is” valuation.

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Impaired loans are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
September 30, 2013					
Commercial and industrial:					
Energy	$545	$538	$—	$538	$—
Other commercial	41,214	19,134	11,528	30,662	6,607
Commercial real estate:					
Buildings, land and other	46,227	23,514	13,978	37,492	2,342
Construction	—	—	—	—	—
Consumer real estate	920	773	—	773	—
Consumer and other	352	311	—	311	—
Total	$89,258	$44,270	$25,506	$69,776	$8,949
December 31, 2012					
Commercial and industrial:					
Energy	$1,255	$—	$1,069	$1,069	$900
Other commercial	56,784	21,709	19,096	40,805	4,200
Commercial real estate:					
Buildings, land and other	44,652	19,010	17,149	36,159	3,137
Construction	1,497	1,100	—	1,100	—
Consumer real estate	961	864	—	864	—
Consumer and other	428	400	—	400	—
Total	$105,577	$43,083	$37,314	$80,397	$8,237

The average recorded investment in impaired loans was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Commercial and industrial:				
Energy	$269	$—	$402	$—
Other commercial	33,613	44,140	38,032	43,087
Commercial real estate:				
Buildings, land and other	37,960	42,569	37,149	41,283
Construction	508	1,671	793	1,465
Consumer real estate	788	1,087	818	1,805
Consumer and other	338	430	365	487
Total	$73,476	$89,897	$77,559	$88,127

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Troubled Debt Restructurings. The restructuring of a loan is considered a "troubled debt restructuring" if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules, reductions in collateral and other actions intended to minimize potential losses.

Troubled debt restructurings during the nine months ended September 30, 2013 and September 30, 2012 are set forth in the following table. Amounts represent the aggregate balance of the loans as of their individual restructuring dates.

	Nine Months Ended September 30,	
	2013	2012
Commercial and industrial:		
Energy	$528	$—
Other commercial	5,862	445
Commercial real estate:		
Buildings, land and other	7,443	—
	$13,833	$445

The modifications during the reported periods primarily related to extending amortization periods, converting the loans to interest only for a limited period of time and/or reducing required collateral. The Corporation did not grant interest-rate concessions on any restructured loan. The modifications did not significantly impact the Corporation's determination of the allowance for loan losses. As of September 30, 2013, $2.1 million of loans restructured during 2012 and 2013 were in excess of 90 days past due. During the nine months ended September 30, 2013, the Corporation charged-off $1.1 million related to loans restructured during 2012 and 2013. These charge-offs and the aforementioned past due loans did not significantly impact the Corporation's determination of the allowance for loan losses.

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Corporation's loan portfolio, management tracks certain credit quality indicators including trends related to (i) the weighted-average risk grade of commercial loans, (ii) the level of classified commercial loans, (iii) the delinquency status of consumer loans (see details above) (iv) net charge-offs, (v) non-performing loans (see details above) and (vi) the general economic conditions in the State of Texas.

The Corporation utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 14. A description of the general characteristics of the 14 risk grades is as follows:

- Grades 1, 2 and 3 – These grades include loans to very high credit quality borrowers of investment or near investment grade. These borrowers are generally publicly traded (grades 1 and 2), have significant capital strength, moderate leverage, stable earnings and growth, and readily available financing alternatives. Smaller entities, regardless of strength, would generally not fit in these grades.
- Grades 4 and 5 – These grades include loans to borrowers of solid credit quality with moderate risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality and the stability of the industry or market area.
- Grades 6, 7 and 8 – These grades include "pass grade" loans to borrowers of acceptable credit quality and risk. Such borrowers are differentiated from Grades 4 and 5 in terms of size, secondary sources of repayment or they are of lesser stature in other key credit metrics in that they may be over-leveraged, under capitalized, inconsistent in performance or in an industry or an economic area that is known to have a higher level of risk, volatility, or susceptibility to weaknesses in the economy.
- Grade 9 – This grade includes loans on management's "watch list" and is intended to be utilized on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near term.
- Grade 10 – This grade is for "Other Assets Especially Mentioned" in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.
- Grade 11 – This grade includes "Substandard" loans, in accordance with regulatory guidelines, for which the accrual of interest has not been stopped. By definition under regulatory guidelines, a "Substandard" loan has defined weaknesses

which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business.

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- Grade 12 – This grade includes “Substandard” loans, in accordance with regulatory guidelines, for which the accrual of interest has been stopped. This grade includes loans where interest is more than 120 days past due and not fully secured and loans where a specific valuation allowance may be necessary, but generally does not exceed 30% of the principal balance.
- Grade 13 – This grade includes “Doubtful” loans in accordance with regulatory guidelines. Such loans are placed on non-accrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Additionally, these loans generally have a specific valuation allowance in excess of 30% of the principal balance.
- Grade 14 – This grade includes “Loss” loans in accordance with regulatory guidelines. Such loans are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. “Loss” is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

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

	September 30, 2013		December 31, 2012	
	Weighted Average Risk Grade	Loans	Weighted Average Risk Grade	Loans
Commercial and industrial:				
Energy				
Risk grades 1-8	5.31	$1,066,168	5.24	$1,081,725
Risk grade 9	9.00	11,172	9.00	392
Risk grade 10	10.00	268	10.00	—
Risk grade 11	11.00	525	11.00	—
Risk grade 12	12.00	766	12.00	169
Risk grade 13	13.00	—	13.00	900
Total energy	5.36	$1,078,899	5.25	$1,083,186
Other commercial				
Risk grades 1-8	5.95	$3,467,415	5.81	$3,367,443
Risk grade 9	9.00	90,404	9.00	250,508
Risk grade 10	10.00	76,834	10.00	28,440
Risk grade 11	11.00	60,558	11.00	53,797
Risk grade 12	12.00	27,286	12.00	40,603
Risk grade 13	13.00	7,276	13.00	4,635
Total other commercial	6.25	$3,729,773	6.21	$3,745,426
Commercial real estate:				
Buildings, land and other				
Risk grades 1-8	6.59	$2,742,070	6.63	$2,460,448
Risk grade 9	9.00	70,918	9.00	92,041
Risk grade 10	10.00	50,321	10.00	42,603
Risk grade 11	11.00	54,405	11.00	77,658
Risk grade 12	12.00	38,384	12.00	35,602
Risk grade 13	13.00	2,342	13.00	3,137
Total commercial real estate	6.86	$2,958,440	6.97	$2,711,489
Construction				
Risk grades 1-8	6.99	$409,359	6.82	$579,108
Risk grade 9	9.00	1,320	9.00	23,046
Risk grade 10	10.00	1,437	10.00	4,435
Risk grade 11	11.00	413	11.00	617
Risk grade 12	12.00	—	12.00	1,100
Risk grade 13	13.00	—	13.00	—
Total construction	7.01	$412,529	6.94	$608,306

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The Corporation has established maximum loan to value standards to be applied during the origination process of commercial and consumer real estate loans. The Corporation does not subsequently monitor loan-to-value ratios (either individually or on a weighted-average basis) for loans that are subsequently considered to be of a pass grade (grades 9 or better) and/or current with respect to principal and interest payments. As stated above, when an individual commercial real estate loan has a calculated risk grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired. At that time, the Corporation reassesses the loan to value position in the loan. If the loan is determined to be collateral dependent, specific allocations of the allowance for loan losses are made for the amount of any collateral deficiency. If a collateral deficiency is ultimately deemed to be uncollectible, the amount is charged-off. These loans and related assessments of collateral position are monitored on an individual, case-by-case basis. The Corporation does not monitor loan-to-value ratios on a weighted-average basis for commercial real estate loans having a calculated risk grade of 10 or higher. Nonetheless, there were three commercial real estate loans having a calculated risk grade of 10 or higher in excess of $5 million as of September 30, 2013, which totaled $30.8 million and had a weighted-average loan-to-value ratio of approximately 75.4%. When an individual consumer real estate loan becomes past due by more than 10 days, the assigned relationship manager will begin collection efforts. The Corporation only reassesses the loan to value position in a consumer real estate loan if, during the course of the collections process, it is determined that the loan has become collateral dependent, and any collateral deficiency is recognized as a charge-off to the allowance for loan losses. Accordingly, the Corporation does not monitor loan-to-value ratios on a weighted-average basis for collateral dependent consumer real estate loans.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Commercial and industrial:				
Energy	$—	$—	$(900)	$4
Other commercial	(4,296)	(4,656)	(22,806)	(9,511)
Commercial real estate:				
Buildings, land and other	110	2,678	81	811
Construction	16	14	246	36
Consumer real estate	(457)	(156)	(718)	(441)
Consumer and other	(734)	(627)	(1,892)	(1,600)
Total	$(5,361)	$(2,747)	$(25,989)	$(10,701)

In assessing the general economic conditions in the State of Texas, management monitors and tracks the Texas Leading Index ("TLI"), which is produced by the Federal Reserve Bank of Dallas. The TLI is a single summary statistic that is designed to signal the likelihood of the Texas economy's transition from expansion to recession and vice versa.

Management believes this index provides a reliable indication of the direction of overall credit quality. The TLI is a composite of the following eight leading indicators: (i) Texas Value of the Dollar, (ii) U.S. Leading Index, (iii) real oil prices (iv) well permits, (v) initial claims for unemployment insurance, (vi) Texas Stock Index, (vii) Help-Wanted Index and (viii) average weekly hours worked in manufacturing. The TLI totaled 126.3 at August 31, 2013 (most recent date available) and 123.5 at December 31, 2012. A higher TLI value implies more favorable economic conditions.

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Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Corporation's allowance for loan loss methodology follows the accounting guidance set forth in U.S. generally accepted accounting principles and the Interagency Policy Statement on the Allowance for Loan and Lease Losses, which was jointly issued by U.S. bank regulatory agencies. In that regard, the Corporation's allowance for loan losses includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss and recovery experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate determination of the appropriate level of the allowance is dependent upon a variety of factors beyond the Corporation's control, including, among other things, the performance of the Corporation's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications. The Corporation monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time.

The Corporation's allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other risk factors both internal and external to the Corporation.

The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.

Historical valuation allowances are calculated based on the historical gross loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Corporation calculates historical gross loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical gross loss ratios are periodically updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based

upon the product of the historical gross loss ratio and the total dollar amount of the loans in the pool. The Corporation's pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.

The components of the general valuation allowance include (i) the additional reserves allocated as a result of applying an environmental risk adjustment factor to the base historical loss allocation, (ii) the additional reserves allocated for loans to borrowers in distressed industries and (iii) the additional reserves allocated for groups of similar loans with risk characteristics that exceed certain concentration limits established by management.

The environmental adjustment factor is based upon a more qualitative analysis of risk and is calculated through a survey of senior officers who are involved in credit making decisions at a corporate-wide and/or regional level. On a quarterly basis, survey participants rate the degree of various risks utilizing a numeric scale that translates to varying grades of high, moderate or low levels of risk. The results are then input into a risk-weighting matrix to determine an appropriate environmental risk adjustment

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factor. The various risks that may be considered in the determination of the environmental adjustment factor include, among other things, (i) the experience, ability and effectiveness of the bank's lending management and staff; (ii) the effectiveness of the Corporation's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) the impact of legislative and governmental influences affecting industry sectors; (v) the effectiveness of the internal loan review function; (vi) the impact of competition on loan structuring and pricing; and (vii) the impact of rising interest rates on portfolio risk. In periods where the surveyed risks are perceived to be higher, the risk-weighting matrix will generally result in a higher environmental adjustment factor, which, in turn will result in higher levels of general valuation allowance allocations. The opposite holds true in periods where the surveyed risks are perceived to be lower. General valuation allowances also include amounts allocated for loans to borrowers in distressed industries. To determine the amount of the allocation for each loan portfolio segment, management calculates the weighted-average risk grade for all loans to borrowers in distressed industries by loan portfolio segment. A multiple is then applied to the amount by which the weighted-average risk grade for loans to borrowers in distressed industries exceeds the weighted-average risk grade for all pass-grade loans within the loan portfolio segment to derive an allocation factor for loans to borrowers in distressed industries. The amount of the allocation for each loan portfolio segment is the product of this allocation factor and the outstanding balance of pass-grade loans within the identified distressed industries that have a risk grade of 6 or higher. Management identifies potential distressed industries by analyzing industry trends related to delinquencies, classifications and charge-offs. At September 30, 2013 and December 31, 2012, contractors were considered to be a distressed industry based on elevated levels of delinquencies, classifications and charge-offs relative to other industries within the Corporation's loan portfolio. Furthermore, the Corporation determined, through a review of borrower financial information that, as a whole, contractors have experienced, among other things, decreased revenues, reduced backlog of work, compressed margins and little, if any, net income. General valuation allowances also include allocations for groups of loans with similar risk characteristics that exceed certain concentration limits established by management and/or the Corporation's board of directors. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy, credit and/or collateral exceptions that exceed specified risk grades. Additionally, general valuation allowances are provided for loans that did not undergo a separate, independent concurrence review during the underwriting process (generally those loans under $1.0 million at origination). The Corporation's allowance methodology for general valuation allowances also includes a reduction factor for recoveries of prior charge-offs to compensate for the fact that historical loss allocations are based upon gross charge-offs rather than net. The adjustment for recoveries is based on the lower of annualized, year-to-date gross recoveries or the total gross recoveries for the preceding four quarters, adjusted, when necessary, for expected future trends in recoveries.

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The following table presents details of the allowance for loan losses, segregated by loan portfolio segment.

	Commercial and Industrial	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Unallocated	Total
September 30, 2013						
Historical valuation allowances	$26,175	$12,705	$2,628	$8,499	$—	$50,007
Specific valuation allowances	6,607	2,342	—	—	—	8,949
General valuation allowances:						
Environmental risk adjustment	5,169	3,085	631	2,193	—	11,078
Distressed industries	8,205	444	—	—	—	8,649
Excessive industry concentrations	2,865	499	—	—	—	3,364
Large relationship concentrations	1,395	978	—	—	—	2,373
Highly-leveraged credit relationships	4,850	723	—	—	—	5,573
Policy exceptions	—	—	—	—	2,401	2,401
Credit and collateral exceptions	—	—	—	—	1,562	1,562
Loans not reviewed by concurrence	1,979	2,169	2,229	1,035	—	7,412
Adjustment for recoveries	(2,667)	(1,229)	(390)	(7,045)	—	(11,331)
General macroeconomic risk	—	—	—	—	3,110	3,110
Total	$54,578	$21,716	$5,098	$4,682	$7,073	$93,147
December 31, 2012						
Historical valuation allowances	$30,565	$15,687	$3,013	$7,344	$—	$56,609
Specific valuation allowances	5,100	3,137	—	—	—	8,237
General valuation allowances:						
Environmental risk adjustment	6,593	3,682	684			