INTERNATIONAL BANCSHARES CORP
Form 10-Q
November 02, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

o **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 0-9439

INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

Texas	**74-2157138**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1200 San Bernardo Avenue, Laredo, Texas 78042-1359

(Address of principal executive offices)

(Zip Code)

(956) 722-7611

(Registrant s telephone number, including area code)

None

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

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

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

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

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

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

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

Class	**Shares Issued and Outstanding**
Common Stock, $1.00 par value	68,237,749 shares outstanding at October 28, 2009

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	September 30, 2009	December 31, 2008
Assets		
Cash and due from banks	$ 252,345	$ 298,720
Total cash and cash equivalents	252,345	298,720
Time deposits with banks		396
Investment securities:		
Held-to-maturity (Market value of $2,450 on September 30, 2009 and $2,300 on December 31, 2008)	2,450	2,300
Available-for-sale (Amortized cost of $4,416,779 on September 30, 2009 and $5,043,703 on December 31, 2008)	4,505,909	5,071,880
Total investment securities	4,508,359	5,074,180
Loans, net of unearned discounts	5,742,356	5,872,833
Less allowance for probable loan losses	(90,322)	(73,461)
Net loans	5,652,034	5,799,372
Bank premises and equipment, net	491,382	466,371
Accrued interest receivable	41,081	48,712
Other investments	354,979	388,071
Identified intangible assets, net	23,434	27,385
Goodwill, net	282,532	282,532
Other assets	79,438	53,602
Total assets	$ 11,685,584	$ 12,439,341

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition, continued (Unaudited)

(Dollars in Thousands)

	September 30, 2009	December 31, 2008
Liabilities and Shareholders Equity		
Liabilities:		
Deposits:		
Demand non-interest bearing	$ 1,448,480	$ 1,459,670
Savings and interest bearing demand	2,130,067	2,081,602
Time	3,333,685	3,317,512
Total deposits	6,912,232	6,858,784
Securities sold under repurchase agreements	1,500,230	1,441,131
Other borrowed funds	1,128,575	2,522,986
Junior subordinated deferrable interest debentures	201,074	201,048
Other liabilities	565,125	158,095
Total liabilities	10,307,236	11,182,044
Commitments, Contingent Liabilities and Other Tax Matters (Note 10)		
Shareholders equity:		
Series A Cumulative perpetual preferred shares, $.01 par value, $1,000 per share liquidation value. Authorized 25,000,000 shares; issued 216,000 shares on September 30, 2009, net of discount of $10,817 and issued 216,000 shares on December 31, 2008, net of discount of $12,442	205,183	203,558
Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 95,685,734 shares on September 30, 2009 and 95,499,339 shares on December 31, 2008	95,686	95,499
Surplus	160,784	158,110
Retained earnings	1,100,041	1,016,004
Accumulated other comprehensive income	57,439	18,189
	1,619,133	1,491,360
Less cost of shares in treasury, 27,447,985 shares on September 30, 2009 and 26,898,219 shares on December 31, 2008	(240,785)	(234,063)
Total shareholders equity	1,378,348	1,257,297
Total liabilities and shareholders equity	$ 11,685,584	$ 12,439,341

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Interest income:				
Loans, including fees	$ 84,263	$ 91,020	$ 252,105	$ 281,569
Federal funds sold		226		907
Investment securities:				
Taxable	40,937	45,996	145,074	138,246
Tax-exempt	1,375	846	3,454	2,680
Other interest income	129	106	465	383
Total interest income	126,704	138,194	401,098	423,785
Interest expense:				
Savings deposits	2,563	6,807	8,182	22,609
Time deposits	14,757	24,093	48,650	85,360
Securities sold under repurchase agreements	11,110	12,486	33,622	38,612
Other borrowings	732	7,133	9,041	24,546
Junior subordinated interest deferrable debentures	3,095	3,461	9,483	10,586
Other interest expense		96		184
Total interest expense	32,257	54,076	108,978	181,897
Net interest income	94,447	84,118	292,120	241,888
Provision for probable loan losses	10,346	7,037	45,429	12,690
Net interest income after provision for probable loan losses	84,101	77,081	246,691	229,198
Non-interest income:				
Service charges on deposit accounts	25,425	25,354	73,753	74,596
Other service charges, commissions and fees				
Banking	10,513	10,437	31,781	30,599
Non-banking	5,485	2,267	9,203	5,412
Gain on investment securities transactions, net	174		11,880	6,410
Other investments, net	3,374	5,785	10,609	13,895
Other income	5,904	6,980	11,853	17,222
Total non-interest income	50,875	50,823	149,079	148,134

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Non-interest expense:				
Employee compensation and benefits	$ 35,316	$ 32,854	$ 99,796	$ 95,314
Occupancy	8,723	9,955	25,899	27,053
Depreciation of bank premises and equipment	8,965	9,481	26,979	27,119
Professional fees	4,958	2,557	16,735	8,442
Stationery and supplies	1,109	1,540	2,925	4,134
Amortization of identified intangible assets	1,320	1,299	3,950	3,897
Advertising	2,647	3,667	7,887	10,329
Other	15,708	15,238	49,982	47,682
Total non-interest expense	78,746	76,591	234,153	223,970
Income before income taxes	56,230	51,313	161,617	153,362
Provision for income taxes	19,257	17,433	55,983	52,953
Net income	$ 36,973	$ 33,880	$ 105,634	$ 100,409
Preferred Stock Dividends	3,250		9,725	
Net income available to common shareholders	$ 33,723	$ 33,880	$ 95,909	$ 100,409
Basic earnings per common share:				
Weighted average number of shares outstanding:	68,192,647	68,571,661	68,437,023	68,573,318
Net income	$ .49	$ .49	$ 1.40	$ 1.46
Fully diluted earnings per common share:				
Weighted average number of shares outstanding:	68,207,682	68,727,949	68,447,067	68,715,082
Net income	$ .49	$ .49	$ 1.40	$ 1.46

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	$ 36,973	$ 33,880	$ 105,634	$ 100,409
Other comprehensive income, net of tax				
Net unrealized holding (losses) gains on securities available for sale arising during period (tax effects of $(431), $(3,270), $25,293 and $4,322)	(801)	(6,073)	46,972	8,027
Reclassification adjustment for gains on securities available for sale included in net income (tax effects of $(61), $-, $(4,158) and $(2,243))	(113)		(7,722)	(4,167)
Comprehensive income	$ 36,059	$ 27,807	$ 144,884	$ 104,269

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2009	2008
Operating activities:		
Net income	$ 105,634	$ 100,409
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for probable loan losses	45,429	12,690
Amortization of loan premiums		134
Accretion of time deposits with banks		1
Accretion of time deposit discounts	(10)	(28)
Depreciation of bank premises and equipment	26,979	27,119
Gain on sale of bank premises and equipment	(133)	(44)
Depreciation and amortization of leased assets	300	760
Accretion of investment securities discounts	(1,463)	(858)
Amortization of investment securities premiums	4,768	4,787
Investment securities transactions, net	(11,880)	(6,410)
Amortization of junior subordinated debenture discounts	26	110
Amortization of identified intangible assets	3,951	3,897
Stock based compensation expense	502	550
Earnings from affiliates and other investments	(9,778)	(9,773)
Deferred tax benefit	(7,811)	(7,727)
Decrease in accrued interest receivable	7,631	7,857
Net increase in other assets	(24,854)	(4,226)
Net (decrease) increase in other liabilities	(72,973)	1,046
Net cash provided by operating activities	66,318	130,294
Investing activities:		
Proceeds from maturities of securities	1,637	16,261
Proceeds from sales of available for sale securities	571,814	8,359
Purchases of available for sale securities	(419,614)	(1,002,839)
Principal collected on mortgage-backed securities	944,989	981,679
Maturities of time deposits with banks	396	4,457
Net decrease (increase) in loans	101,911	(209,873)
Purchases of other investments	(10,425)	(8,315)
Distributions of other investments	53,295	33
Purchases of bank premises and equipment	(52,485)	(47,415)
Proceeds from sale of bank premises and equipment	628	800
Net cash provided by (used in) investing activities	1,192,146	(256,853)

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Financing activities:		
Net decrease in non-interest bearing demand deposits	$ (11,190)	$ (52,063)
Net increase (decrease) in savings and interest bearing demand deposits	48,465	(64,633)
Net increase (decrease) in time deposits	16,183	(39,526)
Net increase in securities sold under repurchase agreements	59,099	139,023
Net (decrease) increase in other borrowed funds	(1,394,411)	167,814
Purchase of treasury stock	(6,722)	(958)
Proceeds from stock transactions	2,359	560
Payment of dividends on common stock	(11,662)	(22,623)
Payments of dividends on preferred stock	(6,960)	
Net cash (used in) provided by financing activities	(1,304,839)	127,594
(Decrease) increase in cash and cash equivalents	(46,375)	1,035
Cash and cash equivalents at beginning of period	298,720	346,052
Cash and cash equivalents at end of period	$ 252,345	$ 347,087
Supplemental cash flow information:		
Interest paid	$ 114,805	$ 191,610
Income taxes paid	56,918	51,711
Accrued dividends, preferred shares	1,350	
Dividends declared, not yet paid		22,630
Sales of available-for-sale securities not yet settled	1,282	
Purchases of available-for-sale securities not yet settled	464,760	149,351

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 - Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (Corporation) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo (IBC), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, IBC Capital Corporation and Premier Tierra Holdings, Inc. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

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

On July 1, 2009, the Financial Accounting Standards Board officially launched the FASB Accounting Standards Codification, (Codification), which is now the single official source of authoritative, non-governmental U.S. GAAP, in addition to guidance issued by the Securities and Exchange Commission (SEC). The Codification supersedes all prior accounting literature. With the launch of the Codification, U.S. GAAP now consists of two levels authoritative (Codification) and non-authoritative (anything not in the Codification). The Codification is effective for interim and annual periods ending after September 15, 2009, and is organized into approximately 90 accounting topics. The FASB will no longer be issuing accounting standards in the form of Statements, Staff Positions or Emerging Issues Task Force Abstracts. The FASB will instead amend the Codification by issuing Accounting Standards Updates. The adoption of the Codification did not have a significant impact to the Company s consolidated financial statements.

Effective June 30, 2009, the Company adopted Statement of Financial Accounting Standards No. 165 (SFAS No. 165), Subsequent Events. SFAS No. 165 is currently included in the Codification under ASC Topic 855, Subsequent Events (ASC 855). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855 defines (i) the period after the balance sheet date during which a reporting entity s management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The adoption of the accounting standard did not have an impact on the Company s consolidated financial statements. The Company has evaluated all events or transactions that occurred after September 30, 2009 through November 2, 2009, the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

Note 2 Fair Value Measurements

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157 (SFAS No. 157), Fair Value Measurements for financial assets and liabilities. Additionally, in accordance with Financial Accounting Standards Board Staff Position No. 157-2, (FSP No 157-2), Effective date of FASB Statement No. 157, the Company delayed application of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009, except for those that are recognized or disclosed at fair value on a recurring basis. SFAS No. 157 and FSP No. 157-2 are now included in the Accounting Standards Codification (ASC) in Topic 820, Fair Value Measurements and Disclosures (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; it also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2 Inputs Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 Inputs Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value as of September 30, 2009 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in thousands)		
	Assets/Liabilities Measured at Fair Value September 30, 2009	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Measured on a recurring basis:				
Assets:				
U.S. Treasury securities Available-for-sale	$ 1,327	$	$ 1,327	$
Mortgage-backed securities Available-for-sale	4,361,946		4,283,391	78,555
States and political subdivisions Available-for-sale	128,472		128,472	

Other Available-for-sale	14,164	664	13,500	
Measured on a non-recurring basis:				
Assets:				
Impaired Loans	88,407			88,407

Investment securities available-for-sale are classified within level 2 and level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within level 1. For investments classified as level 2 in the fair value hierarchy, the Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. Investment securities classified as level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in in-active markets and markets that have experienced significant decreases in volume and level of activity, as exhibited by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company evaluated the performance of the securities since the time of purchase and determined that the securities have performed as expected or better than expected. Therefore, the Company applied the spread from the time of purchase against the current yield curve to determine the fair value represented in the consolidated financial statements since that spread represented an orderly, active market.

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

Balance at December 31, 2008	$	
Principal paydowns, net of discount amortization		(4,010)
Total unrealized gains included in:		
Other comprehensive income		(6)
Transfers into level 3		82,571
Balance at September 30, 2009	$	78,555

As of September 30, 2009, the Company s financial instruments measured at fair value on a non-recurring basis are limited to impaired loans. Impaired loans are classified within level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, Receivables . The fair value of impaired loans is based on the fair value of the collateral, as determined through an external appraisal process, discounted based on internal criteria. Impaired loans are primarily comprised of collateral-dependent commercial loans.

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

The fair value estimates, methods, and assumptions for the Company s financial instruments at September 30, 2009 and December 31, 2008 are outlined below.

Cash and Due From Banks and Federal Funds Sold

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

Time Deposits with Banks

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

Investment securities held-to-maturity

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

Loans

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

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. At September 30, 2009, and December 31, 2008, the carrying amount of fixed rate performing loans was $1,272,210,000 and $1,272,370,000 respectively, and the estimated fair value was $1,255,047,000 and $1,253,496,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of September 30, 2009 and December 31, 2008. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. At September 30, 2009 and December 31, 2008, the carrying amount of time deposits was $3,333,685,000 and $3,317,512,000, respectively, and the estimated fair value was $3,350,874,000 and $3,343,150,000, respectively.

Securities Sold Under Repurchase Agreements and Other Borrowed Funds

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at September 30, 2009 and December 31, 2008. The fair value of the long-term instruments is based on established market spreads. At September 30, 2009 and December 31, 2008, the carrying amount of long-term repurchase agreements was $1,000,000,000 and the estimated fair value was $1,114,056,000 and $1,158,873,000, respectively. Other borrowed funds are short-term Federal Home Loan Bank borrowings. Due to the contractual terms of these financial instruments, the carrying amounts approximated fair value at September 30, 2009 and December 31, 2008.

Junior Subordinated Deferrable Interest Debentures

The Company currently has fixed and floating junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at September 30, 2009 and December 31, 2008. The fair value of the fixed junior subordinated deferrable interest debentures is based on established market spreads to the debentures. At September 30, 2009 and December 31, 2008, the carrying amount of fixed junior subordinated deferrable interest debentures was $139,216,000 and $139,190,000, respectively, and the estimated fair value was $58,795,000 and $44,704,000, respectively.

Commitments to Extend Credit and Letters of Credit

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

Limitations

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

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

Note 3 Loans

A summary of net loans, by loan type at September 30, 2009 and December 31, 2008 is as follows:

	September 30, 2009	December 31, 2008
	(Dollars in Thousands)	
Commercial, financial and agricultural	$ 2,705,704	$ 2,574,247
Real estate mortgage	953,978	888,095
Real estate construction	1,657,685	1,911,954
Consumer	154,726	169,589
Foreign	270,263	328,948
Total loans	$ 5,742,356	$ 5,872,833

Note 4 - Allowance for Probable Loan Losses

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

	September 30, 2009	September 30, 2008
	(Dollars in Thousands)	
Balance at December 31,	$ 73,461	$ 61,726
Losses charged to allowance	(29,864)	(6,345)

Recoveries credited to allowance		1,296		892
Net losses charged to allowance		(28,568)		(5,453)
Provision charged to operations		45,429		12,690
Balance at September 30,	$	90,322	$	68,963

The losses charged to the allowance increased by $23,519,000 for the nine months ended September 30, 2009 versus the same period of 2008. The nationwide recession and its consequences are being felt in the Company s markets, but not to the extent being seen in the nation as a whole. These factors, as well as other economic issues, have elevated the Company s provisions as well as charge-offs.

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on (1) the present value of expected future cash flows discounted at the loan s effective interest rate; (2) the loan s observable market price; or (3) the fair value of the collateral if the loan is collateral dependent. Substantially all of the Company s impaired loans are measured at the fair value of the collateral. In limited cases, the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

The following table details key information regarding the Company s impaired loans:

		September 30, 2009		December 31, 2008
		(Dollars in Thousands)		
Balance of impaired loans where there is a related allowance for loan loss	$	118,407	$	137,153
Balance of impaired loans where there is no related allowance for loan loss		12,314		27,786
Total impaired loans	$	130,721	$	164,939
Allowance allocated to impaired loans	$	30,000	$	20,671

The impaired loans included in the table above are primarily comprised of collateral dependent commercial loans, which have not been fully charged off. The average recorded investment in impaired loans was $161,194,000 and $93,654,000 for the nine months and year ended September 30, 2009 and December 31, 2008, respectively. The interest recognized on impaired loans was not significant. The increase in the balance of impaired loans over historical levels can be partially attributed to certain loans that filed for bankruptcy protection and a few loan relationships that deteriorated during 2008 and 2009. A substantial amount of the impaired loans have adequate collateral and credit enhancements not requiring a related allowance for loan loss. The level of impaired loans is reflective of the economic weakness that has been created by the financial crisis and the subsequent economic downturn. While impaired loans have increased compared to historical levels, they have decreased for the period ended September 30, 2009, compared to the period ending December 31, 2008. Management is confident the Company s loss exposure regarding these credits will be significantly reduced due to the Company s long-standing practices that emphasize secured lending with strong collateral positions and guarantor support. Management is likewise confident the reserve for probable loan losses is adequate. The Company has no direct exposure to sub-prime loans in its loan portfolio, but the sub-prime crisis has affected the credit markets on a national level, and as a result, the Company has experienced an increasing amount of impaired loans; however, management s decision to place loans in this category does not necessarily mean that the Company will experience significant losses from these loans or significant increases in impaired loans from these levels.

Management of the Company recognizes the risks associated with these impaired loans. However, management s decision to place loans in this category does not necessarily mean that losses will occur. In the current environment, troubled loan management can be protracted because of the legal and process problems that delay the collection of an otherwise collectable loan. Additionally, management believes that the collateral related to these impaired loans and/or the secondary support from guarantors mitigates the potential for losses from impaired loans. It is also important to note that even though the economic conditions in Texas and Oklahoma are softening, we believe these markets are stronger and better positioned to recover than many other areas of the country.

The bank subsidiaries charge off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a loss by bank examiners. Commercial and industrial or real estate loans are generally considered by management to represent a loss, in whole or part, when an exposure beyond any collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower s financial condition and general economic conditions in the borrower s industry. Generally, unsecured consumer loans are charged-off when 90 days past due.

While management of the Company considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. It is the judgment of the Company s management that the allowance for probable loan losses at September 30, 2009 was adequate to absorb probable losses from loans in the portfolio at that date.

Note 5 Stock Options

On April 1, 2005, the Board of Directors adopted the 2005 International Bancshares Corporation Stock Option Plan (the 2005 Plan). Effective May 19, 2008, the 2005 Plan was amended to increase the number of shares available for stock option grants under the 2005 Plan by 300,000 shares. The 2005 Plan replaced the 1996 International Bancshares Corporation Key Contributor Stock Option Plan (the 1996 Plan). Under the 2005 Plan both qualified incentive stock options (ISOs) and non-qualified stock options (NQSOs) may be granted. Options granted may be exercisable for a period of up to 10 years from the date of grant, excluding ISOs granted to 10% shareholders, which may be exercisable for a period of up to only five years. As of September 30, 2009, 138,297 shares were available for future grants under the 2005 Plan.

A summary of option activity under the stock option plans for the nine months ended September 30, 2009 is as follows:

	Number of options		Weighted average exercise price	Weighted average remaining contractual term (years)		Aggregate intrinsic value ($) (Dollars in Thousands)
Options outstanding at December 31, 2008	833,597	$	21.43			
Plus: Options granted	247,250		10.42			
Less:						
Options exercised	186,395		12.66			
Options expired	15,052		12.66			
Options forfeited	24,088		17.26			
Options outstanding at September 30, 2009	855,312	$	20.35	4.93	$	1,499
Options fully vested and exercisable at September 30, 2009	275,032	$	22.47	2.81	$	70

Stock-based compensation expense included in the consolidated statements of income for the three and nine months ended September 30, 2009 was approximately $185,400 and $502,000, respectively. As of September 30, 2009, there was approximately $1,342,000 of total unrecognized stock-based compensation cost related to non-vested options granted under the Company plans that will be recognized over a weighted average period of 1.7 years.

Note 6 - Investment Securities

The Company classifies debt and equity securities into one of three categories: held-to maturity, available-for-sale, or trading. Such securities are reassessed for appropriate classification at each reporting date. Securities classified as held-to-maturity are carried at amortized cost for financial statement reporting, while securities classified as available-for-sale and trading are carried at their fair value. Unrealized holding gains and losses are included in net income for those securities classified as trading, while unrealized holding gains and losses related to those securities classified as available-for-sale are excluded from net income and reported net of tax as other comprehensive income (loss) and accumulated other comprehensive income (loss) until realized, or in the case of losses, when deemed other than temporary.

The amortized cost and estimated fair value by type of investment security at September 30, 2009 are as follows:

	Held to Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	$ 2,450	$	$	$ 2,450	$ 2,450
Total investment securities	$ 2,450	$	$	$ 2,450	$ 2,450

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value (1)
	(Dollars in Thousands)				
U.S. Treasury securities	$ 1,327	$	$	$ 1,327	$ 1,327
Mortgage-backed securities	4,275,422	86,821	(297)	4,361,946	4,361,946
Obligations of states and political subdivisions	126,205	2,429	(162)	128,472	128,472
Equity securities	13,825	368	(29)	14,164	14,164
Total investment securities	$ 4,416,779	$ 89,618	$ (488)	$ 4,505,909	$ 4,505,909

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(1) Included in the carrying value of mortgage-backed securities are $1,616,728 of mortgage-backed securities issued by Ginnie Mae, $2,666,663 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and $78,555 issued by non-government entities

The amortized cost and estimated fair value by type of investment security at December 31, 2008 are as follows:

	Held to Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	$ 2,300	$	$	$ 2,300	$ 2,300
Total investment securities	$ 2,300	$	$	$ 2,300	$ 2,300

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value (1)
	(Dollars in Thousands)				
U.S. Treasury securities	$ 1,319	$	$	$ 1,319	$ 1,319
Mortgage-backed securities	4,947,351	59,915	(32,949)	4,974,317	4,974,317
Obligations of states and political subdivisions	81,208	1,346	(340)	82,214	82,214
Equity securities	13,825	205		14,030	14,030
Total investment securities	$ 5,043,703	$ 61,466	$ (33,289)	$	