

FIRST CITIZENS BANCSHARES INC /DE/  
Form 10-Q  
August 08, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2014  
or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 001-16715

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

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|   |  |
|---|--|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 56-1528994<br>(I.R.S. Employer<br>Identification Number) |
|---|--|

|  |                     |
|--|---------------------|
| 4300 Six Forks Road, Raleigh, North Carolina<br>(Address of principle executive offices)<br>(919) 716-7000<br>(Registrant’s telephone number, including area code) | 27609<br>(Zip code) |
|--|---------------------|

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of ‘accelerated filer’ and ‘large accelerated filer’ in Rule 12b-2 of the Exchange Act:

|                         |                                     |                           |                          |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

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

Class A Common Stock—\$1 Par Value—8,586,058 shares  
Class B Common Stock—\$1 Par Value—1,032,883 shares  
(Number of shares outstanding, by class, as of August 8, 2014)



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## PART I

## Item 1. Financial Statements

## First Citizens BancShares, Inc. and Subsidiaries

## Consolidated Balance Sheets

(Dollars in thousands, unaudited)

|  | June 30, 2014 | December 31, 2013 |
|--|---------------|-------------------|
| Assets   |               |                   |
| Cash and due from banks  | \$566,952     | \$533,599         |
| Overnight investments  | 1,118,474     | 859,324           |
| Investment securities available for sale   | 5,538,166     | 5,387,703         |
| Investment securities held to maturity   | 693           | 907               |
| Loans held for sale  | 49,851        | 47,271            |
| Loans and leases:  |               |                   |
| Acquired   | 1,109,933     | 1,029,426         |
| Originated   | 12,415,023    | 12,104,298        |
| Allowance for loan and lease losses  | (206,246      | ) (233,394        |
| Net loans and leases   | 13,318,710    | 12,900,330        |
| Premises and equipment   | 883,303       | 876,522           |
| Other real estate owned:   |               |                   |
| Covered under loss share agreements  | 40,136        | 47,081            |
| Not covered under loss share agreements  | 35,151        | 36,898            |
| Income earned not collected  | 49,019        | 48,390            |
| FDIC loss share receivable   | 49,959        | 93,397            |
| Goodwill   | 127,140       | 102,625           |
| Other intangible assets  | 3,821         | 1,247             |
| Other assets   | 281,465       | 263,797           |
| Total assets   | \$22,062,840  | \$21,199,091      |
| Liabilities  |               |                   |
| Deposits:  |               |                   |
| Noninterest-bearing  | \$5,775,322   | \$5,241,817       |
| Interest-bearing   | 12,781,436    | 12,632,249        |
| Total deposits   | 18,556,758    | 17,874,066        |
| Short-term borrowings  | 788,540       | 511,418           |
| Long-term obligations  | 314,529       | 510,769           |
| FDIC loss share payable  | 114,281       | 109,378           |
| Other liabilities  | 139,587       | 116,785           |
| Total liabilities  | 19,913,695    | 19,122,416        |
| Shareholders' Equity   |               |                   |
| Common stock:  |               |                   |
| Class A - \$1 par value (11,000,000 shares authorized; 8,586,058 shares issued and outstanding at June 30, 2014 and December 31, 2013) | 8,586         | 8,586             |
| Class B - \$1 par value (2,000,000 shares authorized; 1,032,883 shares issued and outstanding at June 30, 2014 and December 31, 2013)  | 1,033         | 1,033             |
| Surplus  | 143,766       | 143,766           |
| Retained earnings  | 1,991,703     | 1,948,558         |
| Accumulated other comprehensive income (loss)  | 4,057         | (25,268           |
| Total shareholders' equity   | 2,149,145     | 2,076,675         |

|  |              |              |
|--|--------------|--------------|
| Total liabilities and shareholders' equity | \$22,062,840 | \$21,199,091 |
|--|--------------|--------------|

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statements of Income

| (Dollars in thousands, except per share data, unaudited)               | Three months ended June 30 |            | Six months ended June 30 |            |
|--|----------------------------|------------|--------------------------|------------|
|  | 2014                       | 2013       | 2014                     | 2013       |
| Interest income  |                            |            |                          |            |
| Loans and leases   | \$ 164,108                 | \$ 185,151 | \$ 325,142               | \$ 396,914 |
| Investment securities interest and dividend income                     | 12,447                     | 8,119      | 24,195                   | 16,603     |
| Overnight investments  | 756                        | 656        | 1,368                    | 1,013      |
| Total interest income  | 177,311                    | 193,926    | 350,705                  | 414,530    |
| Interest expense   |                            |            |                          |            |
| Deposits   | 6,006                      | 8,997      | 12,831                   | 19,310     |
| Short-term borrowings  | 1,551                      | 680        | 2,136                    | 1,384      |
| Long-term obligations  | 4,056                      | 4,721      | 9,109                    | 9,426      |
| Total interest expense   | 11,613                     | 14,398     | 24,076                   | 30,120     |
| Net interest income  | 165,698                    | 179,528    | 326,629                  | 384,410    |
| Provision (credit) for loan and lease losses                           | (7,299)                    | ) (13,242) | ) (9,202)                | ) (31,848) |
| Net interest income after provision (credit) for loan and lease losses | 172,997                    | 192,770    | 335,831                  | 416,258    |
| Noninterest income   |                            |            |                          |            |
| Cardholder services  | 13,257                     | 12,026     | 25,089                   | 23,097     |
| Merchant services  | 15,035                     | 15,245     | 28,556                   | 27,731     |
| Service charges on deposit accounts                                    | 15,265                     | 14,883     | 29,705                   | 29,882     |
| Wealth management services   | 15,815                     | 15,097     | 30,695                   | 29,612     |
| Fees from processing services  | 5,682                      | 5,051      | 10,543                   | 10,670     |
| Other service charges and fees   | 4,250                      | 3,966      | 8,194                    | 7,732      |
| Mortgage income  | 1,210                      | 3,669      | 2,165                    | 7,457      |
| Insurance commissions  | 2,253                      | 2,394      | 5,540                    | 5,374      |
| ATM income   | 1,260                      | 1,314      | 2,462                    | 2,482      |
| Adjustments to FDIC loss share receivable                              | (15,295)                   | ) (14,439) | ) (27,644)               | ) (38,492) |
| Other  | 6,650                      | 5,789      | 11,258                   | 16,963     |
| Total noninterest income   | 65,382                     | 64,995     | 126,563                  | 122,508    |
| Noninterest expense  |                            |            |                          |            |
| Salaries and wages   | 82,683                     | 75,802     | 162,557                  | 151,921    |
| Employee benefits  | 19,772                     | 23,228     | 39,872                   | 48,247     |
| Occupancy expense  | 20,937                     | 18,464     | 41,362                   | 37,273     |
| Equipment expense  | 19,686                     | 18,698     | 38,477                   | 37,644     |
| FDIC insurance expense   | 2,640                      | 2,423      | 5,276                    | 5,089      |
| Foreclosure-related expenses   | 3,858                      | 3,467      | 9,268                    | 7,772      |
| Other  | 49,444                     | 46,485     | 93,238                   | 94,976     |
| Total noninterest expense  | 199,020                    | 188,567    | 390,050                  | 382,922    |
| Income before income taxes   | 39,359                     | 69,198     | 72,344                   | 155,844    |
| Provision for income taxes   | 12,809                     | 25,292     | 23,428                   | 56,353     |
| Net income   | \$ 26,550                  | \$ 43,906  | \$ 48,916                | \$ 99,491  |
| Average shares outstanding   | 9,618,941                  | 9,618,941  | 9,618,941                | 9,618,963  |
| Net income per share   | \$ 2.76                    | \$ 4.56    | \$ 5.09                  | \$ 10.34   |

See accompanying Notes to Consolidated Financial Statements.



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

| (Dollars in thousands, unaudited)  | Three months ended June 30 |           | Six months ended June 30 |           |
|--|----------------------------|-----------|--------------------------|-----------|
|  | 2014                       | 2013      | 2014                     | 2013      |
| Net income   | \$26,550                   | \$43,906  | \$48,916                 | \$99,491  |
| Other comprehensive income (loss)  |                            |           |                          |           |
| Unrealized gains (losses) on securities:                                     |                            |           |                          |           |
| Change in unrealized securities gains (losses) arising during period         | 31,550                     | (38,992)  | ) 43,449                 | (40,468)  |
| Tax effect   | (12,225)                   | ) 15,269  | (16,868)                 | ) 15,834  |
| Total change in unrealized gains (losses) on securities, net of tax          | 19,325                     | (23,723)  | ) 26,581                 | (24,634)  |
| Change in fair value of cash flow hedges:                                    |                            |           |                          |           |
| Change in unrecognized gain on cash flow hedges                              | 568                        | 1,388     | 1,287                    | 2,202     |
| Tax effect   | (218)                      | ) (548)   | ) (496)                  | ) (869)   |
| Total change in unrecognized gain on cash flow hedges, net of tax            | 350                        | 840       | 791                      | 1,333     |
| Change in pension obligation:  |                            |           |                          |           |
| Reclassification adjustment for gains included in income before income taxes | 1,598                      | 4,294     | 3,197                    | 8,598     |
| Tax effect   | (622)                      | ) (1,682) | ) (1,244)                | ) (3,367) |
| Total change in pension obligation, net of tax                               | 976                        | 2,612     | 1,953                    | 5,231     |
| Other comprehensive income (loss)  | 20,651                     | (20,271)  | ) 29,325                 | (18,070)  |
| Total comprehensive income   | \$47,201                   | \$23,635  | \$78,241                 | \$81,421  |

See accompanying Notes to Consolidated Financial Statements.



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

| (Dollars in thousands,<br>unaudited)                  | Class A<br>Common Stock | Class B<br>Common Stock | Surplus    | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income | Total<br>Shareholders'<br>Equity |
|---|-------------------------|-------------------------|------------|----------------------|--|----------------------------------|
| Balance at December 31,<br>2012                       | \$ 8,588                | \$ 1,033                | \$ 143,766 | \$ 1,792,726         | \$ (82,106 )   | \$ 1,864,007                     |
| Net income  | —                       | —                       | —          | 99,491               | —  | 99,491                           |
| Other comprehensive loss,<br>net of tax               | —                       | —                       | —          | —                    | (18,070 )  | (18,070 )                        |
| Repurchase of 1,973 shares<br>of Class A common stock | (2 )                    | —                       | —          | (319 )               | —  | (321 )                           |
| Cash dividends (\$0.60 per<br>share)                  | —                       | —                       | —          | (5,777 )             | —  | (5,777 )                         |
| Balance at June 30, 2013                              | \$ 8,586                | \$ 1,033                | \$ 143,766 | \$ 1,886,121         | \$ (100,176 )  | \$ 1,939,330                     |
| Balance at December 31,<br>2013                       | \$ 8,586                | \$ 1,033                | \$ 143,766 | \$ 1,948,558         | \$ (25,268 )   | \$ 2,076,675                     |
| Net income  | —                       | —                       | —          | 48,916               | —  | 48,916                           |
| Other comprehensive<br>income, net of tax             | —                       | —                       | —          | —                    | 29,325   | 29,325                           |
| Cash dividends (\$0.60 per<br>share)                  | —                       | —                       | —          | (5,771 )             | —  | (5,771 )                         |
| Balance at June 30, 2014                              | \$ 8,586                | \$ 1,033                | \$ 143,766 | \$ 1,991,703         | \$ 4,057   | \$ 2,149,145                     |

See accompanying Notes to Consolidated Financial Statements.

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

|   | Six months ended June 30 |              |
|---|--------------------------|--------------|
|   | 2014                     | 2013         |
| (Dollars in thousands, unaudited)   |                          |              |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                   |                          |              |
| Net income  | \$48,916                 | 99,491       |
| Adjustments to reconcile net income to cash provided by operating activities: |                          |              |
| Provision (credit) for loan and lease losses                                  | (9,202                   | ) (31,848    |
| Deferred tax (benefit) expense  | (2,744                   | ) 2,360      |
| Change in current taxes payable   | 5,973                    | (20,649      |
| Depreciation  | 35,455                   | 35,545       |
| Change in accrued interest payable  | 560                      | (145         |
| Change in income earned not collected   | (629                     | ) 2,099      |
| Gain on sale of processing services, net                                      | —                        | (4,085       |
| Origination of loans held for sale  | (123,144                 | ) (223,128   |
| Proceeds from sale of loans held for sale                                     | 123,967                  | 254,087      |
| Gain on sale of loans   | (2,220                   | ) (7,123     |
| Net writedowns/losses on other real estate                                    | 6,993                    | 1,480        |
| Net amortization of premiums and discounts                                    | (18,172                  | ) (74,175    |
| FDIC receivable for loss share agreements                                     | 17,121                   | 20,464       |
| FDIC payable for loss share agreements  | 4,903                    | 95           |
| Net change in other assets  | (31,249                  | ) 68,587     |
| Net change in other liabilities   | 35,033                   | 21,365       |
| Net cash provided by operating activities                                     | 91,561                   | 144,420      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                   |                          |              |
| Net change in loans outstanding   | (57,271                  | ) 325,057    |
| Purchases of investment securities available for sale                         | (1,409,878               | ) (1,375,766 |
| Proceeds from maturities/calls of investment securities held to maturity      | 214                      | 212          |
| Proceeds from maturities/calls of investment securities available for sale    | 1,529,687                | 1,365,287    |
| Net change in overnight investments   | (259,150                 | ) (596,745   |
| Cash (paid to) received from the FDIC for loss share agreements               | (4,350                   | ) 46,534     |
| Proceeds from sale of other real estate                                       | 38,370                   | 80,010       |
| Additions to premises and equipment   | (39,550                  | ) (26,696    |
| Business acquisition, net of cash acquired                                    | 18,194                   | —            |
| Net cash used by investing activities   | (183,734                 | ) (182,107   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                   |                          |              |
| Net change in time deposits   | (219,297                 | ) (390,329   |
| Net change in demand and other interest-bearing deposits                      | 270,118                  | 322,319      |
| Net change in short-term borrowings   | 81,716                   | 13,432       |
| Repayment of long-term obligations  | (1,240                   | ) (1,608     |
| Repurchase of common stock  | —                        | (321         |
| Cash dividends paid   | (5,771                   | ) (2,891     |
| Net cash provided (used) by financing activities                              | 125,526                  | (59,398      |
| Change in cash and due from banks   | 33,353                   | (97,085      |
| Cash and due from banks at beginning of period                                | 533,599                  | 639,730      |
| Cash and due from banks at end of period                                      | \$566,952                | \$542,645    |
| <b>CASH PAYMENTS FOR:</b>   |                          |              |
| Interest  | \$23,516                 | \$30,265     |

|  |         |        |
|--|---------|--------|
| Income taxes   | 47,962  | 75,917 |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: |         |        |
| Transfers of loans to other real estate                                | 25,080  | 57,175 |
| Dividends declared but not paid  | 2,886   | 2,886  |
| Reclassification of long-term obligations to short-term borrowings     | 195,000 | —      |

See accompanying Notes to Consolidated Financial Statements.

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

### NOTE A - ACCOUNTING POLICIES AND BASIS OF PRESENTATION

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

#### General

These consolidated financial statements and notes are presented in accordance with instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and notes necessary for a complete presentation of financial position, results of operations and cash flow activity required in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the consolidated financial position and consolidated results of operations have been made. The unaudited interim consolidated financial statements included in this Form 10-Q should be read in conjunction with the consolidated financial statements and footnotes included in BancShares' Annual Report on Form 10-K for the year ended December 31, 2013.

#### Reclassifications

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

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

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates, and different assumptions in the application of these policies could result in material changes in BancShares' consolidated financial position, the consolidated results of its operations or related disclosures. Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan and lease losses; determination of the fair value of financial instruments; pension plan assumptions; cash flow estimates on acquired loans; the receivable from and payable to the Federal Deposit Insurance Corporation (FDIC) for loss share agreements; purchase accounting-related adjustments; and income tax assets, liabilities and expense.

#### Recent Accounting Pronouncements

Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2014-12, "Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period)"

This ASU requires a reporting entity to treat a performance target that affects vesting and that could be achieved after the requisite service period as a performance condition. A reporting entity should apply FASB ASC Topic 718, Compensation—Stock Compensation, to awards with performance conditions that affect vesting.

The guidance in this ASU is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. This update may be adopted either prospectively for share-based payment awards granted or

modified on or after the effective date, or retrospectively, using a modified retrospective approach. The modified retrospective approach would apply to share-based payment awards outstanding as of the beginning of the earliest annual period presented in the financial statements on adoption, and to all new or modified awards thereafter. BancShares will adopt the standard effective the first quarter of 2016. Since BancShares does not currently have any share-based stock compensation plans, adoption of Topic 718 is not projected to have an impact on BancShares' consolidated financial position or consolidated results of operations.

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FASB ASU 2014-11, “Transfers and Servicing (Topic 860)”

This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. The ASU requires a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. The ASU also requires expanded disclosures about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings.

The accounting changes in this ASU are effective for fiscal years beginning after December 15, 2014. In addition, the disclosure for certain transactions accounted for as a sale is effective for the fiscal period beginning after December 15, 2014, the disclosure for transactions accounted for as secured borrowings is required to be presented for fiscal periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. We will adopt the guidance effective in the first quarter of 2015, and we do not anticipate any effect on our consolidated financial position or consolidated results of operations as a result of adoption.

FASB ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)”

In May 2014, the FASB issued a standard on the recognition of revenue from contracts with customers with the core principle being for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard also results in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively and improve guidance for multiple-element arrangements.

The guidance in this ASU is effective for fiscal periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Early adoption is not permitted. We are currently evaluating the impact of the new standard and we will adopt during the first quarter of 2017.

FASB ASU 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity”

This ASU limits presentation of discontinued operations and disclosure of disposals to disposals representing a strategic shift in operations in which the strategic shifts should have a major effect on the organization's operations and financial results. Additionally, the new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The new guidance also requires disclosure of pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting.

The new standard is effective in the first quarter of 2015 for public companies with a calendar year end. We will adopt the standard effective in the first quarter of 2015, and we do not anticipate any effect on our consolidated financial position or consolidated results of operations as a result of adoption.

FASB ASU 2014-04, “Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40)”

This ASU clarifies that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

The amendments in this ASU are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. BancShares will adopt the guidance effective in the first quarter of 2015, and is

currently evaluating the impact of the new standard on the financial statement disclosures. BancShares does not anticipate any effect on our consolidated financial position or consolidated results of operations as a result of adoption.

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FASB ASU 2014-01 "Investments - Equity Method and Joint Ventures (Topic 323) - Accounting for Investments in Qualified Affordable Housing Projects"

This ASU permits an accounting policy election to account for investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, the initial cost of the investment is amortized in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment in accordance with Subtopic 970-323.

The decision to apply the proportional amortization method of accounting will be applied consistently to all qualifying affordable housing project investments rather than a decision to be applied to individual investments.

The amendments in this ASU should be applied retrospectively to all periods presented and are effective for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted.

BancShares is currently evaluating the impact of the new standard and is targeting a December 31, 2014, adoption and implementation for qualifying affordable housing project investments.

FASB ASU 2013-11, "Income Taxes (Topic 740)"

This ASU states that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows: to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require BancShares to use, and BancShares does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date.

The provisions of this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. BancShares adopted the guidance effective in the first quarter of 2014. The initial adoption had no effect on our consolidated financial position or consolidated results of operations.

FASB ASU 2013-04, "Liabilities"

This ASU provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this ASU is fixed at the reporting date, except for obligations addressed within existing guidance in GAAP.

The amendments in this update are effective for fiscal years beginning after December 31, 2013. BancShares adopted the guidance effective first quarter of 2014. The initial adoption did not have any effect on our consolidated financial position or consolidated results of operations.

**NOTE B - BUSINESS COMBINATIONS**

**Merger Agreement with First Citizens Bancorporation, Inc.**

On June 10, 2014, BancShares and First Citizens Bancorporation, Inc. (Bancorporation) entered into an Agreement and Plan of Merger (the Merger Agreement). Pursuant to the Merger Agreement, Bancorporation will merge with and into BancShares, whereupon the separate corporate existence of Bancorporation will cease and BancShares will continue (the Merger). The Merger is expected to be completed during the fourth quarter of 2014. Sometime thereafter, First Citizens Bank and Trust Company, Inc. (FCB-SC), a wholly-owned subsidiary of Bancorporation, will merge with and into FCB, whereupon the separate corporate existence of FCB-SC will cease and FCB will



continue.

Under the terms of the Merger Agreement, each share of Bancorporation common stock will be converted into the right to receive 4.00 shares of BancShares' Class A common stock and \$50.00 cash, unless the holder elects for each share to be converted into the right to receive 3.58 shares of BancShares' Class A common stock and 0.42 shares of BancShares' Class B common stock.

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Consummation of the Merger is subject to customary conditions, including, among others, approval of the shareholders of each company and receipt of regulatory approvals.

The Merger Agreement includes certain termination rights for both BancShares and Bancorporation and under specified circumstances Bancorporation may be required to pay BancShares a termination fee equal to \$6.5 million, \$10.0 million or \$22.6 million, depending on the circumstances of the termination.

## 1st Financial Services Corporation Merger

On January 1, 2014, FCB completed its merger with 1st Financial Services Corporation (1st Financial) of Hendersonville, NC and its wholly-owned subsidiary, Mountain 1st Bank & Trust Company (Mountain 1st). The merger allowed FCB to expand its presence in Western North Carolina. Mountain 1st had twelve branches located in Asheville, Brevard, Columbus, Etowah, Fletcher, Forest City, Hendersonville, Hickory, Marion, Shelby and Waynesville. FCB requested and received approval from the North Carolina Commissioner of Banks and the FDIC to close seven Mountain 1st branches due to their proximity to legacy FCB branches. The branches in Asheville, Brevard, Fletcher, Forest City, Hendersonville, Hickory and Marion were closed in May. All customer relationships assigned to those branches were transferred to the nearest FCB branch.

FCB paid \$10.0 million to acquire 1st Financial, including payments of \$8.0 million to the U.S. Treasury to acquire and subsequently retire 1st Financial's Troubled Asset Relief Program (TARP) obligation and \$2.0 million paid to the shareholders of 1st Financial. As a result of the merger, FCB recorded \$24.5 million in goodwill and \$3.8 million in core deposit intangibles.

The 1st Financial transaction was accounted for under the acquisition method of accounting, and the purchased assets, assumed liabilities and identifiable intangible assets were recorded at their estimated fair values as of the acquisition date. Fair values are subject to refinement for up to one year after the closing date of the transaction as additional information regarding closing date fair values becomes available. During the second quarter of 2014, no adjustments were deemed necessary.

The following table provides the carrying value of acquired assets and assumed liabilities, as recorded by 1st Financial, the fair value adjustments calculated at the time of the merger and the resulting fair value recorded by FCB.

| (Dollars in thousands)          | January 1, 2014                 |                        |                    |
|---------------------------------|---------------------------------|------------------------|--------------------|
|                                 | As recorded by<br>1st Financial | Fair value adjustments | As recorded by FCB |
| <b>Assets</b>                   |                                 |                        |                    |
| Cash and cash equivalents       | \$28,194                        | \$—                    | \$28,194           |
| Investment securities           | 246,890                         | (9,452                 | ) 237,438          |
| Loans held for sale             | 1,183                           | —                      | 1,183              |
| Restricted equity securities    | 3,105                           | 671                    | 3,776              |
| Loans                           | 338,170                         | (21,843                | ) 316,327          |
| Less: allowance for loan losses | (7,796                          | ) 7,796                | —                  |
| Premises and equipment          | 3,871                           | (1,185                 | ) 2,686            |
| Other real estate owned         | 12,896                          | (1,305                 | ) 11,591           |
| Intangible asset                | —                               | 3,780                  | 3,780              |
| Other assets                    | 16,811                          | (465                   | ) 16,346           |
| Total assets acquired           | \$643,324                       | \$(22,003              | ) \$621,321        |
| <b>Liabilities</b>              |                                 |                        |                    |
| <b>Deposits:</b>                |                                 |                        |                    |

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|                                       |            |          |            |
|---------------------------------------|------------|----------|------------|
| Noninterest-bearing                   | \$ 152,444 | \$—      | \$ 152,444 |
| Interest-bearing                      | 477,881    | 1,546    | 479,427    |
| Total deposits                        | 630,325    | 1,546    | 631,871    |
| Short-term borrowings                 | 406        | —        | 406        |
| Other liabilities                     | 3,392      | 167      | 3,559      |
| Total liabilities assumed             | \$ 634,123 | \$ 1,713 | 635,836    |
| Fair value of net liabilities assumed |            |          | 14,515     |
| Cash paid to shareholders             |            |          | 2,000      |
| Cash paid to acquire TARP securities  |            |          | 8,000      |
| Goodwill recorded for 1st Financial   |            |          | \$ 24,515  |

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Goodwill recorded for 1st Financial represents future revenues to be derived from the existing customer base, including efficiencies that will result from combining operations and other non-identifiable intangible assets. The 1st Financial transaction is a taxable asset acquisition, and goodwill resulting from the transaction is deductible for income tax purposes.

Merger costs related to the 1st Financial transaction are estimated to be between \$5.5 million and \$6.0 million. Loan related interest income generated from 1st Financial was approximately \$4.2 million for the second quarter of 2014 and \$8.6 million for the year to date.

All loans acquired with the 1st Financial transaction are accounted for under the expected cash flow method (ASC 310-30).

For loans acquired from 1st Financial, the contractually required payments including principal and interest, cash flows expected to be collected and fair values as of the merger date were:

| (Dollars in thousands)              | January 1, 2014 |
|-------------------------------------|-----------------|
| Contractually required payments     | \$414,233       |
| Cash flows expected to be collected | 400,622         |
| Fair value at acquisition date      | 316,327         |

The recorded fair values of loans acquired in the 1st Financial transaction as of the merger date were as follows:

| (Dollars in thousands)                  | January 1, 2014 |
|---|-----------------|
| Commercial:                             |                 |
| Construction and land development       | \$41,516        |
| Commercial mortgage                     | 123,925         |
| Other commercial real estate            | 6,698           |
| Commercial and industrial               | 29,126          |
| Total commercial loans                  | 201,265         |
| Noncommercial:                          |                 |
| Residential mortgage                    | 113,177         |
| Consumer                                | 1,885           |
| Total noncommercial loans               | 115,062         |
| Total loans acquired from 1st Financial | \$316,327       |

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## NOTE C - INVESTMENTS

The amortized cost and fair value of investment securities classified as available for sale and held to maturity at June 30, 2014 and December 31, 2013, are as follows:

|  | June 30, 2014     |                        |                         |             |
|--|-------------------|------------------------|-------------------------|-------------|
| (Dollars in thousands)                         | Cost              | Gross unrealized gains | Gross unrealized losses | Fair value  |
| Investment securities available for sale       |                   |                        |                         |             |
| U.S. Treasury                                  | \$1,623,564       | \$2,084                | \$18                    | \$1,625,630 |
| Government agency                              | 1,281,724         | 2,020                  | 178                     | 1,283,566   |
| Mortgage-backed securities                     | 2,605,333         | 8,251                  | 17,298                  | 2,596,286   |
| Equity securities                              | 543               | 31,955                 | —                       | 32,498      |
| Municipal securities                           | 185               | 1                      | —                       | 186         |
| Total investment securities available for sale | \$5,511,349       | \$44,311               | \$17,494                | \$5,538,166 |
|  |                   |                        |                         |             |
|  | December 31, 2013 |                        |                         |             |
|  | Cost              | Gross unrealized gains | Gross unrealized losses | Fair value  |
| U.S. Treasury                                  | \$373,223         | \$259                  | \$45                    | \$373,437   |
| Government agency                              | 2,543,223         | 1,798                  | 792                     | 2,544,229   |
| Mortgage-backed securities                     | 2,486,297         | 4,526                  | 43,950                  | 2,446,873   |
| Equity securities                              | 543               | 21,604                 | —                       | 22,147      |
| Municipal securities                           | 186               | 1                      | —                       | 187         |
| Other  | 863               | —                      | 33                      | 830         |
| Total investment securities available for sale | \$5,404,335       | \$28,188               | \$44,820                | \$5,387,703 |
|  |                   |                        |                         |             |
|  | June 30, 2014     |                        |                         |             |
|  | Cost              | Gross unrealized gains | Gross unrealized losses | Fair value  |
| Investment securities held to maturity         |                   |                        |                         |             |
| Mortgage-backed securities                     | \$693             | \$36                   | \$—                     | \$729       |
|  |                   |                        |                         |             |
|  | December 31, 2013 |                        |                         |             |
|  | Cost              | Gross unrealized gains | Gross unrealized losses | Fair value  |
| Mortgage-backed securities                     | \$907             | \$67                   | \$—                     | \$974       |

A single subordinated debt security, previously classified within other, was called during the second quarter of 2014.

Investments in mortgage-backed securities primarily represent securities issued by the Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation.

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The following table provides the amortized cost and fair value by contractual maturity. Expected maturities will differ from contractual maturities on certain securities because borrowers and issuers may have the right to call or prepay obligations with or without prepayment penalties. Repayments of mortgage-backed securities are dependent on the repayments of the underlying loan balances. Equity securities do not have a stated maturity date.

| (Dollars in thousands)                         | June 30, 2014 |             | December 31, 2013 |             |
|--|---------------|-------------|-------------------|-------------|
|  | Cost          | Fair value  | Cost              | Fair value  |
| Investment securities available for sale       |               |             |                   |             |
| Non-amortizing securities maturing in:         |               |             |                   |             |
| One year or less                               | \$683,598     | \$684,265   | \$839,956         | \$840,883   |
| One through five years                         | 2,221,875     | 2,225,117   | 2,077,539         | 2,077,800   |
| Mortgage-backed securities                     | 2,605,333     | 2,596,286   | 2,486,297         | 2,446,873   |
| Equity securities                              | 543           | 32,498      | 543               | 22,147      |
| Total investment securities available for sale | \$5,511,349   | \$5,538,166 | \$5,404,335       | \$5,387,703 |
| Investment securities held to maturity         |               |             |                   |             |
| Mortgage-backed securities held to maturity    | \$693         | \$729       | \$907             | \$974       |

There were no realized securities gains (losses) during any period presented.

The following table provides information regarding securities with unrealized losses as of June 30, 2014 and December 31, 2013.

| (Dollars in thousands)                    | June 30, 2014 |                      |               |                      | Total<br>Fair<br>value | Unrealized<br>losses |
|---|---------------|----------------------|---------------|----------------------|------------------------|----------------------|
|   | Fair<br>value | Unrealized<br>losses | Fair<br>value | Unrealized<br>losses |                        |                      |
| Investment securities available for sale: |               |                      |               |                      |                        |                      |
| U.S. Treasury                             | \$135,712     | \$18                 | \$—           | \$—                  | \$135,712              | \$18                 |
| Government agency                         | 242,563       | 178                  | —             | —                    | 242,563                | 178                  |
| Mortgage-backed securities                | 728,997       | 2,163                | 1,109,829     | 15,135               | 1,838,826              | 17,298               |
| Total                                     | \$1,107,272   | \$2,359              | \$1,109,829   | \$15,135             | \$2,217,101            | \$17,494             |

| Investment securities available for sale: | December 31, 2013 |                      |               |                      | Total<br>Fair<br>value | Unrealized<br>losses |
|---|-------------------|----------------------|---------------|----------------------|------------------------|----------------------|
|   | Fair<br>value     | Unrealized<br>losses | Fair<br>value | Unrealized<br>losses |                        |                      |
| U.S. Treasury                             | \$102,105         | \$45                 | \$—           | \$—                  | \$102,105              | \$45                 |
| Government agency                         | 780,552           | 761                  | 29,969        | 31                   | 810,521                | 792                  |
| Mortgage-backed securities                | 2,221,213         | 42,876               | 26,861        | 1,074                | 2,248,074              | 43,950               |
| Other                                     | 830               | 33                   | —             | —                    | 830                    | 33                   |
| Total                                     | \$3,104,700       | \$43,715             | \$56,830      | \$1,105              | \$3,161,530            | \$44,820             |

Investment securities with an aggregate fair value of \$1.11 billion and \$56.8 million have had continuous unrealized losses for more than 12 months as of June 30, 2014 and December 31, 2013, with an aggregate unrealized loss of \$15.1 million and \$1.1 million, respectively. As of June 30, 2014, all 104 of these investments are U.S. government agency and government sponsored enterprise-issued mortgage-backed securities. None of the unrealized losses identified as of June 30, 2014 or December 31, 2013 relate to the marketability of the securities or the issuer's ability to

honor redemption obligations. For all periods presented, BancShares had the ability and intent to retain these securities for a period of time sufficient to recover all unrealized losses. Therefore, none of the securities were deemed to be other than temporarily impaired.

Investment securities having an aggregate carrying value of \$2.85 billion at June 30, 2014 and \$2.75 billion at December 31, 2013 were pledged as collateral to secure public funds on deposit and certain short-term borrowings, and for other purposes as required by law.

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NOTE D - LOANS AND LEASES

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

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

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

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

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

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

Lease financing – Lease financing consists solely of lease financing agreements.

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

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

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

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

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

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



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Loans and leases outstanding include the following at June 30, 2014 and December 31, 2013:

| (Dollars in thousands)            | June 30, 2014 | December 31, 2013 |
|-----------------------------------|---------------|-------------------|
| Acquired loans                    |               |                   |
| Commercial:                       |               |                   |
| Construction and land development | \$80,827      | \$78,915          |
| Commercial mortgage               | 637,481       | 642,891           |
| Other commercial real estate      | 34,688        | 41,381            |
| Commercial and industrial         | 33,851        | 17,254            |
| Other                             | 1,270         | 866               |
| Total commercial loans            | 788,117       | 781,307           |
| Noncommercial:                    |               |                   |
| Residential mortgage              | 270,688       | 213,851           |
| Revolving mortgage                | 20,129        | 30,834            |
| Construction and land development | 28,759        | 2,583             |
| Consumer                          | 2,240         | 851               |
| Total noncommercial loans         | 321,816       | 248,119           |
| Total acquired loans              | 1,109,933     | 1,029,426         |
| Originated loans and leases:      |               |                   |
| Commercial:                       |               |                   |
| Construction and land development | 342,021       | 319,847           |
| Commercial mortgage               | 6,367,096     | 6,362,490         |
| Other commercial real estate      | 178,899       | 178,754           |
| Commercial and industrial         | 1,292,213     | 1,081,158         |
| Lease financing                   | 413,422       | 381,763           |
| Other                             | 131,051       | 175,336           |
| Total commercial loans            | 8,724,702     | 8,499,348         |
| Noncommercial:                    |               |                   |
| Residential mortgage              | 1,071,089     | 982,421           |
| Revolving mortgage                | 2,122,675     | 2,113,285         |
| Construction and land development | 119,420       | 122,792           |
| Consumer                          | 377,137       | 386,452           |
| Total noncommercial loans         | 3,690,321     | 3,604,950         |
| Total originated loans and leases | 12,415,023    | 12,104,298        |
| Total loans and leases            | \$13,524,956  | \$13,133,724      |

At June 30, 2014, \$816.3 million in acquired loans were covered under loss share agreements, compared to \$1.03 billion at December 31, 2013. The remaining acquired loans as of June 30, 2014 are primarily from the 1st Financial merger. The loss share protection will expire for non-single family residential loans acquired from Temecula Valley Bank (TVB) and Venture Bank (VB) during the third quarter of 2014. The acquired loan balance at June 30, 2014 for the expiring agreements from TVB and VB is \$195.4 million and \$73.3 million, respectively.

At June 30, 2014, \$2.65 billion in originated loans were pledged to secure debt obligations, compared to \$2.56 billion at December 31, 2013.

## Credit quality indicators

Loans and leases are monitored for credit quality on a recurring basis. The credit quality indicators used are dependent on the portfolio segment to which the loan relates. Originated commercial loans and leases, originated noncommercial

loans and leases and acquired loans have different credit quality indicators as a result of the unique characteristics relative to each loan segment being evaluated.

The credit quality indicators for commercial loans and leases are developed through a review of individual borrowers on an ongoing basis. Each commercial loan is evaluated annually with more frequent evaluation of more severely criticized loans or leases. The credit quality indicators for noncommercial loans are based on the delinquency status of the borrower. As the

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borrower becomes more delinquent, the likelihood of loss increases. Acquired loans are bifurcated into commercial and noncommercial segments and credit quality indicators are assigned in the same manner as the originated portfolio. The indicators represent the rating for loans or leases as of the date presented based on the most recent assessment performed. These credit quality indicators are defined as follows:

Pass – A pass rated asset is one in which repayment is considered highly likely and there are no observable weaknesses in the asset. Such an asset does not meet any of the characteristics for adverse classification.

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

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

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

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

Ungraded – Ungraded loans represent loans that are not included in the individual credit grading process due to their relatively small balances or borrower type. The majority of originated, ungraded loans at June 30, 2014 and December 31, 2013 relate to business credit cards. Business credit card loans are subject to automatic charge-off when they become 120 days past due in the same manner as unsecured consumer lines of credit. The remaining balance is comprised of a small amount of commercial mortgage loans and other commercial real estate loans. As of December 31, 2013, ungraded loans also included tobacco buyout loans classified as commercial and industrial loans. Final payment from the Commodity Credit Corporation was received during January 2014 for tobacco buyout loans held by FCB. As of June 30, 2014, ungraded also includes \$94.7 million of loans resulting from the 1st Financial merger.

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Originated loans and leases outstanding at June 30, 2014 and December 31, 2013 by credit quality indicator are provided below:

|                        |                                   | June 30, 2014                          |                         |                               |                 |           |  |
|------------------------|-----------------------------------|--|-------------------------|-------------------------------|-----------------|-----------|--|
| (Dollars in thousands) |                                   | Originated commercial loans and leases |                         |                               |                 |           |  |
| Grade:                 | Construction and land development | Commercial mortgage                    | Other commercial estate | Commercial realand industrial | Lease financing | Other     | Total originated commercial loans and leases |
| Pass                   | \$330,946                         | \$6,102,219                            | \$175,413               | \$1,178,124                   | \$405,495       | \$130,997 | \$8,323,194                                  |
| Special mention        | 7,901                             | 121,824                                | 1,370                   | 25,606                        | 4,324           | 8         | 161,033                                      |
| Substandard            | 3,174                             | 138,451                                | 1,966                   | 6,474                         | 3,122           | 46        | 153,233                                      |
| Doubtful               | —                                 | 3,296                                  | —                       | 460                           | 481             | —         | 4,237  |
| Ungraded               | —                                 | 1,306                                  | 150                     | 81,549                        | —               | —         | 83,005                                       |
| Total                  | \$342,021                         | \$6,367,096                            | \$178,899               | \$1,292,213                   | \$413,422       | \$131,051 | \$8,724,702                                  |

December 31, 2013

Originated commercial loans and leases

|                        |                                   | December 31, 2013                      |                         |                               |                 |           |  |
|------------------------|-----------------------------------|--|-------------------------|-------------------------------|-----------------|-----------|--|
| (Dollars in thousands) |                                   | Originated commercial loans and leases |                         |                               |                 |           |  |
| Grade:                 | Construction and land development | Commercial mortgage                    | Other commercial estate | Commercial realand industrial | Lease financing | Other     | Total originated commercial loans and leases |
| Pass                   | \$308,231                         | \$6,094,505                            | \$174,913               | \$964,840                     | \$375,371       | \$174,314 | \$8,092,174                                  |
| Special mention        | 8,620                             | 119,515                                | 1,362                   | 14,686                        | 2,160           | 982       | 147,325                                      |
| Substandard            | 2,944                             | 141,913                                | 2,216                   | 6,352                         | 3,491           | 40        | 156,956                                      |
| Doubtful               | 52                                | 5,159                                  | 75                      | 144                           | 592             | —         | 6,022  |
| Ungraded               | —                                 | 1,398                                  | 188                     | 95,136                        | 149             | —         | 96,871                                       |
| Total                  | \$319,847                         | \$6,362,490                            | \$178,754               | \$1,081,158                   | \$381,763       | \$175,336 | \$8,499,348                                  |

June 30, 2014

Originated noncommercial loans and leases

|                             |                      | June 30, 2014                             |                                   |           |                                      |  |
|-----------------------------|----------------------|---|-----------------------------------|-----------|--------------------------------------|--|
| (Dollars in thousands)      |                      | Originated noncommercial loans and leases |                                   |           |                                      |  |
|                             | Residential mortgage | Revolving mortgage                        | Construction and land development | Consumer  | Total originated noncommercial loans |  |
| Current                     | \$1,047,270          | \$2,107,889                               | \$118,078                         | \$373,579 | \$3,646,816                          |  |
| 30-59 days past due         | 11,219               | 7,690                                     | 949                               | 1,949     | 21,807                               |  |
| 60-89 days past due         | 4,693                | 2,434                                     | 229                               | 843       | 8,199                                |  |
| 90 days or greater past due | 7,907                | 4,662                                     | 164                               | 766       | 13,499                               |  |
| Total                       | \$1,071,089          | \$2,122,675                               | \$119,420                         | \$377,137 | \$3,690,321                          |  |

December 31, 2013

Originated noncommercial loans and leases

|                        |                      | December 31, 2013                         |                       |          |                                |
|------------------------|----------------------|---|-----------------------|----------|--------------------------------|
| (Dollars in thousands) |                      | Originated noncommercial loans and leases |                       |          |                                |
|                        | Residential mortgage | Revolving mortgage                        | Construction and land | Consumer | Total originated noncommercial |
|                        |                      |   |                       |          |                                |

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|                             |           |             | development |           | loans       |
|-----------------------------|-----------|-------------|-------------|-----------|-------------|
| Current                     | \$955,300 | \$2,095,480 | \$121,026   | \$382,710 | \$3,554,516 |
| 30-59 days past due         | 12,885    | 10,977      | 1,193       | 2,114     | 27,169      |
| 60-89 days past due         | 4,658     | 2,378       | 317         | 955       | 8,308       |
| 90 days or greater past due | 9,578     | 4,450       | 256         | 673       | 14,957      |
| Total                       | \$982,421 | \$2,113,285 | \$122,792   | \$386,452 | \$3,604,950 |

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Acquired loans and leases outstanding at June 30, 2014 and December 31, 2013 by credit quality indicator are provided below:

| June 30, 2014          |  |                     |                              |                           |                      |                    |   |                    |                      |
|------------------------|--|---------------------|------------------------------|---------------------------|----------------------|--------------------|---|--------------------|----------------------|
| (Dollars in thousands) |  |                     |                              |                           |                      |                    |   |                    |                      |
| Acquired loans         |  |                     |                              |                           |                      |                    |   |                    |                      |
| Grade:                 | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other | Total acquired loans |
| Pass                   | \$14,193                                     | \$349,009           | \$11,422                     | \$26,313                  | \$138,836            | \$15,238           | \$112   | \$1,469            | \$556,592            |
| Special mention        | 10,957                                       | 106,582             | 16,014                       | 3,869                     | 5,543                | 2,375              | —   | —                  | 145,340              |
| Substandard            | 49,746                                       | 148,880             | 7,252                        | 3,221                     | 44,396               | 1,696              | 1,237   | 2                  | 256,430              |
| Doubtful               | 2,214  | 32,503              | —                            | 431                       | 1,401                | 612                | 295   | —                  | 37,456               |
| Ungraded               | 3,717  | 507                 | —                            | 17                        | 80,512               | 208                | 27,115  | 2,039              | 114,115              |
| Total                  | \$80,827                                     | \$637,481           | \$34,688                     | \$33,851                  | \$270,688            | \$20,129           | \$28,759  | \$3,510            | \$1,109,933          |
| December 31, 2013      |  |                     |                              |                           |                      |                    |   |                    |                      |
| Acquired loans         |  |                     |                              |                           |                      |                    |   |                    |                      |
| Grade:                 | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other | Total acquired loans |
| Pass                   | \$2,619                                      | \$296,824           | \$22,225                     | \$8,021                   | \$135,326            | \$26,322           | \$149   | \$1,345            | \$492,831            |
| Special mention        | 15,530                                       | 125,295             | 3,431                        | 2,585                     | 6,301                | 2,608              | —   | —                  | 155,750              |
| Substandard            | 52,228                                       | 179,657             | 7,012                        | 5,225                     | 52,774               | 1,013              | 2,139   | —                  | 300,048              |
| Doubtful               | 7,436  | 40,471              | 8,713                        | 1,257                     | 2,058                | 891                | 295   | —                  | 61,121               |
| Ungraded               | 1,102  | 644                 | —                            | 166                       | 17,392               | —                  | —   | 372                | 19,676               |
| Total                  | \$78,915                                     | \$642,891           | \$41,381                     | \$17,254                  | \$213,851            | \$30,834           | \$2,583   | \$1,717            | \$1,029,426          |

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The aging of the outstanding loans and leases, by class, at June 30, 2014 and December 31, 2013 (excluding loans and leases acquired with deteriorated credit quality) is provided in the table below.

The calculation of days past due begins on the day after payment is due and includes all days through which all required interest or principal has not been paid. Loans and leases 30 days or less past due are considered current as various grace periods allow borrowers to make payments within a stated period after the due date and still remain in compliance with the loan agreement.

| (Dollars in thousands)                            | June 30, 2014       |                     |                    |                | Current      | Total loans and leases |
|---|---------------------|---------------------|--------------------|----------------|--------------|------------------------|
|   | 30-59 days past due | 60-89 days past due | 90 days or greater | Total past due |              |                        |
| Originated loans and leases:                      |                     |                     |                    |                |              |                        |
| Construction and land development - commercial    | \$657               | \$40                | \$462              | \$1,159        | \$340,862    | \$342,021              |
| Commercial mortgage                               | 11,755              | 3,089               | 10,501             | 25,345         | 6,341,751    | 6,367,096              |
| Other commercial real estate                      | 149                 | —                   | 52                 | 201            | 178,698      | 178,899                |
| Commercial and industrial                         | 5,459               | 805                 | 593                | 6,857          | 1,285,356    | 1,292,213              |
| Lease financing                                   | 1,110               | 8                   | 97                 | 1,215          | 412,207      | 413,422                |
| Other   | 343                 | —                   | —                  | 343            | 130,708      | 131,051                |
| Residential mortgage                              | 11,219              | 4,693               | 7,907              | 23,819         | 1,047,270    | 1,071,089              |
| Revolving mortgage                                | 7,690               | 2,434               | 4,662              | 14,786         | 2,107,889    | 2,122,675              |
| Construction and land development - noncommercial | 949                 | 229                 | 164                | 1,342          | 118,078      | 119,420                |
| Consumer  | 1,949               | 843                 | 766                | 3,558          | 373,579      | 377,137                |
| Total originated loans and leases                 | \$41,280            | \$12,141            | \$25,204           | \$78,625       | \$12,336,398 | \$12,415,023           |
|   |                     |                     |                    |                |              |                        |
|   | December 31, 2013   |                     |                    |                | Current      | Total loans and leases |
|   | 30-59 days past due | 60-89 days past due | 90 days or greater | Total past due |              |                        |
| Originated loans and leases:                      |                     |                     |                    |                |              |                        |
| Construction and land development - commercial    | \$1,603             | \$9                 | \$457              | \$2,069        | \$317,778    | \$319,847              |
| Commercial mortgage                               | 11,131              | 3,601               | 14,407             | 29,139         | 6,333,351    | 6,362,490              |
| Other commercial real estate                      | 139                 | 210                 | 470                | 819            | 177,935      | 178,754                |
| Commercial and industrial                         | 3,336               | 682                 | 436                | 4,454          | 1,076,704    | 1,081,158              |
| Lease financing                                   | 789                 | 1,341               | 101                | 2,231          | 379,532      | 381,763                |
| Other   | —                   | 85                  | —                  | 85             | 175,251      | 175,336                |
| Residential mortgage                              | 12,885              | 4,658               | 9,578              | 27,121         | 955,300      | 982,421                |
| Revolving mortgage                                | 10,977              | 2,378               | 4,450              | 17,805         | 2,095,480    | 2,113,285              |
| Construction and land development - noncommercial | 1,193               | 317                 | 256                | 1,766          | 121,026      | 122,792                |
| Consumer  | 2,114               | 955                 | 673                | 3,742          | 382,710      | 386,452                |
| Total originated loans and leases                 | \$44,167            | \$14,236            | \$30,828           | \$89,231       | \$12,015,067 | \$12,104,298           |

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The recorded investment, by class, in loans and leases on nonaccrual status, and loans and leases greater than 90 days past due and still accruing at June 30, 2014 and December 31, 2013 (excluding acquired loans and leases) are as follows:

| (Dollars in thousands)                            | June 30, 2014               |   | December 31, 2013           |   |
|---|-----------------------------|---|-----------------------------|---|
|   | Nonaccrual loans and leases | Loans and leases > 90 days and accruing | Nonaccrual loans and leases | Loans and leases > 90 days and accruing |
| Originated loans and leases:                      |                             |   |                             |   |
| Construction and land development - commercial    | \$659                       | \$—                                     | \$544                       | \$—                                     |
| Other commercial real estate                      | 1,385                       | 41                                      | 1,610                       | —                                       |
| Commercial mortgage                               | 28,591                      | 1,802                                   | 33,529                      | 1,113                                   |
| Commercial and industrial                         | 1,367                       | 502                                     | 1,428                       | 294                                     |
| Lease financing                                   | 624                         | 5                                       | 832                         | —                                       |
| Residential mortgage                              | 13,836                      | 1,930                                   | 14,701                      | 1,998                                   |
| Revolving mortgage                                | —                           | 4,662                                   | —                           | 4,450                                   |
| Construction and land development - noncommercial | —                           | 164                                     | 457                         | 256                                     |
| Consumer  | 23                          | 766                                     | 69                          | 673                                     |
| Total originated loans and leases                 | \$46,485                    | \$9,872                                 | \$53,170                    | \$8,784                                 |
| Acquired Loans                                    |                             |   |                             |   |

The following table provides changes in the recorded investment of acquired loans during the six months ended June 30, 2014 and June 30, 2013:

| (Dollars in thousands)                   | 2014        | 2013        |
|--|-------------|-------------|
| Balance at January 1                     | \$1,029,426 | \$1,809,235 |
| Fair value of acquired loans             | 316,327     | —           |
| Accretion                                | 60,660      | 131,909     |
| Payments received and other changes, net | (296,480)   | (497,808)   |
| Balance at June 30                       | \$1,109,933 | \$1,443,336 |
| Outstanding principal balance at June 30 | \$1,888,475 | \$2,456,347 |

The recorded investment of acquired loans on the cost recovery method was \$54.0 million at June 30, 2014 and \$28.5 million at December 31, 2013. This increase is primarily driven by one large acquired loan relationship that was moved to cost recovery during the first quarter. The cost recovery method is applied to loans when the timing of future cash flows is not reasonably estimable due to borrower nonperformance or uncertainty in the timing and amount of ultimate disposition of the asset.

The following table documents changes to the amount of accretable yield for the first six months of 2014 and 2013.

| (Dollars in thousands)   | 2014      | 2013      |
|--|-----------|-----------|
| Balance at January 1   | \$439,990 | \$539,564 |
| Additions  | 84,295    | —         |
| Accretion  | (60,660)  | (131,909) |
| Reclassifications from nonaccretable difference                            | 9,992     | 72,149    |
| Changes in expected cash flows that do not affect nonaccretable difference | (17,126)  | 42,402    |
| Balance at June 30   | \$456,491 | \$522,206 |





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## NOTE E - ALLOWANCE FOR LOAN AND LEASE LOSSES

The following tables present the activity in the allowance for originated loan and lease losses by loan class for the three and six months ended June 30, 2014 and June 30, 2013:

## Three months ended June 30, 2014

| (Dollars in thousands)               | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer | Non-specific |
|--------------------------------------|--|---------------------|------------------------------|---------------------------|-----------------|-------|----------------------|--------------------|--|----------|--------------|
| Originated Loans                     |  |                     |                              |                           |                 |       |                      |                    |  |          |              |
| Allowance for loan and lease losses: |  |                     |                              |                           |                 |       |                      |                    |  |          |              |
| Balance at April 1                   | \$12,246                                       | \$94,217            | \$945                        | \$24,021                  | \$4,183         | \$454 | \$10,944             | \$16,408           | \$1,249  | \$13,282 | \$—          |
| Provision                            | (1,135 )                                       | (1,961 )            | (155 )                       | 3,033                     | 176             | 163   | (1,557 )             | 1,252              | (323 )   | 2,737    | —            |
| Charge-offs                          | —  | (272 )              | —                            | (531 )                    | (14 )           | (5 )  | (234 )               | (1,064 )           | (23 )  | (2,628 ) | —            |
| Recoveries                           | 5  | 145                 | 16                           | 386                       | 20              | —     | 148                  | 201                | 2  | 584      | —            |
| Balance at June 30                   | \$11,116                                       | \$92,129            | \$806                        | \$26,909                  | \$4,365         | \$612 | \$9,301              | \$16,797           | \$905  | \$13,975 | \$—          |

## Three months ended June 30, 2013

| (Dollars in thousands)          | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other    | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer  | Non-specific |
|---------------------------------|--|---------------------|------------------------------|---------------------------|-----------------|----------|----------------------|--------------------|--|-----------|--------------|
| Balance at April 1              | \$4,311  | \$82,119            | \$1,915                      | \$13,661                  | \$3,543         | \$1,490  | \$3,790              | \$24,499           | \$1,419  | \$24,027  | \$15,777     |
| Provision                       | 3,296  | (4,976 )            | (51 )                        | (1,203 )                  | 1,775           | 155      | 878                  | 907                | (244 )   | 1,694     | —            |
| Charge-offs                     | (1,286 )                                       | (213 )              | (18 )                        | (988 )                    | (92 )           | —        | (450 )               | (878 )             | —  | (2,569 )  | —            |
| Recoveries                      | 270  | 491                 | 26                           | 288                       | 19              | 3        | 61                   | 307                | 23   | 643       | —            |
| Reclassification <sup>(1)</sup> | 5,141  | 27,421              | (815 )                       | 7,551                     | (253 )          | (1,288 ) | 5,717                | (9,838 )           | (478 )   | (10,018 ) | (15,777)     |
| Balance at June 30              | \$11,732                                       | \$104,842           | \$1,057                      | \$19,309                  | \$4,992         | \$360    | \$9,996              | \$14,997           | \$720  | \$13,777  | \$—          |

## Six months ended June 30, 2014

| (Dollars in thousands) | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer | Non-specific |
|------------------------|--|---------------------|------------------------------|---------------------------|-----------------|-------|----------------------|--------------------|--|----------|--------------|
| Balance at January 1   | \$10,335                                       | \$100,257           | \$1,009                      | \$22,362                  | \$4,749         | \$190 | \$10,511             | \$16,239           | \$681  | \$13,541 | \$—          |
| Provision              | 750  | (8,940 )            | (229 )                       | 5,009                     | (348 )          | 435   | (948 )               | 2,605              | 254  | 4,012    | —            |
| Charge-offs            | —  | (440 )              | —                            | (1,027 )                  | (72 )           | (13 ) | (418 )               | (2,324 )           | (94 )  | (4,805 ) | —            |
| Recoveries             | 31   | 1,252               | 26                           | 565                       | 36              | —     | 156                  | 277                | 64   | 1,227    | —            |
| Balance at June 30     | \$11,116                                       | \$92,129            | \$806                        | \$26,909                  | \$4,365         | \$612 | \$9,301              | \$16,797           | \$905  | \$13,975 | \$—          |

Six months ended June 30, 2013

|                                 | Construction<br>and land<br>development<br>- commercial | Commercial<br>mortgage | Other<br>real<br>estate | Commercial<br>and industrial | Lease<br>financing | Other   | Residential<br>mortgage | Revolving<br>mortgage | Construction<br>and<br>land<br>development<br>- non-<br>commercial | Consumer | Non-<br>specific |
|---------------------------------|---|------------------------|-------------------------|------------------------------|--------------------|---------|-------------------------|-----------------------|--|----------|------------------|
| Balance at January 1            | \$6,031   | \$80,229               | \$2,059                 | \$14,050                     | \$3,521            | \$1,175 | \$3,836                 | \$25,185              | \$1,721  | \$25,389 | \$15,851         |
| Provision                       | 1,462   | (2,438)                | (151)                   | (703)                        | 1,797              | 476     | 1,611                   | 2,338                 | (357)  | 2,290    | (78)             |
| Charge-offs                     | (1,540)   | (869)                  | (72)                    | (2,246)                      | (92)               | (6)     | (1,268)                 | (3,066)               | (245)  | (5,157)  | —                |
| Recoveries                      | 638   | 499                    | 36                      | 657                          | 19                 | 3       | 100                     | 378                   | 79   | 1,273    | —                |
| Reclassification <sup>(1)</sup> | 5,141   | 27,421                 | (815)                   | 7,551                        | (253)              | (1,288) | 5,717                   | (9,838)               | (478)  | (10,018) | (15,777)         |
| Balance at June 30              | \$11,732  | \$104,842              | \$1,057                 | \$19,309                     | \$4,992            | \$360   | \$9,996                 | \$14,997              | \$720  | \$13,777 | \$—              |

<sup>(1)</sup> Reclassification results from enhancements to the ALLL calculation during the second quarter of 2013 that resulted in the allocation of \$15.8 million previously designated as 'non-specific' to other loan classes and the absorption of \$7.4 million of the reserve for unfunded commitments related to unfunded, revocable loan commitments into the ALLL.

The provision for construction and land development - commercial was a credit of \$1.1 million for the quarter ended June 30, 2014 compared to expense of \$3.3 million for the same period in the prior year. Provision expense for the six month periods ended June 30, 2014 and June 30, 2013 was \$0.8 million and \$1.5 million, respectively. The decrease in provision expense for both comparative periods is due to improvements in credit risk rating and lower credit default trends.

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The commercial mortgage loan class had a net credit provision of \$2.0 million and \$8.9 million for the three and six months ended June 30, 2014, respectively. The net credit provision for the three and six months ended June 30, 2013 was \$5.0 million and \$2.4 million, respectively. The net credit provision for all periods was primarily the result of improvements in the credit risk rating mix and lower credit default trends within this loan class.

The provision for commercial and industrial loans totaled \$3.0 million and \$5.0 million for the three and six months ended June 30, 2014, respectively. The 2014 provision expense was a result of increased loans during the respective periods. Conversely, the three and six months ended June 30, 2013 credit provisions of \$1.2 million and \$0.7 million, respectively, resulted from a decline in the outstanding loan balances.

The residential mortgage loan class had a net credit provision of \$1.6 million and \$0.9 million for the three and six months ended June 30, 2014, respectively. Provision expense for the three and six months ended June 30, 2013 was \$0.9 million and \$1.6 million. The decrease in provision expense can be attributed to a decline in past due residential mortgage loans.

The following tables present the allowance for originated loan losses and the recorded investment in originated loans, by loan class, based on impairment method as of June 30, 2014 and December 31, 2013:

|   | June 30, 2014                                  |                     |                              |                           |                 |        | Residential mortgage | Revolving mortgage | Construction and land development - non-commercial | Consumer  |
|---|--|---------------------|------------------------------|---------------------------|-----------------|--------|----------------------|--------------------|--|-----------|
|   | Construction and land development - commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Lease financing | Other  |                      |                    |  |           |
| Allowance for loan and lease losses:                            |  |                     |                              |                           |                 |        |                      |                    |  |           |
| ALLL for loans and leases individually evaluated for impairment | \$ 155   | \$ 7,704            | \$ 179                       | \$ 1,425                  | \$ 297          | \$ —   | \$ 1,613             | \$ 1,024           | \$ 201   | \$ 653    |
| ALLL for loans and leases collectively evaluated for impairment | 10,961   | 84,425              | 627                          | 25,484                    | 4,068           | 612    | 7,688                | 15,773             | 704  | 13,322    |
| Total allowance for loan and lease losses                       | \$ 11,116                                      | \$ 92,129           | \$ 806                       | \$ 26,909                 | \$ 4,365        | \$ 612 | \$ 9,301             | \$ 16,797          | \$ 905   | \$ 13,975 |
| Loans and leases:   |  |                     |                              |                           |                 |        |                      |                    |  |           |
| Loans and leases individually                                   | \$ 2,573                                       | \$ 87,046           | \$ 1,962                     | \$ 10,811                 | \$ 376          | \$ 46  | \$ 15,448            | \$ 3,754           | \$ 1,934   | \$ 937    |

|   |           |             |           |             |           |           |             |             |           |           |
|---|-----------|-------------|-----------|-------------|-----------|-----------|-------------|-------------|-----------|-----------|
| evaluated<br>for<br>impairment<br>Loans and<br>leases<br>collectively<br>evaluated<br>for<br>impairment | 339,448   | 6,280,050   | 176,937   | 1,281,402   | 413,046   | 131,005   | 1,055,641   | 2,118,921   | 117,486   | 376,200   |
| Total loan<br>and leases  | \$342,021 | \$6,367,096 | \$178,899 | \$1,292,213 | \$413,422 | \$131,051 | \$1,071,089 | \$2,122,675 | \$119,420 | \$377,137 |

|   | December 31, 2013                                       |                        |                                       |                              |                    |         |                         |                       |   |          |
|---|---|------------------------|---------------------------------------|------------------------------|--------------------|---------|-------------------------|-----------------------|---|----------|
| (Dollars in<br>thousands)   | Construction<br>and land<br>development<br>- commercial | Commercial<br>mortgage | Other<br>commercial<br>real<br>estate | Commercial<br>and industrial | Lease<br>financing | Other   | Residential<br>mortgage | Revolving<br>mortgage | Construction<br>and land<br>development<br>- non-commercial | Consumer |
| Allowance<br>for loan and<br>lease losses:<br>ALLL for<br>loans and<br>leases<br>individually<br>evaluated<br>for<br>impairment | \$103   | \$6,873                | \$209                                 | \$771                        | \$54               | \$—     | \$1,586                 | \$372                 | \$72  | \$121    |
| ALLL for<br>loans and<br>leases<br>collectively<br>evaluated<br>for<br>impairment   | 10,232  | 93,384                 | 800                                   | 21,591                       | 4,695              | 190     | 8,925                   | 15,867                | 609   | 13,420   |
| Total<br>allowance<br>for loan and<br>lease losses  | \$10,335  | \$100,257              | \$1,009                               | \$22,362                     | \$4,749            | \$190   | \$10,511                | \$16,239              | \$681   | \$13,541 |
| Loans and<br>leases:<br>Loans and<br>leases<br>individually<br>evaluated<br>for<br>impairment                                   | \$2,272   | \$97,111               | \$1,878                               | \$9,300                      | \$188              | \$—     | \$15,539                | \$3,596               | \$1,108   | \$1,154  |
| Loans and<br>leases<br>collectively<br>evaluated  | 317,575   | 6,265,379              | 176,876                               | 1,071,858                    | 381,575            | 175,336 | 966,882                 | 2,109,689             | 121,684   | 385,298  |

for  
impairment

|                          |           |             |           |             |           |           |           |             |           |           |
|--------------------------|-----------|-------------|-----------|-------------|-----------|-----------|-----------|-------------|-----------|-----------|
| Total loan<br>and leases | \$319,847 | \$6,362,490 | \$178,754 | \$1,081,158 | \$381,763 | \$175,336 | \$982,421 | \$2,113,285 | \$122,792 | \$386,452 |
|--------------------------|-----------|-------------|-----------|-------------|-----------|-----------|-----------|-------------|-----------|-----------|

The total reserves for individually impaired loans increased during the second quarter of 2014 due to enhancements in the TDR impairment calculation. TDR impairment evaluation, for performing TDRs, has historically been calculated on pools of homogeneous loan groups, as determined by loan type with similar risk characteristics and performance trends, using a discounted cash flow analysis. Management enhanced

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this process during the second quarter to include individual loan level impairment analysis for performing TDRs which resulted in higher impairment estimates for some TDR loans.

The following tables show the activity in the allowance for acquired loan and lease losses by loan class for the three and six months ended June 30, 2014 and June 30, 2013.

| (Dollars in thousands)               | Three months ended June 30, 2014             |                     |                              |                            |                      |                    |   |                    | Total    |
|--------------------------------------|--|---------------------|------------------------------|----------------------------|----------------------|--------------------|---|--------------------|----------|
|                                      | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial land industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other |          |
| Acquired Loans                       |  |                     |                              |                            |                      |                    |   |                    |          |
| Allowance for loan and lease losses: |  |                     |                              |                            |                      |                    |   |                    |          |
| Balance at April 1                   | \$4,476                                      | \$ 23,003           | \$ 1,204                     | \$ 2,256                   | \$ 9,764             | \$ 3,493           | \$ 583  | \$ 214             | \$44,993 |
| Provision                            | (77 )  | (1,185 )            | (797 )                       | (1,729 )                   | (2,176 )             | (3,031 )           | (583 )  | 49                 | (9,529 ) |
| Charge-offs                          | (596 )                                       | (4,503 )            | —                            | (152 )                     | (495 )               | (381 )             | —   | (6 )               | (6,133 ) |
| Recoveries                           | —  | —                   | —                            | —                          | —                    | —                  | —   | —                  | —        |
| Balance at June 30                   | \$3,803                                      | \$ 17,315           | \$ 407                       | \$ 375                     | \$ 7,093             | \$ 81              | \$ —  | \$ 257             | \$29,331 |

| (Dollars in thousands) | Three months ended June 30, 2013             |                     |                              |                            |                      |                    |   |                    | Total     |
|------------------------|--|---------------------|------------------------------|----------------------------|----------------------|--------------------|---|--------------------|-----------|
|                        | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial land industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other |           |
| Balance at April 1     | \$13,306                                     | \$ 38,293           | \$ 5,172                     | \$ 11,876                  | \$ 17,603            | \$ 7,135           | \$ 2,756  | \$ 332             | \$96,473  |
| Provision              | (5,091 )                                     | (2,522 )            | (576 )                       | (4,936 )                   | 55                   | (869 )             | (1,524 )  | (10 )              | (15,473 ) |
| Charge-offs            | (626 )                                       | (2,183 )            | —                            | (1,004 )                   | (386 )               | (235 )             | —   | (32 )              | (4,466 )  |
| Recoveries             | —  | —                   | —                            | —                          | —                    | —                  | —   | —                  | —         |
| Balance at June 30     | \$7,589                                      | \$ 33,588           | \$ 4,596                     | \$ 5,936                   | \$ 17,272            | \$ 6,031           | \$ 1,232  | \$ 290             | \$76,534  |

| (Dollars in thousands) | Six months ended June 30, 2014               |                     |                              |                            |                      |                    |   |                    | Total     |
|------------------------|--|---------------------|------------------------------|----------------------------|----------------------|--------------------|---|--------------------|-----------|
|                        | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial land industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other |           |
| Balance at January 1   | \$1,320                                      | \$ 29,906           | \$ 1,354                     | \$ 5,275                   | \$ 11,802            | \$ 2,959           | \$ 682  | \$ 222             | \$53,520  |
| Provision              | 3,278  | (4,571 )            | (947 )                       | (2,065 )                   | (4,476 )             | (2,397 )           | (682 )  | 58                 | (11,802 ) |
| Charge-offs            | (795 )                                       | (8,020 )            | —                            | (2,835 )                   | (233 )               | (481 )             | —   | (23 )              | (12,387 ) |
| Recoveries             | —  | —                   | —                            | —                          | —                    | —                  | —   | —                  | —         |
| Balance at June 30     | \$3,803                                      | \$ 17,315           | \$ 407                       | \$ 375                     | \$ 7,093             | \$ 81              | \$ —  | \$ 257             | \$29,331  |

Six months ended June 30, 2013

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| (Dollars in thousands) | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial land industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other | Total      |
|------------------------|--|---------------------|------------------------------|----------------------------|----------------------|--------------------|---|--------------------|------------|
| Balance at January 1   | \$ 31,186                                    | \$ 50,275           | \$ 11,234                    | \$ 8,897                   | \$ 19,837            | \$ 9,754           | \$ 8,287  | \$ 502             | \$ 139,972 |
| Provision              | (18,238 )                                    | (4,606 )            | (5,707 )                     | (704 )                     | (1,450 )             | (3,373 )           | (3,837 )  | (180 )             | (38,095 )  |
| Charge-offs            | (5,359 )                                     | (12,081 )           | (931 )                       | (2,257 )                   | (1,115 )             | (350 )             | (3,218 )  | (32 )              | (25,343 )  |
| Recoveries             | —  | —                   | —                            | —                          | —                    | —                  | —   | —                  | —          |
| Balance at June 30     | \$ 7,589                                     | \$ 33,588           | \$ 4,596                     | \$ 5,936                   | \$ 17,272            | \$ 6,031           | \$ 1,232  | \$ 290             | \$ 76,534  |



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The following tables show the ending balances of acquired loans and leases and related allowance by class of loans as of June 30, 2014 and December 31, 2013:

| (Dollars in thousands)  | June 30, 2014                                |                     |                              |                           |                      |                    |   |                    | Total     |
|---|--|---------------------|------------------------------|---------------------------|----------------------|--------------------|---|--------------------|-----------|
|   | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other |           |
| ALLL for loans and leases acquired with deteriorated credit quality | \$3,803                                      | \$ 17,315           | \$ 407                       | \$ 375                    | \$ 7,093             | \$ 81              | \$ —  | \$ 257             | \$ 29,331 |
| Loans and leases acquired with deteriorated credit quality          | 80,827                                       | 637,481             | 34,688                       | 33,851                    | 270,688              | 20,129             | 28,759  | 3,510              | 1,109,933 |
| (Dollars in thousands)  | December 31, 2013                            |                     |                              |                           |                      |                    |   |                    | Total     |
|   | Construction and land development commercial | Commercial mortgage | Other commercial real estate | Commercial and industrial | Residential mortgage | Revolving mortgage | Construction and land development noncommercial | Consumer and other |           |
| ALLL for loans and leases acquired with deteriorated credit quality | \$1,320                                      | \$ 29,906           | \$ 1,354                     | \$ 5,275                  | \$ 11,802            | \$ 2,959           | \$ 682  | \$ 222             | \$ 53,520 |
| Loans and leases acquired with deteriorated credit quality          | 78,915                                       | 642,891             | 41,381                       | 17,254                    | 213,851              | 30,834             | 2,583   | 1,717              | 1,029,426 |

As of June 30, 2014 and December 31, 2013, \$454.8 million and \$459.9 million, respectively, in acquired loans experienced an adverse change in expected cash flows since the date of acquisition.

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The following tables provide information on originated loans and leases that are individually evaluated for impairment as of June 30, 2014 and December 31, 2013.

| (Dollars in thousands)                            | June 30, 2014             |                            |            | Unpaid principal balance | Related allowance recorded |
|---|---------------------------|----------------------------|------------|--------------------------|----------------------------|
|   | With a recorded allowance | With no recorded allowance | Total      |                          |                            |
| Impaired originated loans and leases              |                           |                            |            |                          |                            |
| Construction and land development - commercial    | \$ 1,305                  | \$ 1,268                   | \$ 2,573   | \$ 3,539                 | \$ 155                     |
| Commercial mortgage                               | 58,223                    | 28,823                     | 87,046     | 92,164                   | 7,704                      |
| Other commercial real estate                      | 741                       | 1,221                      | 1,962      | 2,361                    | 179                        |
| Commercial and industrial                         | 8,371                     | 2,440                      | 10,811     | 11,939                   | 1,425                      |
| Lease financing                                   | 376                       | —                          | 376        | 376                      | 297                        |
| Other   | —                         | 46                         | 46         | 46                       | —                          |
| Residential mortgage                              | 10,016                    | 5,432                      | 15,448     | 15,903                   | 1,613                      |
| Revolving mortgage                                | 3,537                     | 217                        | 3,754      | 4,801                    | 1,024                      |
| Construction and land development - noncommercial | 1,934                     | —                          | 1,934      | 1,934                    | 201                        |
| Consumer  | 936                       | 1                          | 937        | 968                      | 653                        |
| Total impaired originated loans and leases        | \$ 85,439                 | \$ 39,448                  | \$ 124,887 | \$ 134,031               | \$ 13,251                  |
|   |                           |                            |            |                          |                            |
| (Dollars in thousands)                            | December 31, 2013         |                            |            | Unpaid principal balance | Related allowance recorded |
|   | With a recorded allowance | With no recorded allowance | Total      |                          |                            |
| Impaired originated loans and leases              |                           |                            |            |                          |                            |
| Construction and land development - commercial    | \$ 1,025                  | \$ 1,247                   | \$ 2,272   | \$ 7,306                 | \$ 103                     |
| Commercial mortgage                               | 57,819                    | 39,292                     | 97,111     | 103,522                  | 6,873                      |
| Other commercial real estate                      | 783                       | 1,095                      | 1,878      | 2,279                    | 209                        |
| Commercial and industrial                         | 7,197                     | 2,103                      | 9,300      | 10,393                   | 771                        |
| Lease financing                                   | 133                       | 55                         | 188        | 188                      | 54                         |
| Residential mortgage                              | 11,534                    | 4,005                      | 15,539     | 15,939                   | 1,586                      |
| Revolving mortgage                                | 3,382                     | 214                        | 3,596      | 3,596                    | 372                        |
| Construction and land development - noncommercial | 651                       | 457                        | 1,108      | 1,108                    | 72                         |
| Consumer  | 1,154                     | —                          | 1,154      | 1,154                    | 121                        |
| Total impaired originated loans and leases        | \$ 83,678                 | \$ 48,468                  | \$ 132,146 | \$ 145,485               | \$ 10,161                  |

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The following tables show the average impaired originated loan balance and the interest income recognized by loan class for the three and six months ended June 30, 2014 and June 30, 2013:

| (Dollars in thousands)                            | Three months ended June 30, 2014 |                            | Three months ended June 30, 2013 |                            |
|---|----------------------------------|----------------------------|----------------------------------|----------------------------|
|   | Average balance                  | Interest income recognized | Average balance                  | Interest income recognized |
| Impaired originated loans and leases:             |                                  |                            |                                  |                            |
| Construction and land development - commercial    | \$2,592                          | \$28                       | \$8,541                          | \$101                      |
| Commercial mortgage                               | 87,687                           | 799                        | 102,356                          | 1,413                      |
| Other commercial real estate                      | 1,981                            | 7                          | 2,647                            | 37                         |
| Commercial and industrial                         | 11,208                           | 113                        | 10,298                           | 139                        |
| Lease financing                                   | 384                              | 4                          | 531                              | 9                          |
| Other   | 48                               | 1                          | —                                | —                          |
| Residential mortgage                              | 15,592                           | 107                        | 13,855                           | 184                        |
| Revolving mortgage                                | 3,779                            | 29                         | 6,976                            | 47                         |
| Construction and land development - noncommercial | 2,061                            | 26                         | 913                              | 13                         |
| Consumer  | 986                              | 17                         | 1,587                            | 25                         |
| Average impaired originated loans and leases      | \$126,318                        | \$1,131                    | \$147,704                        | \$1,968                    |

| (Dollars in thousands)                            | Six months ended June 30, 2014 |                            | Six months ended June 30, 2013 |                            |
|---|--------------------------------|----------------------------|--------------------------------|----------------------------|
|   | Average balance                | Interest income recognized | Average balance                | Interest income recognized |
| Impaired originated loans and leases:             |                                |                            |                                |                            |
| Construction and land development - commercial    | \$1,413                        | \$31                       | \$8,899                        | \$213                      |
| Commercial mortgage                               | 84,359                         | 1,716                      | 103,032                        | 2,838                      |
| Other commercial real estate                      | 2,731                          | 60                         | 3,028                          | 82                         |
| Commercial and industrial                         | 15,690                         | 353                        | 14,465                         | 406                        |
| Lease financing                                   | 732                            | 21                         | 408                            | 14                         |
| Other   | 24                             | 1                          | —                              | —                          |
| Residential mortgage                              | 15,824                         | 284                        | 15,003                         | 412                        |
| Revolving mortgage                                | 4,262                          | 76                         | 6,390                          | 72                         |
| Construction and land development - noncommercial | 1,946                          | 50                         | 783                            | 25                         |
| Consumer  | 2,058                          | 51                         | 1,611                          | 29                         |
| Average impaired originated loans and leases      | \$129,039                      | \$2,643                    | \$153,619                      | \$4,091                    |

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## Troubled Debt Restructurings

BancShares accounts for certain loan modifications or restructurings as troubled debt restructurings (TDRs). In general, the modification or restructuring of a loan is considered a TDR if, for economic reasons or legal reasons related to a borrower's financial difficulties, a concession is granted to the borrower that creditors would not otherwise grant. Concessions may relate to the contractual interest rate, maturity date, payment structure or other actions. In accordance with GAAP, loans acquired under ASC 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, are not initially considered to be TDRs, but can be classified as such if a modification is made subsequent to acquisition. Modifications of acquired loans that are part of a pool are not designated as TDRs. The following table provides a summary of total TDRs by accrual status.

| (Dollars in thousands)                            | June 30, 2014 |             |           | December 31, 2013 |             |           |
|---|---------------|-------------|-----------|-------------------|-------------|-----------|
|   | Accruing      | Nonaccruing | Total     | Accruing          | Nonaccruing | Total     |
| Commercial loans                                  |               |             |           |                   |             |           |
| Construction and land development - commercial    | \$5,946       | \$2,248     | \$8,194   | \$21,032          | \$1,002     | \$22,034  |
| Commercial mortgage                               | 99,843        | 32,019      | 131,862   | 113,323           | 23,387      | 136,710   |
| Other commercial real estate                      | 3,203         | 1,277       | 4,480     | 3,470             | 1,150       | 4,620     |
| Commercial and industrial                         | 10,935        | 818         | 11,753    | 9,838             | 1,142       | 10,980    |
| Lease   | 233           | 144         | 377       | 49                | —           | 49        |
| Other   | 46            | —           | 46        | —                 | —           | —         |
| Total commercial TDRs                             | 120,206       | 36,506      | 156,712   | 147,712           | 26,681      | 174,393   |
| Noncommercial                                     |               |             |           |                   |             |           |
| Residential                                       | 29,598        | 2,919       | 32,517    | 23,343            | 3,663       | 27,006    |
| Revolving mortgage                                | 3,821         | —           | 3,821     | 3,095             | —           | 3,095     |
| Construction and land development - noncommercial | 1,934         | —           | 1,934     | 651               | 457         | 1,108     |
| Consumer and other                                | 937           | —           | 937       | 1,154             | —           | 1,154     |
| Total noncommercial TDRs                          | 36,290        | 2,919       | 39,209    | 28,243            | 4,120       | 32,363    |
| Total TDRs  | \$156,496     | \$39,425    | \$195,921 | \$175,955         | \$30,801    | \$206,756 |

The following table shows the accrual status of acquired and originated TDRs.

| (Dollars in thousands) | June 30, 2014 | December 31, 2013 |
|------------------------|---------------|-------------------|
| Accruing TDRs:         |               |                   |
| Acquired               | \$62,592      | \$90,829          |
| Originated             | 93,904        | 85,126            |
| Total accruing TDRs    | 156,496       | 175,955           |
| Nonaccruing TDRs:      |               |                   |
| Acquired               | 17,861        | 11,479            |
| Originated             | 21,564        | 19,322            |
| Total nonaccruing TDRs | 39,425        | 30,801            |
| All TDRs:              |               |                   |
| Acquired               | 80,453        | 102,308           |
| Originated             | 115,468       | 104,448           |
| Total TDRs             | \$195,921     | \$206,756         |

All TDRs are impaired loans. TDRs are, therefore, evaluated for impairment on a quarterly basis or more frequently as needed. The impairment evaluations for performing TDRs has historically been performed by pools of homogeneous loan groups, as determined by loan type with similar risk characteristics and performance trends, using a discounted cash flow analysis. Management enhanced this process during the second quarter to include individual loan level impairment analyses for all performing TDRs.

Impairment is evaluated using one of three approved valuation methodologies: discounted cash flows, market prices or collateral values. Based on the accrual status and credit grade, management determines the most appropriate method to reasonably assess expectations for recovery of the investment. Expected cash flows are discounted at the loan's original effective interest rate. Specific valuation allowances are established for discounted cash flows or partial charge-offs and are recorded for TDRs in the amount equal to the calculated impairment.

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The majority of TDRs are included in the special mention, substandard or doubtful grading categories. When a restructured loan subsequently defaults, it is evaluated and downgraded if appropriate. The more severely graded the loan, the lower the estimated expected cash flows and the greater the allowance recorded.

The following tables provide the types of TDRs made during the three and six months ended June 30, 2014 and June 30, 2013 for originated loans, as well as a summary of originated loans that were modified as a TDR during the 12 months ended June 30, 2014 and June 30, 2013 that subsequently defaulted during the three and six months ended June 30, 2014 and June 30, 2013. BancShares defines payment default as movement of the TDR to nonaccrual status, which is generally 90 days past due for TDRs, foreclosure or charge-off, whichever occurs first.

| (Dollars in thousands)                            | Three months ended June 30, 2014 |                                   |                                     |                                   | Three months ended June 30, 2013 |                                   |                                     |                                   |
|---|----------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|----------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|
|   | All restructurings               |                                   | Restructurings with payment default |                                   | All restructurings               |                                   | Restructurings with payment default |                                   |
|   | Number of Loans                  | Recorded investment at period end | Number of Loans                     | Recorded investment at period end | Number of Loans                  | Recorded investment at period end | Number of Loans                     | Recorded investment at period end |
| Originated loans                                  |                                  |                                   |                                     |                                   |                                  |                                   |                                     |                                   |
| Interest only period provided                     |                                  |                                   |                                     |                                   |                                  |                                   |                                     |                                   |
| Commercial mortgage                               | 2                                | \$ 720                            | 1                                   | \$ 494                            | 1                                | \$ 71                             | —                                   | \$ —                              |
| Other commercial real estate                      | —                                | —                                 | —                                   | —                                 | 1                                | 100                               | —                                   | —                                 |
| Other   | 1                                | 46                                | —                                   | —                                 | —                                | —                                 | —                                   | —                                 |
| Total interest only                               | 3                                | 766                               | 1                                   | 494                               | 2                                | 171                               | —                                   | —                                 |
| Loan term extension                               |                                  |                                   |                                     |                                   |                                  |                                   |                                     |                                   |
| Construction and land development - commercial    | 2                                | 191                               | —                                   | —                                 | —                                | —                                 | —                                   | —                                 |
| Commercial mortgage                               | —                                | —                                 | —                                   | —                                 | 1                                | 242                               | 1                                   | 223                               |
| Commercial and industrial                         | 4                                | 2,069                             | —                                   | —                                 | —                                | —                                 | 1                                   | 22                                |
| Residential mortgage                              | 6                                | 260                               | —                                   | —                                 | —                                | —                                 | 1                                   | 106                               |
| Consumer  | 1                                | 10                                | —                                   | —                                 | 1                                | 46                                | —                                   | —                                 |
| Total loan term extension                         | 13                               | 2,530                             | —                                   | —                                 | 2                                | 288                               | 3                                   | 351                               |
| Below market interest rate                        |                                  |                                   |                                     |                                   |                                  |                                   |                                     |                                   |
| Commercial mortgage                               | 3                                | 1,991                             | 5                                   | 1,563                             | 7                                | 2,035                             | —                                   | —                                 |
| Commercial and industrial                         | —                                | —                                 | —                                   | —                                 | 3                                | 831                               | —                                   | —                                 |
| Other commercial real estate                      | 1                                | 365                               | —                                   | —                                 | 3                                | 753                               | —                                   | —                                 |
| Residential mortgage                              | 10                               | 427                               | —                                   | —                                 | 6                                | 885                               | 1                                   | 99                                |
| Revolving mortgage                                | —                                | —                                 | —                                   | —                                 | 1                                | 99                                | —                                   | —                                 |
| Construction and land development - noncommercial | —                                | —                                 | —                                   | —                                 | 2                                | 521                               | —                                   | —                                 |
| Total below market interest rate                  | 14                               | 2,783                             | 5                                   | 1,563                             | 22                               | 5,124                             | 1                                   | 99                                |
| Discharged from bankruptcy                        |                                  |                                   |                                     |                                   |                                  |                                   |                                     |                                   |
| Residential mortgage                              | 1                                | 13                                | —                                   | —                                 | 2                                | 87                                | —                                   | —                                 |
| Revolving mortgage                                | 2                                | 39                                | —                                   | —                                 | 9                                | 727                               | —                                   | —                                 |
| Consumer  | 2                                | 8                                 | —                                   | —                                 | —                                | —                                 | —                                   | —                                 |
| Total discharged from bankruptcy                  | 5                                | 60                                | —                                   | —                                 | 11                               | 814                               | —                                   | —                                 |

|                                 |    |          |   |          |    |          |   |        |
|---------------------------------|----|----------|---|----------|----|----------|---|--------|
| Total originated restructurings | 35 | \$ 6,139 | 6 | \$ 2,057 | 37 | \$ 6,397 | 4 | \$ 450 |
|---------------------------------|----|----------|---|----------|----|----------|---|--------|

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| (Dollars in thousands)                          | Six months ended June 30, 2014 |                                   |                                     |                                   | Six months ended June 30, 2013 |                                   |                                     |                                   |
|---|--------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|--------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|
|   | All restructurings             |                                   | Restructurings with payment default |                                   | All restructurings             |                                   | Restructurings with payment default |                                   |
|   | Number of Loans                | Recorded investment at period end | Number of Loans                     | Recorded investment at period end | Number of Loans                | Recorded investment at period end | Number of Loans                     | Recorded investment at period end |
| Originated loans                                |                                |                                   |                                     |                                   |                                |                                   |                                     |                                   |
| Interest only period provided                   |                                |                                   |                                     |                                   |                                |                                   |                                     |                                   |
| Commercial mortgage                             | 6                              | \$ 2,600                          | 2                                   | \$ 708                            | 8                              | \$ 3,406                          | —                                   | \$ —                              |
| Commercial and industrial                       | 1                              | 196                               | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Other commercial real estate                    | —                              | —                                 | —                                   | —                                 | 1                              | 100                               | —                                   | —                                 |
| Residential mortgage                            | —                              | —                                 | —                                   | —                                 | 1                              | 630                               | —                                   | —                                 |
| Lease financing                                 | 2                              | 144                               | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Other   | 1                              | 46                                | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Total interest only                             | 10                             | 2,986                             | 2                                   | 708                               | 10                             | 4,136                             | —                                   | —                                 |
| Loan term extension                             |                                |                                   |                                     |                                   |                                |                                   |                                     |                                   |
| Construction and land development - commercial  | 2                              | 191                               | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Commercial mortgage                             | 5                              | 2,584                             | —                                   | —                                 | 5                              | 1,972                             | 1                                   | 223                               |
| Commercial and industrial                       | 4                              | 2,069                             | —                                   | —                                 | 1                              | 229                               | 1                                   | 22                                |
| Lease financing                                 | 2                              | 224                               | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Residential mortgage                            | 11                             | 593                               | —                                   | —                                 | 3                              | 51                                | 1                                   | 106                               |
| Consumer  | 3                              | 44                                | —                                   | —                                 | 1                              | 46                                | —                                   | —                                 |
| Total loan term extension                       | 27                             | 5,705                             | —                                   | —                                 | 10                             | 2,298                             | 3                                   | 351                               |
| Below market interest rate                      |                                |                                   |                                     |                                   |                                |                                   |                                     |                                   |
| Construction and land development - commercial  | 10                             | 363                               | —                                   | —                                 | 1                              | 224                               | —                                   | —                                 |
| Commercial mortgage                             | 15                             | 6,591                             | 6                                   | 2,011                             | 12                             | 5,819                             | —                                   | —                                 |
| Commercial and industrial                       | 6                              | 143                               | —                                   | —                                 | 4                              | 846                               | —                                   | —                                 |
| Other commercial real estate                    | 1                              | 365                               | —                                   | —                                 | 3                              | 753                               | —                                   | —                                 |
| Residential mortgage                            | 18                             | 820                               | 1                                   | 140                               | 14                             | 1,579                             | 1                                   | 99                                |
| Revolving mortgage                              | 5                              | 274                               | —                                   | —                                 | 1                              | 99                                | —                                   | —                                 |
| Construction & land development - noncommercial | 8                              | 1,248                             | —                                   | —                                 | 2                              | 521                               | —                                   | —                                 |
| Consumer  | —                              | —                                 | —                                   | —                                 | 3                              | 235                               | —                                   | —                                 |
| Total below market interest rate                | 63                             | 9,804                             | 7                                   | 2,151                             | 40                             | 10,076                            | 1                                   | 99                                |
| Discharged from bankruptcy                      |                                |                                   |                                     |                                   |                                |                                   |                                     |                                   |
| Commercial mortgage                             | 1                              | 983                               | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Residential mortgage                            | 8                              | 649                               | 2                                   | 85                                | 3                              | 352                               | —                                   | —                                 |
| Revolving mortgage                              | 7                              | 442                               | —                                   | —                                 | 30                             | 2,383                             | 3                                   | 93                                |
| Construction & land development - noncommercial | 1                              | 62                                | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |
| Consumer  | 3                              | 26                                | —                                   | —                                 | —                              | —                                 | —                                   | —                                 |



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|                                  |     |           |    |          |    |           |   |        |
|----------------------------------|-----|-----------|----|----------|----|-----------|---|--------|
| Total discharged from bankruptcy | 20  | 2,162     | 2  | 85       | 33 | 2,735     | 3 | 93     |
| Total originated restructurings  | 120 | \$ 20,657 | 11 | \$ 2,944 | 93 | \$ 19,245 | 7 | \$ 543 |

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The following tables provide the types of TDRs made during the three and six months ended June 30, 2014 and June 30, 2013 for acquired loans, as well as a summary of acquired loans that were modified as a TDR during the 12 months ended June 30, 2014 and June 30, 2013 that subsequently defaulted during the three and six months ended June 30, 2014 and June 30, 2013. BancShares defines payment default as movement of the TDR to nonaccrual status, which is generally 90 days past due for TDRs, foreclosure or charge-off, whichever occurs first.

| (Dollars in thousands)                         | Three months ended June 30, 2014       |                                   |  |                                   | Three months ended June 30, 2013       |                                   |  |                                   |
|--|--|-----------------------------------|--|-----------------------------------|--|-----------------------------------|--|-----------------------------------|
|  | All restructurings                     |                                   | Restructurings with payment default    |                                   | All restructurings                     |                                   | Restructurings with payment default    |                                   |
|  | Recorded Number of loans at period end | Investment of loans at period end | Recorded Number of loans at period end | Investment of loans at period end | Recorded Number of loans at period end | Investment of loans at period end | Recorded Number of loans at period end | Investment of loans at period end |
| Acquired loans                                 |  |                                   |  |                                   |  |                                   |  |                                   |
| Interest only period provided                  |  |                                   |  |                                   |  |                                   |  |                                   |
| Construction and land development - commercial | —                                      | \$ —                              | —                                      | \$ —                              | —                                      | \$ —                              | 1                                      | \$ 104                            |
| Commercial mortgage                            | —                                      | —                                 | —                                      | —                                 | —                                      | —                                 | 1                                      | 1,699                             |
| Residential mortgage                           | —                                      | —                                 | —                                      | —                                 | 1                                      | 134                               | —                                      | —                                 |
| Total interest only                            | —                                      | —                                 | —                                      | —                                 | 1                                      | 134                               | 2                                      | 1,803                             |
| Loan term extension                            |  |                                   |  |                                   |  |                                   |  |                                   |
| Residential mortgage                           | 1                                      | 53                                | 1                                      | 53                                | —                                      | —                                 | —                                      | —                                 |
| Total loan term extension                      | 1                                      | 53                                | 1                                      | 53                                | —                                      | —                                 | —                                      | —                                 |
| Below market interest rate                     |  |                                   |  |                                   |  |                                   |  |                                   |
| Construction and land development - commercial | 1                                      | 273                               | —                                      | —                                 | —                                      | —                                 | —                                      | —                                 |
| Commercial mortgage                            | 5                                      | 1,811                             | —                                      | —                                 | 1                                      | 813                               | —                                      | —                                 |
| Commercial and industrial                      | 1                                      | 23                                | —                                      | —                                 | —                                      | —                                 | —                                      | —                                 |
| Residential mortgage                           | 23                                     | 2,963                             | 1                                      | 23                                | 2                                      | 997                               | 1                                      | 224                               |
| Total below market interest rate               | 30                                     | 5,070                             | 1                                      | 23                                | 3                                      | 1,810                             | 1                                      | 224                               |
| Discharged from bankruptcy                     |  |                                   |  |                                   |  |                                   |  |                                   |
| Residential mortgage                           | 26                                     | 1,828                             | 2                                      | 94                                | —                                      | —                                 | —                                      | —                                 |
| Total discharged from bankruptcy               | 26                                     | 1,828                             | 2                                      | 94                                | —                                      | —                                 | —                                      | —                                 |
| Total acquired restructurings                  | 57                                     | \$ 6,951                          | 4                                      | \$ 170                            | 4                                      | \$ 1,944                          | 3                                      | \$ 2,027                          |

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| (Dollars in thousands)                         | Six months ended June 30, 2014                    |  |   |  | Six months ended June 30, 2013                    |  |   |  |
|--|---|--|---|--|---|--|---|--|
|  | All restructurings                                |  | Restructurings with payment default               |  | All restructurings                                |  | Restructurings with payment default               |  |
|  | Recorded Number investment of loans at period end | Recorded investment of loans at period end | Recorded Number investment of loans at period end | Recorded investment of loans at period end | Recorded Number investment of loans at period end | Recorded investment of loans at period end | Recorded Number investment of loans at period end | Recorded investment of loans at period end |
| Acquired loans                                 |   |  |   |  |   |  |   |  |
| Interest only period provided                  |   |  |   |  |   |  |   |  |
| Construction and land development - commercial | —   | \$ —                                       | —   | \$ —                                       | —   | \$ —                                       | 1   | \$ 104                                     |
| Commercial mortgage                            | 2   | —  | 2   | 44   | 1   | 290  | 2   | 1,989                                      |
| Residential mortgage                           | —   | —  | —   | —  | 2   | 177  | —   | —  |
| Total interest only                            | 2   | —  | 2   | 44   | 3   | 467  | 3   | 2,093                                      |
| Loan term extension                            |   |  |   |  |   |  |   |  |
| Construction and land development - commercial | 1   | 276  | —   | —  | —   | —  | —   | —  |
| Residential mortgage                           | 1   | 53   | 1   | 53   | 1   | 199  | —   | —  |
| Total loan term extension                      | 2   | 329  | 1   | 53   | 1   | 199  | —   | —  |
| Below market interest rate                     |   |  |   |  |   |  |   |  |
| Construction and land development - commercial | 2   | 308  | —   | —  | 4   | 3,331                                      | —   | —  |
| Commercial mortgage                            | 9   | 5,060                                      | 1   | 39   | 5   | 11,871                                     | 3   | 3,145                                      |
| Commercial and industrial                      | 1   | 23   | —   | —  | 2   | 435  | —   | —  |
| Residential mortgage                           | 25  | 3,066                                      | 2   | 23   | 7   | 2,484                                      | 3   | 931  |
| Total below market interest rate               | 37  | 8,457                                      | 3   | 62   | 18  | 18,121                                     | 6   | 4,076                                      |
| Discharged from bankruptcy                     |   |  |   |  |   |  |   |  |
| Residential mortgage                           | 26  | 1,828                                      | 2   | 94   | —   | —  | —   | —  |
| Total discharged from bankruptcy               | 26  | 1,828                                      | 2   | 94   | —   | —  | —   | —  |
| Total acquired restructurings                  | 67  | \$ 10,614                                  | 8   | \$ 253                                     | 22  | \$ 18,787                                  | 9   | \$ 6,169                                   |

For the three and six months ended June 30, 2014 and June 30, 2013, the recorded investment in TDRs subsequent to modification was not materially impacted by the modification since forgiveness of principal is not a restructuring option frequently used by BancShares.

## NOTE F - OTHER REAL ESTATE OWNED (OREO)

The following table explains changes in other real estate owned during the six months ended June 30, 2014 and June 30, 2013.

| (Dollars in thousands)       | Covered   | Noncovered | Total     |
|------------------------------|-----------|------------|-----------|
| Balance at December 31, 2012 | \$102,577 | \$43,513   | \$146,090 |
| Additions                    | 41,315    | 16,615     | 57,930    |
| Sales                        | (53,676)  | (21,026)   | (74,702)  |

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|                              |          |           |           |   |
|------------------------------|----------|-----------|-----------|---|
| Writedowns                   | (5,383   | ) (2,160  | ) (7,543  | ) |
| Balance at June 30, 2013     | \$84,833 | \$36,942  | \$121,775 |   |
| Balance at December 31, 2013 | \$47,081 | \$36,898  | \$83,979  |   |
| Additions <sup>1</sup>       | 16,186   | 20,485    | 36,671    |   |
| Sales                        | (18,522  | ) (19,150 | ) (37,672 | ) |
| Writedowns                   | (4,609   | ) (3,082  | ) (7,691  | ) |
| Balance at June 30, 2014     | \$40,136 | \$35,151  | \$75,287  |   |

<sup>1</sup> Noncovered additions include \$11.6 million from the 1st Financial merger.

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## NOTE G - FDIC LOSS SHARE RECEIVABLE

The following table provides changes in the receivable from the FDIC for the three-month and six-month periods ended June 30, 2014 and June 30, 2013.

| (Dollars in thousands)       | Three months ended June 30 |           | Six months ended June 30 |           |
|------------------------------|----------------------------|-----------|--------------------------|-----------|
|                              | 2014                       | 2013      | 2014                     | 2013      |
| Beginning balance            | \$74,784                   | \$195,942 | \$93,397                 | \$270,192 |
| Amortization                 | (12,922                    | ) (19,069 | ) (30,667                | ) (45,181 |
| Cash payments to (from) FDIC | 859                        | (4,015    | ) 4,350                  | (46,534   |
| Post-acquisition adjustments | (12,762                    | ) (14,845 | ) (17,121                | ) (20,464 |
| Ending balance               | \$49,959                   | \$158,013 | \$49,959                 | \$158,013 |

The receivable from the FDIC for loss share agreements is measured separately from the related covered assets and is recorded at fair value at the acquisition date using projected cash flows based on the expected reimbursements for losses and the applicable loss share percentages. See Note J for information related to FCB's recorded payable to the FDIC for loss share agreements.

Cash payments to (from) FDIC represent the net impact of loss share loan recoveries, charge-offs and related expenses as calculated and reported in FDIC loss share certificates. Post-acquisition adjustments represent the net change in loss estimates related to acquired loans and covered OREO as a result of changes in expected cash flows and the allowance for loan and lease losses related to those covered loans. For loans covered by loss share agreements, subsequent decreases in the amount expected to be collected from the borrower or collateral liquidation result in a provision for loan and lease losses, an increase in the allowance for loan and lease losses and a proportional adjustment to the receivable from the FDIC for the estimated amount to be reimbursed. Subsequent increases in the amount expected to be collected from the borrower or collateral liquidation result in the reversal of some or all previously recorded provision for loan and lease losses, a decrease in the related allowance for loan and lease losses and a proportional adjustment to the receivable from the FDIC, or prospective adjustment to the accretable yield and the related receivable from the FDIC if no provision for loan and lease losses had been recorded previously. Two of the loss share agreements expire during the third quarter of 2014, and two expire during the first quarter of 2015.

## NOTE H - ESTIMATED FAIR VALUES

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

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

Level 1 values are based on quoted prices for identical instruments in active markets.

Level 2 values are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market.

•

Level 3 values are generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates that market participants would use in pricing the asset or liability. Valuation techniques include the use of discounted cash flow models and similar techniques.

The methodologies used to estimate the fair value of financial assets and financial liabilities are discussed below: Investment securities available for sale. U.S.Treasury, government agency, mortgage-backed securities and municipal securities are generally measured at fair value using a third party pricing service and are classified as level 2 instruments. Equity securities are measured at fair value using observable closing prices. Management also considers the amount of market activity by examining the trade volume of each security. Due to the relatively inactive nature of the markets for the existing equity securities at BancShares, the inputs used for these equity securities are considered level 2 inputs.

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Loans held for sale. Loans held for sale are carried at the lower of aggregate cost or fair value and are, therefore, carried at fair value only when fair value is less than the asset cost. These loans are generally traded in active secondary markets and are priced using current market pricing for similar securities adjusted for servicing, interest rate risk and credit risk. Accordingly, the inputs used to calculate fair value of residential real estate loans are classified as Level 2 inputs.

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

Receivable from the FDIC for loss share agreements. Fair value is estimated based on discounted future cash flows using current discount rates. Due to post-acquisition improvements in expected losses, significant portions of the FDIC receivable will be recovered through amortization of the receivable over the remaining life of the loss share agreement rather than by cash flows from the FDIC. The estimated amounts to be amortized in future periods have no fair value. The inputs used in the fair value measurement for the FDIC receivable are considered level 3 inputs. The FDIC loss share agreements are not transferable and, accordingly, there is no market for this receivable.

FHLB stock. The carrying amount of FHLB stock is a reasonable estimate of fair value as these securities are not readily marketable and are evaluated for impairment based on the ultimate recoverability of the par value. BancShares considers positive and negative evidence, including the profitability and asset quality of the issuer, dividend payment history and recent redemption experience, when determining the ultimate recoverability of the par value. BancShares believes its investment in FHLB stock is ultimately recoverable at par. The inputs used in the fair value measurement for the FHLB stock are considered level 2 inputs.

Preferred stock issued under the TARP program and other acquired financial assets. Preferred securities issued under the Troubled Asset Recovery Program are recorded at cost and are evaluated quarterly for impairment based on the ultimate recoverability of the purchase price. The fair value of these securities is derived from a third-party proprietary model that is considered to be a level 3 input. Other acquired financial assets represent acquired investments in various entities for Community Reinvestment Act and correspondent banking purposes. These investments were recorded at fair value at acquisition date based on level 2 inputs.

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

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

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

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

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

For all other financial assets and financial liabilities, the carrying value is a reasonable estimate of the fair value as of June 30, 2014 and December 31, 2013. The carrying value and fair value for these assets and liabilities are equivalent because they are



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relatively short term in nature and there is no interest rate or credit risk that would cause the fair value to differ from the carrying value.

| (Dollars in thousands)                                    | June 30, 2014  |            | December 31, 2013 |            |
|---|----------------|------------|-------------------|------------|
|   | Carrying value | Fair value | Carrying value    | Fair value |
| Cash and due from banks                                   | \$566,952      | \$566,952  | \$533,599         | \$533,599  |
| Overnight investments                                     | 1,118,474      | 1,118,474  | 859,324           | 859,324    |
| Investment securities available for sale                  | 5,538,166      | 5,538,166  | 5,387,703         | 5,387,703  |
| Investment securities held to maturity                    | 693            | 729        | 907               | 974        |
| Loans held for sale                                       | 49,851         | 50,675     | 47,271            | 47,956     |
| Net loans and leases                                      | 13,318,710     | 12,846,888 | 12,900,330        | 12,545,537 |
| Receivable from the FDIC for loss share agreements<br>(1) | 49,959         | 22,741     | 93,397            | 38,438     |
| Income earned not collected                               | 49,019         | 49,019     | 48,390            | 48,390     |
| Federal Home Loan Bank stock                              | 32,878         | 32,878     | 40,819            | 40,819     |
| Preferred stock and other acquired financial assets       | 15,462         | 16,199     | 33,564            | 34,786     |
| Deposits  | 18,556,758     | 18,113,243 | 17,874,066        | 17,898,570 |
| Short-term borrowings                                     | 788,540        | 788,540    | 511,418           | 511,418    |
| Long-term obligations                                     | 314,529        | 324,874    | 510,769           | 526,037    |
| Payable to the FDIC for loss share agreements             | 114,281        | 119,465    | 109,378           | 111,941    |
| Accrued interest payable                                  | 7,297          | 7,297      | 6,737             | 6,737      |
| Interest rate swap  | 5,933          | 5,933      | 7,220             | 7,220      |

(1) The fair value of the FDIC receivable excludes amortization expected to be recognized in prospective periods.

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Among BancShares' assets and liabilities, investment securities available for sale and interest rate swaps accounted for as cash flow hedges are reported at their fair values on a recurring basis. Certain other assets are adjusted to their fair value on a nonrecurring basis, including loans held for sale, which are carried at the lower of cost or fair value, and impaired loans, OREO, goodwill and other intangible assets, which are periodically tested for impairment. Non-impaired loans held for investment, deposits, short-term borrowings and long-term obligations are not reported at fair value. BancShares did not elect to voluntarily report any assets or liabilities at fair value.

For assets and liabilities carried at fair value on a recurring basis, the following table provides fair value information as of June 30, 2014 and December 31, 2013.

| (Dollars in thousands)                                | June 30, 2014 |                                |                |                |
|---|---------------|--------------------------------|----------------|----------------|
|   | Fair value    | Fair value measurements using: |                |                |
|   |               | Level 1 inputs                 | Level 2 inputs | Level 3 inputs |
| Assets measured at fair value                         |               |                                |                |                |
| Investment securities available for sale              |               |                                |                |                |
| U.S. Treasury   | \$1,625,630   | \$—                            | \$1,625,630    | \$—            |
| Government agency                                     | 1,283,566     | —                              | 1,283,566      | —              |
| Mortgage-backed securities                            | 2,596,286     | —                              | 2,596,286      | —              |
| Equity securities                                     | 32,498        | —                              | 32,498         | —              |
| Municipal securities                                  | 186           | —                              | 186            | —              |
| Total   | \$5,538,166   | \$—                            | \$5,538,166    | \$—            |
| Liabilities measured at fair value                    |               |                                |                |                |
| Interest rate swaps accounted for as cash flow hedges | \$5,933       | \$—                            | \$5,933        | \$—            |
| December 31, 2013                                     |               |                                |                |                |
|   | Fair value    | Fair value measurements using: |                |                |
|   |               | Level 1 inputs                 | Level 2 inputs | Level 3 inputs |
| Assets measured at fair value                         |               |                                |                |                |
| Investment securities available for sale              |               |                                |                |                |
| U.S. Treasury   | \$373,437     | \$—                            | \$373,437      | \$—            |
| Government agency                                     | 2,544,229     | —                              | 2,544,229      | —              |
| Mortgage-backed securities                            | 2,446,873     | —                              | 2,446,873      | —              |
| Equity securities                                     | 22,147        | —                              | 22,147         | —              |
| Municipal securities                                  | 187           | —                              | 187            | —              |
| Other   | 830           | —                              | 830            | —              |
| Total   | \$5,387,703   | \$—                            | \$5,387,703    | \$—            |
| Liabilities measured at fair value                    |               |                                |                |                |
| Interest rate swaps accounted for as cash flow hedges | \$7,220       | \$—                            | \$7,220        | \$—            |

There were no transfers between levels during the six months ended June 30, 2014. A single subordinated debt security, previously classified within other, was called during the second quarter of 2014.

Certain financial assets and liabilities are carried at fair value on a nonrecurring basis, including loans held for sale, impaired loans and OREO.

Impaired loans are deemed to be at fair value if an associated allowance or current period charge-off has been recorded. The value of impaired loans is determined by either collateral valuations or discounted present value of the expected cash flow calculations. Collateral values are determined using appraisals or other third-party value estimates

of the subject property with discounts generally between 10 and 14 percent applied for estimated holding and selling costs and other external factors that may impact the marketability of the property. Impaired loans are assigned to an asset manager and monitored monthly for significant changes since the last valuation. If significant changes are noted, the asset manager orders a new valuation or adjusts the valuation accordingly. Expected cash flows are determined using expected loss rates developed from historic experience for loans with similar risk characteristics, discounted using the effective interest rate.

OREO is measured and reported at fair value using collateral valuations. Collateral values are determined using appraisals or other third-party value estimates of the subject property with discounts generally between 10 and 14 percent applied for estimated holding and selling costs and other external factors that may impact the marketability of the property. Changes to the value of the assets between scheduled valuation dates are monitored through continued communication with brokers and monthly reviews by the asset manager assigned to each asset. The asset manager uses the information gathered from brokers

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and other market sources to identify any significant changes in the market or the subject property as they occur. Valuations are then adjusted or new appraisals are ordered to ensure the reported values reflect the most current information. OREO that has been recently remeasured is deemed to be at fair value and included in the table below.

For financial assets and liabilities carried at fair value on a nonrecurring basis, the following table provides fair value information as of June 30, 2014 and December 31, 2013.

|  | June 30, 2014     |                                |                |                |
|--|-------------------|--------------------------------|----------------|----------------|
| (Dollars in thousands)   | Fair value        | Fair value measurements using: |                |                |
|  |                   | Level 1 inputs                 | Level 2 inputs | Level 3 inputs |
| Loans held for sale  | \$32,551          | \$—                            | \$32,551       | \$—            |
| Originated impaired loans  | 73,881            | —                              | —              | 73,881         |
| Other real estate not covered under loss share agreements remeasured during current year | 9,101             | —                              | —              | 9,101          |
| Other real estate covered under loss share agreements remeasured during current year     | 22,927            | —                              | —              | 22,927         |
|  |                   |                                |                |                |
|  | December 31, 2013 |                                |                |                |
|  | Fair value        | Fair value measurements using: |                |                |
|  |                   | Level 1 inputs                 | Level 2 inputs | Level 3 inputs |
| Loans held for sale  | 29,389            | —                              | 29,389         | —              |
| Originated impaired loans  | 77,817            | —                              | —              | 77,817         |
| Other real estate not covered under loss share agreements remeasured during current year | 20,526            | —                              | —              | 20,526         |
| Other real estate covered under loss share agreements remeasured during current year     | 37,587            | —                              | —              | 37,587         |

No financial liabilities were carried at fair value on a nonrecurring basis as of June 30, 2014 and December 31, 2013.

**NOTE I - EMPLOYEE BENEFIT PLANS**

Pension expense is a component of employee benefits expense. For the three and six months ended June 30, 2014 and 2013, the components of pension expense are as follows:

|                                    | Three months ended June 30 |         | Six months ended June 30 |          |
|------------------------------------|----------------------------|---------|--------------------------|----------|
| (Dollars in thousands)             | 2014                       | 2013    | 2014                     | 2013     |
| Service cost                       | \$2,785                    | \$4,261 | \$6,166                  | \$8,483  |
| Interest cost                      | 6,251                      | 6,409   | 12,807                   | 12,304   |
| Expected return on assets          | (8,340)                    | (7,474) | (16,152)                 | (14,405) |
| Amortization of prior service cost | 52                         | 53      | 105                      | 105      |
| Amortization of net actuarial loss | 1,546                      | 4,241   | 3,092                    | 8,493    |
| Total pension expense              | \$2,294                    | \$7,490 | \$6,018                  | \$14,980 |

The assumed discount rate for 2014 is 4.90 percent, the expected long-term rate of return on plan assets is 7.50 percent and the assumed rate of salary increases is 4.00 percent. For 2013, the assumed discount rate was 4.00 percent, expected long-term rate of return was 7.25 percent and the assumed rate of salary increases was 4.00 percent.

**NOTE J - COMMITMENTS AND CONTINGENCIES**

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

risk.

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. Established credit standards control the credit risk exposure associated with these commitments. In some cases, BancShares requires that collateral be pledged to secure the commitment, including cash deposits, securities and other assets. At June 30, 2014, BancShares had unused commitments totaling \$6.20 billion, compared to \$5.84 billion at December 31, 2013.

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Standby letters of credit are commitments guaranteeing performance of a customer to a third party. Those commitments are primarily issued to support public and private borrowing arrangements. To mitigate its risk, BancShares' follows its credit policies in the issuance of standby letters of credit. At June 30, 2014 and December 31, 2013, BancShares had standby letters of credit amounting to \$61.4 million and \$54.8 million, respectively. The credit risk related to the issuance of these letters of credit is essentially the same as that involved in extending loans to clients and, therefore, these letters of credit are collateralized when necessary.

Pursuant to standard representations and warranties relating to residential mortgage loan sales, contingent obligations exist for various events that may occur following the loan sale. If underwriting or documentation deficiencies are discovered at any point in the life of the loan or if the loan becomes nonperforming within 120 days of its sale, the investor may require BancShares to repurchase the loan or to repay a portion of the sale proceeds. Other liabilities included reserves of \$3.3 million and \$3.6 million as of June 30, 2014 and December 31, 2013, respectively, for estimated losses arising from these standard representation and warranty provisions.

BancShares has recorded a receivable from the FDIC totaling \$50.0 million and \$93.4 million as of June 30, 2014 and December 31, 2013, respectively, for the expected reimbursement of losses on assets covered under the various loss share agreements. These loss share agreements impose certain obligations on us that, in the event of noncompliance, could result in the delay or disallowance of some or all of our rights under those agreements. Requests for reimbursement are subject to FDIC review and may be delayed or disallowed for noncompliance. The loss share agreements are subject to interpretation by both the FDIC and BancShares, and disagreements may arise regarding coverage of losses, expenses and contingencies.

The loss share agreements for four FDIC-assisted transactions include provisions related to contingent payments that may be owed to the FDIC at the termination of the agreements (clawback liability). The clawback liability represents a payment by BancShares to the FDIC if actual cumulative losses on acquired covered assets are lower than the cumulative losses originally estimated by the FDIC at the time of acquisition. The clawback liability is estimated by discounting estimated future payments and is recorded in the Consolidated Balance Sheets as a payable to the FDIC under the relevant loss share agreements. As of June 30, 2014 and December 31, 2013, the estimated clawback liability was \$114.3 million and \$109.4 million, respectively.

Following announcement of the proposed merger with Bancorporation, BancShares received a shareholder demand from the City of Providence, Rhode Island, pursuant to Section 220 of the Delaware General Corporation Law ("DGCL") for access to certain books and records of BancShares. The purported basis for the demand was to investigate potential breaches of fiduciary duty and other wrongdoing by BancShares' officers and directors in connection with the merger. The City of Providence concurrently filed a putative class action lawsuit in the Delaware Court of Chancery against BancShares and its directors challenging Article X, Section 8 of BancShares' Bylaws, which requires certain litigation to be brought only in North Carolina courts to the fullest extent permitted by law. The Delaware complaint alleges that the Bylaw violates the DGCL and that adoption of the Bylaw constituted a breach of fiduciary duty by BancShares' directors. While not directly challenging the merger, the complaint contains allegations referencing the merger and seeks a declaration that any stockholder action regarding the merger may be brought in the Delaware Court of Chancery. On July 31, 2014, the City of Providence filed a second litigation in Delaware Court of Chancery challenging the merger and seeking to enjoin the BancShares stockholder vote. Any potential claim for damages is not reasonably calculable at this time. BancShares and its directors have moved to dismiss both complaints.

BancShares and various subsidiaries have been named as defendants in legal actions arising from their normal business activities in which damages in various amounts are claimed. BancShares is also exposed to litigation risk relating to the prior business activities of banks from which assets were acquired and liabilities assumed in the various FDIC-assisted transactions. Although the amount of any ultimate liability with respect to such matters cannot be

determined, in the opinion of management, any such liability will not have a material effect on BancShares' consolidated financial statements.

#### NOTE K - DERIVATIVES

At June 30, 2014, BancShares had an interest rate swap entered into during 2011 that qualifies as a cash flow hedge under GAAP. For all periods presented, the fair value of the outstanding derivative is included in other liabilities in the consolidated balance sheets, and the net change in fair value is included in the consolidated statements of cash flows under the caption net change in other liabilities.

The interest rate swap is used for interest rate risk management purposes and converts variable-rate exposure on outstanding debt to a fixed rate. The 2011 interest rate swap has a notional amount of \$93.5 million, representing the amount of variable rate trust preferred capital securities issued during 2006 and still outstanding at the swap inception date. The 2011 interest rate

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swap hedges interest payments through June 2016 and requires fixed-rate payments by BancShares at 5.50 percent in exchange for variable-rate payments of 175 basis points above the three-month LIBOR, which is equal to the interest paid to the holders of the trust preferred capital securities. Settlement of the swap occurs quarterly. As of June 30, 2014, collateral with a fair value of \$7.0 million was pledged to secure the existing obligation under the interest rate swap.

| (Dollars in thousands)   | June 30, 2014   |                                   | December 31, 2013 |                                   |
|--|-----------------|-----------------------------------|-------------------|-----------------------------------|
|  | Notional amount | Estimated fair value of liability | Notional amount   | Estimated fair value of liability |
| 2011 interest rate swap hedging variable rate exposure on trust preferred securities 2011-2016 | \$93,500        | \$5,933                           | \$93,500          | \$7,220                           |

For cash flow hedges, the effective portion of the gain or loss due to changes in the fair value of the derivative hedging instrument is included in other comprehensive income, while the ineffective portion, representing the excess of the cumulative change in the fair value of the derivative over the cumulative change in expected future discounted cash flows on the hedged transaction, is recorded in the consolidated income statement. BancShares' interest rate swap has been fully effective since inception. Therefore, changes in the fair value of the interest rate swap has had no impact on net income. For the three months ended June 30, 2014 and 2013, BancShares recognized interest expense of \$0.8 million during both periods, resulting from incremental interest paid to the interest rate swap counterparty, none of which related to ineffectiveness. For the six months ended June 30, 2014 and 2013, BancShares recognized interest expense of \$1.7 million and \$1.6 million, respectively, resulting from incremental interest paid to the interest rate swap counterparty, none of which related to ineffectiveness. BancShares monitors the credit risk of the interest rate swap counterparty.

## NOTE L - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) included the following as of June 30, 2014 and December 31, 2013:

| (Dollars in thousands)   | June 30, 2014                                 |                                |   | December 31, 2013                    |                      |  |
|--|---|--------------------------------|---|--------------------------------------|----------------------|--|
|  | Accumulated other comprehensive income (loss) | Deferred tax expense (benefit) | Accumulated other comprehensive income (loss), net of tax | Accumulated other comprehensive loss | Deferred tax benefit | Accumulated other comprehensive loss, net of tax |
| Unrealized gains (losses) on investment securities available for sale, net | \$26,817                                      | \$10,327                       | \$16,490  | \$(16,632)                           | \$(6,541)            | \$(10,091)                                       |
| Unrealized loss on cash flow hedge   | (5,933)                                       | (2,290)                        | (3,643)   | (7,220)                              | (2,786)              | (4,434)  |
| Funded status of defined benefit plan                                      | (14,385)                                      | (5,595)                        | (8,790)   | (17,582)                             | (6,839)              | (10,743)   |
| Total  | \$6,499                                       | \$2,442                        | \$4,057   | \$(41,434)                           | \$(16,166)           | \$(25,268)                                       |



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The following table highlights changes in accumulated other comprehensive income (loss) by component for the three and six months ended June 30, 2014 and June 30, 2013:

| (Dollars in thousands)   | Three months ended June 30, 2014  |   |  | Total         |
|--|---|---|--|---------------|
|  | Unrealized gains (losses) on available for sale securities <sup>1</sup> | Gains (losses) on cash flow hedges <sup>1</sup> | Defined benefit pension items <sup>1</sup> |               |
| Beginning balance  | \$ (2,835 )   | \$ (3,993 )                                     | \$ (9,766 )                                | \$ (16,594 )  |
| Other comprehensive income before reclassifications            | 19,325  | 350   | —  | 19,675        |
| Amounts reclassified from accumulated other comprehensive loss | —   | —   | 976  | 976           |
| Net current period other comprehensive income                  | 19,325  | 350   | 976  | 20,651        |
| Ending balance   | \$ 16,490   | \$ (3,643 )                                     | \$ (8,790 )                                | \$ 4,057      |
|  | Three months ended June 30, 2013  |   |  |               |
|  | Unrealized gains (losses) on available for sale securities <sup>1</sup> | Gains (losses) on cash flow hedges <sup>1</sup> | Defined benefit pension items <sup>1</sup> | Total         |
| Beginning balance  | \$ 19,606   | \$ (5,799 )                                     | \$ (93,712 )                               | \$ (79,905 )  |
| Other comprehensive (loss) income before reclassifications     | (23,723 )   | 840   | —  | (22,883 )     |
| Amounts reclassified from accumulated other comprehensive loss | —   | —   | 2,612                                      | 2,612         |
| Net current period other comprehensive (loss) income           | (23,723 )   | 840   | 2,612                                      | (20,271 )     |
| Ending balance   | \$ (4,117 )   | \$ (4,959 )                                     | \$ (91,100 )                               | \$ (100,176 ) |
|  | Six months ended June 30, 2014  |   |  |               |
|  | Unrealized gains (losses) on available for sale securities <sup>1</sup> | Gains (losses) on cash flow hedges <sup>1</sup> | Defined benefit pension items <sup>1</sup> | Total         |
| Beginning balance  | \$ (10,091 )  | \$ (4,434 )                                     | \$ (10,743 )                               | \$ (25,268 )  |
| Other comprehensive income before reclassifications            | 26,581  | 791   | —  | 27,372        |
| Amounts reclassified from accumulated other comprehensive loss | —   | —   | 1,953                                      | 1,953         |
| Net current period other comprehensive income                  | 26,581  | 791   | 1,953                                      | 29,325        |
| Ending balance   | \$ 16,490   | \$ (3,643 )                                     | \$ (8,790 )                                | \$ 4,057      |
|  | Six months ended June 30, 2013  |   |  |               |
|  | Unrealized gains (losses) on available for sale securities <sup>1</sup> | Gains (losses) on cash flow hedges <sup>1</sup> | Defined benefit pension items <sup>1</sup> | Total         |

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|  |             |             |              |               |
|--|-------------|-------------|--------------|---------------|
| Beginning balance  | \$20,517    | \$ (6,292 ) | \$ (96,331 ) | \$ (82,106 )  |
| Other comprehensive (loss) income before reclassifications     | (24,634 )   | 1,333       | —            | (23,301 )     |
| Amounts reclassified from accumulated other comprehensive loss | —           | —           | 5,231        | 5,231         |
| Net current period other comprehensive (loss) income           | (24,634 )   | 1,333       | 5,231        | (18,070 )     |
| Ending balance   | \$ (4,117 ) | \$ (4,959 ) | \$ (91,100 ) | \$ (100,176 ) |

<sup>1</sup> All amounts are net of tax.

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The following table presents the amounts reclassified from accumulated other comprehensive income (loss) and the line item affected in the statement where net income is presented for the three and six months ended June 30, 2014 and June 30, 2013:

|   | Three months ended June 30, 2014  |   |
|---|---|---|
| Details about accumulated other comprehensive income (loss) | Amount reclassified from accumulated other comprehensive income (loss) <sup>1</sup> | Affected line item in the statement where net income is presented |
| Amortization of defined benefit pension items               |   |   |
| Prior service costs   | \$(52   | ) Employee benefits   |
| Actuarial losses  | (1,546  | ) Employee benefits   |
|   | (1,598  | ) Income before income taxes                                      |
|   | 622   | Provision for income taxes  |
|   | \$(976  | ) Net income  |
| Total reclassifications for the period                      | \$(976  | )   |
|   | Three months ended June 30, 2013  |   |
| Details about accumulated other comprehensive income (loss) | Amount reclassified from accumulated other comprehensive income (loss) <sup>1</sup> | Affected line item in the statement where net income is presented |
| Amortization of defined benefit pension items               |   |   |
| Prior service costs   | \$(53   | ) Employee benefits   |
| Actuarial losses  | (4,241  | ) Employee benefits   |
|   | (4,294  | ) Income before income taxes                                      |
|   | 1,682   | Provision for income taxes  |
|   | \$(2,612  | ) Net income  |
| Total reclassifications for the period                      | \$(2,612  | )   |
|   | Six months ended June 30, 2014  |   |
| Details about accumulated other comprehensive income (loss) | Amount reclassified from accumulated other comprehensive income (loss) <sup>1</sup> | Affected line item in the statement where net income is presented |
| Amortization of defined benefit pension items               |   |   |
| Prior service costs   | \$(105  | ) Employee benefits   |
| Actuarial losses  | (3,092  | ) Employee benefits   |
|   | (3,197  | ) Income before income taxes                                      |
|   | 1,244   | Provision for income taxes  |
|   | \$(1,953  | ) Net income  |
| Total reclassifications for the period                      | \$(1,953  | )   |
|   | Six months ended June 30, 2013  |   |
| Details about accumulated other comprehensive income (loss) | Amount reclassified from accumulated other comprehensive income (loss) <sup>1</sup> | Affected line item in the statement where net income is presented |
| Amortization of defined benefit pension items               |   |   |

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|  |            |                              |
|--|------------|------------------------------|
| Prior service costs                    | \$ (105)   | ) Employee benefits          |
| Actuarial losses                       | (8,493)    | ) Employee benefits          |
|  | (8,598)    | ) Income before income taxes |
|  | 3,367      | Provision for income taxes   |
|  | \$ (5,231) | ) Net income                 |
| Total reclassifications for the period | \$ (5,231) | )                            |

NOTE M - SUBSEQUENT EVENTS

During July, BancShares purchased \$25.0 million of FCB/SC Capital Trust II's outstanding Trust Preferred Securities from an unaffiliated third party. BancShares paid approximately \$23.0 million, plus unpaid accrued distributions on the securities for the current distribution period, for the Trust Preferred Securities. FCB/SC Capital Trust II is a trust subsidiary of First Citizens Bancorporation, Inc. (Bancorporation). The Trust Preferred Securities pay interest at a floating rate based on three month LIBOR plus 2.25 percent, reset quarterly, and mature on June 15, 2034. The securities represent preferred beneficial interests in

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a junior subordinated deferrable interest debenture in a like principal amount issued by Bancorporation and held by FCB/SC Capital Trust II.

BancShares historically has considered Bancorporation and its subsidiaries to be related persons for purposes of BancShares' related person transaction approval policy. BancShares' Audit Committee reviewed and approved BancShares' purchase of Trust Preferred Securities described above.

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

### INTRODUCTION

Management's discussion and analysis (MD&A) of earnings and related financial data are presented to assist in understanding the financial condition and results of operations of First Citizens BancShares, Inc. and Subsidiaries (BancShares). This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and related notes presented within this report along with our financial statements and related MD&A of financial condition and results of operations included in our 2013 Annual Report on Form 10-K. In the MD&A, asset yields and net interest margin are presented on a fully taxable equivalent (FTE) basis. Intercompany accounts and transactions have been eliminated. Although certain amounts for prior years have been reclassified to conform to statement presentations for 2014, the reclassifications have no material effect on shareholders' equity or net income as previously reported. Unless otherwise noted, the terms "we," "us" and "BancShares" refer to the consolidated financial position and consolidated results of operations for BancShares.

BancShares is a financial holding company headquartered in Raleigh, North Carolina, that offers full-service banking through its wholly-owned banking subsidiary, First-Citizens Bank & Trust Company (FCB). FCB is a state-chartered bank organized under the laws of the state of North Carolina. As of August 8, 2014, FCB operated 397 branches in North Carolina, Virginia, West Virginia, Maryland, Tennessee, Washington, California, Florida, Georgia, Texas, Arizona, New Mexico, Oregon, Colorado, Oklahoma, Kansas, Missouri, and Washington, DC.

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

### EXECUTIVE OVERVIEW

#### Recent Economic and Industry Developments

Various external factors influence the focus of our business efforts, and the results of our operations can change significantly based on those external factors. Based on the latest real gross domestic product (GDP) information available, the Bureau of Economic Analysis' first estimate of second quarter GDP indicated growth of 4.0 percent, a significant rebound from the 2.1 percent contraction during the first quarter of the year. This advancement is primarily due to increases in personal consumption expenditures, inventory investments, exports, and residential and nonresidential fixed investments. Second quarter results indicate improvements in labor market conditions, with the unemployment rate declining further. However, housing activity, while continuing to improve, is behind last year's trends as a result of higher rates, low housing inventory and new regulations.

The Federal Reserve's Federal Open Market Committee (FOMC) indicated in the second quarter that "there is sufficient underlying strength in the broader economy to support ongoing improvement in labor market conditions." In light of this cumulative progress, the FOMC decided to make further reductions in its stimulus program and is on pace to end

its monthly asset purchase program in October 2014.

The FOMC stated it will maintain its target range for the federal funds rate and reiterated it would assess the appropriate timing of the first increase in the target rate based on progress toward its objectives of maximum employment and 2 percent inflation. The FOMC stated that it expects to maintain the current target range for a considerable time after the asset purchase program ends.

The trends in the banking industry are similar to those of the broader economy as shown in the latest national banking results from the first quarter of 2014. FDIC-insured institutions reported a decline in aggregate net income of 7.6 percent compared to the first quarter of 2013. Net income fell as banks are experiencing lower noninterest income due to reduced mortgage revenue and declining trading income. Noninterest expense remained relatively unchanged from the same quarter in 2013. Average net interest margin decreased to 3.17 percent from 3.27 percent in the same quarter in 2013. Nonetheless, 54 percent of banks reported higher net interest margins during the same period. Credit improvement remains key to earnings growth.

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Net charge-offs and delinquent loans and lease balances continue to decline, with the largest declines in residential mortgage loans and home equity lines.

Other industry trends noted based on review of first quarter 2014 data, in comparison to the same quarter in 2013 unless otherwise specified, include the following:

- The largest positive contribution to the year-over-year change in net income is due to lower provision for loan and lease losses. This is the 18th consecutive quarter the provision for loan and lease losses has declined year-over-year.
- Earnings declined as a reduction in noninterest income outweighed growth in net interest income; however, 54 percent of FDIC-insured banks reported year-over-year improvements in earnings.
- Total assets increased by 1.2 percent in the first quarter of 2014, compared to the fourth quarter of 2013, with increases in loans and leases of 0.5 percent and investment securities of 1.8 percent. Deposit balances increased 1.1 percent during the quarter, compared to the fourth quarter of 2013, with the primarily increase in domestic deposits.
- Asset quality indicators continued to show improvement. This is the 15th consecutive quarter that net charge-offs have posted a year-over-year decline, and is the lowest quarterly total since second quarter 2007.

### Financial Performance Highlights for Second Quarter 2014

Improved economic stability and operational execution has contributed to organic loan growth as well as improved credit quality in comparison to March 31, 2014 and the same quarter in the prior year. However, low interest rates, competitive loan and deposit pricing, and continued reduction in the acquired loan portfolio, continue to constrain interest margins and earnings.

BancShares' consolidated net income during the second quarter of 2014 equaled \$26.6 million, or \$2.76 per share, compared to \$22.4 million, or \$2.33 per share in the first quarter and compared to \$43.9 million, or \$4.56 per share in the second quarter of 2013. The annualized returns on average assets and equity amounted to 0.48 percent and 5.01 percent, respectively, during the second quarter of 2014, compared to 0.83 percent and 9.13 percent during the second quarter of 2013. Net interest margin for the second quarter of 2014 was 3.29 percent, compared to 3.74 percent for the second quarter of the prior year. Net interest margin excluding acquired loans was 2.85 percent in comparison to 2.88 percent for the same quarter in 2013.

For the first six months of 2014, consolidated net income totaled \$48.9 million, compared to \$99.5 million for the same period of 2013. The annualized return on average assets was 0.45 percent for the first six months of 2014, compared to 0.95 percent for the same period of 2013. The annualized return on average shareholders' equity was 4.67 percent and 10.55 percent for the respective periods.

Noninterest income for the second quarter of 2014 totaled \$65.4 million, compared to \$65.0 million in the comparable period of 2013. For the six-month period, noninterest income totaled \$126.6 million for 2014, compared to \$122.5 million for 2013. Noninterest expense totaled \$199.0 million for the second quarter of 2014, an increase of \$10.5 million from the sequential quarter. For the six-month period, noninterest expense totaled \$390.1 million, compared to \$382.9 million for 2013.

Income tax expense totaled \$12.8 million and \$25.3 million for the second quarter of 2014 and 2013, respectively, and totaled \$23.4 million and \$56.4 million for the six months ended June 30, 2014, and 2013, respectively.

Loans for the second quarter of 2014 totaled \$13.5 billion, an increase of \$53.9 million, or 0.4 percent, compared to the first quarter of 2014, and an increase of \$426.2 million, or 3.3 percent, compared to the same quarter of 2013. Loans increased \$391.2 million, or 3.0 percent from December 31, 2013 to June 30, 2014. Investment securities available for sale equaled \$5.5 billion at June 30, 2014, compared to \$5.7 billion and \$5.2 billion at March 31, 2014 and June 30, 2013, respectively. Investment securities as of June 30, 2014 increased \$150.5 million, or 2.8 percent, from December 31, 2013.

The allowance for loan and lease losses as a percentage of total loans was 1.52 percent for the second quarter of 2014 compared to 1.65 percent for the first quarter of 2014 and 1.97 percent for the second quarter of 2013. Provision credit for acquired loans totaled \$9.5 million for the second quarter of 2014 compared to a provision credit of \$2.3 million for the first quarter of 2014. The increase in the net credit was partially offset by the originated provision expense increase of \$1.9 million.

Annualized net charge-offs as a percentage of average originated loans remained relatively consistent during the second quarter of 2014 at 0.11 percent compared to 0.08 percent and 0.15 percent for the first quarter of 2014 and second quarter of 2013, respectively. Total nonperforming assets as a percent of total loans and leases plus other real estate totaled 1.29 percent at June 30, 2014 compared to 1.37 percent and 1.80 percent at March 31, 2014 and June 30, 2013.

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At June 30, 2014, total deposits equaled \$18.6 billion, a decrease of \$206.8 million, or 1.1 percent, when compared to the prior quarter, and an increase of \$538.7 million, or 3.0 percent, when compared to the second quarter of 2013. Total deposits increased \$682.7 million, or 3.8 percent, compared to December 31, 2013.

BancShares remains well-capitalized with a tier 1 leverage capital ratio of 9.71 percent, tier 1 risk-based capital ratio of 14.61 percent and total risk-based capital ratio of 15.95 percent at June 30, 2014.

**BUSINESS COMBINATIONS**

Merger Agreement with First Citizens Bancorporation, Inc.

On June 10, 2014, BancShares entered into an Agreement and Plan of Merger (the "Merger Agreement") with First Citizens Bancorporation, Inc., a South Carolina corporation ("Bancorporation"), pursuant to which Bancorporation will merge with and into BancShares. The Merger Agreement provides that each share of Bancorporation common stock will be converted into the right to receive 4.00 shares of BancShares' Class A common stock and \$50.00 cash, unless the holder elects for each share of such holder's Bancorporation common stock to be converted into the right to receive 3.58 shares of BancShares' Class A common stock and 0.42 shares of BancShares' Class B common stock.

The Merger Agreement has been approved by the independent members of the Board of Directors of each company following a recommendation by a special committee of independent members of the board of each company. Subject to certain conditions, including receipt of shareholder and regulatory approvals, the merger is expected to be completed in the fourth quarter of 2014 with the subsidiary banks merging sometime thereafter.

See Note B to the Consolidated Financial Statements, "Business Combinations," for additional information related to the Merger.

**1st Financial Services Corporation Merger**

On January 1, 2014, FCB completed its merger with 1<sup>st</sup> Financial Services Corporation (1<sup>st</sup> Financial) and its wholly-owned banking subsidiary Mountain 1<sup>st</sup> Bank & Trust Company. FCB paid \$10.0 million to acquire 1<sup>st</sup> Financial, including \$8.0 million to acquire and subsequently retire the 1<sup>st</sup> Financial securities that had been issued under the Troubled Asset Relief Program. In accordance with the acquisition method of accounting, all assets and liabilities were recorded at their fair value as of the acquisition date. As a result of the 1<sup>st</sup> Financial transaction, during the first quarter of 2014, FCB recorded loans with a fair value of \$316.3 million, investment securities with a fair value of \$237.4 million and other real estate with a fair value of \$11.6 million. The fair value of deposits assumed totaled \$631.9 million. FCB also recorded \$24.5 million of goodwill and \$3.8 million in core deposit intangibles.

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Table 1

FAIR VALUE OF 1<sup>ST</sup> FINANCIAL SERVICES ACQUIRED ASSETS AND LIABILITIES

| (Dollars in thousands)                | January 1, 2014 |
|---------------------------------------|-----------------|
| Assets                                |                 |
| Cash and cash equivalents             | \$28,194        |
| Investment securities                 | 237,438         |
| Loans and leases                      | 316,327         |
| Other real estate owned               | 11,591          |
| Intangible assets                     | 3,780           |
| Other assets                          | 23,991          |
| Total assets acquired                 | \$621,321       |
| Liabilities                           |                 |
| Deposits:                             |                 |
| Noninterest-bearing                   | \$152,444       |
| Interest-bearing                      | 479,427         |
| Total deposits                        | 631,871         |
| Short-term borrowings                 | 406             |
| Other liabilities                     | 3,559           |
| Total liabilities assumed             | 635,836         |
| Fair value of net liabilities assumed | 14,515          |
| Cash paid to shareholders             | 2,000           |
| Cash paid to acquire TARP securities  | 8,000           |
| Goodwill recorded                     | \$24,515        |

## FDIC-Assisted Transactions

We participated in six FDIC-assisted transactions between 2009 and 2011 that provided significant growth opportunities and continue to provide significant contributions to our results of operations. These transactions allowed us to increase our presence in existing markets and to expand our banking presence to adjacent markets. Each of the FDIC-assisted transactions included loss share agreements that, for the term of the loss share agreement, protect us from a substantial portion of the credit and asset quality risk we would otherwise incur. Two of the loss share agreements expire during the third quarter of 2014, and two expire during the first quarter of 2015. We will process all necessary filings in accordance with the agreements before expiration to collect the earned loss share receivables. Going forward, we will continue to manage these loans and loan relationships in accordance with our standard credit administration policies and procedures.

## Income Statement Impact of Business Combinations

The 1st Financial merger was accretive to net interest income during the three and six months ended June 30, 2014 and is expected to continue to be accretive going forward. The nonrecurring merger related costs totaled approximately \$5.2 million. Loan related interest income generated from 1st Financial was approximately \$4.2 million for the second quarter of 2014 and \$8.6 million for the first six months of 2014.

When comparing the current quarter of 2014 to the second quarter of 2013, acquired loans had an unfavorable impact on earnings. Unfavorable variances were noted in interest income and provision for loan and lease losses, partially offset by favorable adjustments to the FDIC receivable. The decrease in interest income, and overall earnings, for the second quarter and first six months of 2014 compared to the same quarter and six months in the prior year is primarily driven by sustained runoff in the acquired loan portfolio. The unfavorable six-month comparison is affected by nonrecurring FDIC-assisted acquisition accounting adjustments recorded during the the first quarter of 2013. Due to various factors that affect income or expense related to acquired loans recognized in a given period, these components of net income are not easily predictable for future periods. Variations among these items may affect the comparability

of various components of net income.

Acquired loan accretion income, which is included in interest income, may be accelerated in the event of unscheduled repayments and various other post-acquisition events. During the three months ended June 30, 2014, accretion income on acquired loans equaled \$30.5 million, compared to \$52.0 million during the second quarter of 2013. Accretion income for the six months ended June 30, 2014 and June 30, 2013 was \$60.7 million and \$131.9 million, respectively. The decrease during both the second quarter and the six-month periods of 2014 is attributed to accelerated repayments, loan portfolio runoff and a decrease in cash basis income. Cash basis income is generated when a loan pays off outside of expectations.

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During the three months ended June 30, 2014, we recorded a credit to provision for loan and lease losses for acquired loans totaling \$9.5 million compared to a credit of \$15.5 million during the same period of 2013. For the six months ended June 30, 2014 and June 30, 2013, the credit to provision expense was \$11.8 million and \$38.1 million, respectively. For all periods, accelerated loan payments resulted in the reversal of previously-recognized impairment, although as expected, the volume of repayments during 2014 was significantly less than repayments during 2013.

During the three-month period ended June 30, 2014, the net adjustment to the FDIC receivable resulted in a reduction to noninterest income of \$15.3 million, compared to a corresponding reduction in noninterest income of \$14.4 million during the same period of 2013. The six months ended June 30, 2014 and June 30, 2013 saw reductions to noninterest income of \$27.6 million and \$38.5 million. The changes result from lower amortization expense of the FDIC receivable as the expiration dates of the loss share agreements approach.

## FDIC Loss Share Receivable

The various terms of each loss share agreement and the components of the receivable from the FDIC are provided in Table 2. As of June 30, 2014, the FDIC receivable included \$22.7 million of expected FDIC cash receipts and \$27.2 million we expect to recover through prospective amortization of the asset due to post-acquisition improvements in the related loans. Generally, losses on single family residential loans are covered for ten years. All other loans are generally covered for five years. During the third quarter of 2014, loss share protection will expire for non-single family residential loans acquired from Temecula Valley Bank (TVB) and Venture Bank (VB). During the first quarter of 2015, loss share protection will expire for loans acquired from First Regional Bank (FRB) and for non-single family residential loans acquired from Sun American Bank (SAB). Protection for all other covered assets extends beyond December 31, 2015.

Table 2

| (Dollars in thousands)                              | Fair value at acquisition date | Losses/expenses incurred through 6/30/2014 | Cumulative amount reimbursed by FDIC through 6/30/2014 | Carrying value at June 30, 2014 |                 | Current portion of receivable due from (to) FDIC for 6/30/2014 filings | Prospective amortization (accretion) |
|---|--------------------------------|--|--|---------------------------------|-----------------|--|--------------------------------------|
|   |                                |  |  | Receivable from FDIC            | Payable to FDIC |  |                                      |
| Entity  |                                |  |  |                                 |                 |  |                                      |
| TVB - combined losses                               | \$103,558                      | \$199,226                                  | \$1,858  | \$3,090                         | \$—             | \$2,913  | \$1,505                              |
| VB - combined losses                                | 138,963                        | 156,155                                    | 125,184  | 1,357                           | —               | (260)  | (316)                                |
| FRB - combined losses                               | 378,695                        | 244,889                                    | 165,661  | 2,289                           | 78,891          | (3,203)  | 5,766                                |
| SAB - combined losses                               | 89,734                         | 97,197                                     | 78,211   | 8,793                           | 2,036           | (454)  | 6,490                                |
| United Western Non-single family residential losses | 112,672                        | 111,785                                    | 88,880   | 12,138                          | 17,529          | 225  | 4,711                                |
| Single family residential losses                    | 24,781                         | 4,884                                      | 3,744  | 10,645                          | —               | 164  | 2,813                                |
| Colorado Capital - combined losses                  | 155,070                        | 185,857                                    | 149,364  | 11,647                          | 15,825          | (514)  | 6,250                                |
| Total   | \$1,003,473                    | \$999,993                                  | \$612,902  | \$49,959                        | \$114,281       | \$(1,129)  | \$27,219                             |

Fair value at acquisition date represents the initial fair value of the receivable from FDIC, excluding the payable to FDIC. Prospective amortization (accretion) reflects balances that, due to post-acquisition credit quality improvement,

will be amortized over the shorter of the covered asset's life or the term of the loss share period.

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Table 3

## SELECTED QUARTERLY DATA

|   | 2014<br>Second | First        | 2013<br>Fourth | Third        | Second       | Six months ended June 30 |              |
|---|----------------|--------------|----------------|--------------|--------------|--------------------------|--------------|
| (Dollars in thousands, except share data)                     | Quarter        | Quarter      | Quarter        | Quarter      | Quarter      | 2014                     | 2013         |
| <b>SUMMARY OF OPERATIONS</b>                                  |                |              |                |              |              |                          |              |
| Interest income   | \$177,311      | \$173,394    | \$189,640      | \$192,634    | \$193,926    | \$350,705                | \$414,530    |
| Interest expense  | 11,613         | 12,463       | 13,047         | 13,451       | 14,398       | 24,076                   | 30,120       |
| Net interest income   | 165,698        | 160,931      | 176,593        | 179,183      | 179,528      | 326,629                  | 384,410      |
| Provision (credit) for loan and lease losses                  | (7,299 )       | (1,903 )     | 7,276          | (7,683 )     | (13,242 )    | (9,202 )                 | (31,848 )    |
| Net interest income after provision for loan and lease losses | 172,997        | 162,834      | 169,317        | 186,866      | 192,770      | 335,831                  | 416,258      |
| Noninterest income  | 65,382         | 61,181       | 69,177         | 71,918       | 64,995       | 126,563                  | 122,508      |
| Noninterest expense   | 199,020        | 191,030      | 196,315        | 192,143      | 188,567      | 390,050                  | 382,922      |
| Income before income taxes                                    | 39,359         | 32,985       | 42,179         | 66,641       | 69,198       | 72,344                   | 155,844      |
| Income taxes  | 12,809         | 10,619       | 14,953         | 25,659       | 25,292       | 23,428                   | 56,353       |
| Net income  | \$26,550       | \$22,366     | \$27,226       | \$40,982     | \$43,906     | \$48,916                 | \$99,491     |
| Net interest income, taxable equivalent                       | \$166,570      | \$161,694    | \$177,280      | \$179,823    | \$180,188    | \$328,263                | \$385,743    |
| <b>PER SHARE DATA</b>   |                |              |                |              |              |                          |              |
| Net income  | \$2.76         | \$2.33       | \$2.83         | \$4.26       | \$4.56       | \$5.09                   | \$10.34      |
| Cash dividends  | 0.30           | 0.30         | 0.30           | 0.30         | 0.30         | 0.60                     | 0.60         |
| Market price at period end (Class A)                          | 245.00         | 240.75       | 222.63         | 205.60       | 192.05       | 245.00                   | 192.05       |
| Book value at period end                                      | 223.43         | 218.82       | 215.89         | 206.06       | 201.62       | 223.43                   | 201.62       |
| <b>SELECTED PERIOD AVERAGE BALANCES</b>                       |                |              |                |              |              |                          |              |
| Total assets  | \$22,022,465   | \$21,872,343 | \$21,562,920   | \$21,260,384 | \$21,224,412 | \$21,947,818             | \$21,187,274 |
| Investment securities   | 5,629,467      | 5,606,723    | 5,285,783      | 5,177,729    | 5,162,893    | 5,618,157                | 5,179,818    |
|   | 13,566,612     | 13,459,945   | 13,088,636     | 13,111,710   | 13,167,580   | 13,513,580               | 13,228,367   |

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|  |              |              |              |              |              |              |              |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Loans and leases (acquired and originated)                     |              |              |              |              |              |              |              |
| Interest-earning assets  | 20,304,777   | 20,139,131   | 19,787,236   | 19,428,949   | 19,332,679   | 20,222,418   | 19,256,916   |
| Deposits   | 18,561,927   | 18,492,310   | 18,102,752   | 17,856,882   | 17,908,705   | 18,527,311   | 18,014,058   |
| Long-term obligations  | 398,615      | 500,805      | 510,871      | 449,013      | 443,804      | 449,428      | 444,170      |
| Interest-bearing liabilities                                   | 14,020,480   | 14,189,227   | 13,790,088   | 13,757,983   | 13,958,137   | 14,104,388   | 14,048,820   |
| Shareholders' equity   | \$2,125,239  | \$2,094,557  | \$2,010,191  | \$1,953,128  | \$1,929,621  | \$2,110,533  | \$1,902,217  |
| Shares outstanding   | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,963    |
| SELECTED PERIOD-END BALANCES                                   |              |              |              |              |              |              |              |
| Total assets   | \$22,062,840 | \$22,154,997 | \$21,199,091 | \$21,511,352 | \$21,308,822 | \$22,062,840 | \$21,308,822 |
| Investment securities  | 5,538,859    | 5,677,019    | 5,388,610    | 5,162,598    | 5,186,106    | 5,538,859    | 5,186,106    |
| Loans and leases:  |              |              |              |              |              |              |              |
| Acquired   | 1,109,933    | 1,270,818    | 1,029,426    | 1,188,281    | 1,443,336    | 1,109,933    | 1,443,336    |
| Originated   | 12,415,023   | 12,200,226   | 12,104,298   | 11,884,585   | 11,655,469   | 12,415,023   | 11,655,469   |
| Deposits   | 18,556,758   | 18,763,545   | 17,874,066   | 18,063,319   | 18,018,015   | 18,556,758   | 18,018,015   |
| Long-term obligations  | 314,529      | 440,300      | 510,769      | 510,963      | 443,313      | 314,529      | 443,313      |
| Shareholders' equity   | \$2,149,145  | \$2,104,830  | \$2,076,675  | \$1,982,057  | \$1,939,330  | \$2,149,145  | \$1,939,330  |
| Shares outstanding   | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    | 9,618,941    |
| SELECTED RATIOS AND OTHER DATA                                 |              |              |              |              |              |              |              |
| Rate of return on average assets (annualized)                  | 0.48         | %0.41        | %0.50        | %0.76        | %0.83        | %0.45        | %0.95        |
| Rate of return on average shareholders' equity (annualized)    | 5.01         | 4.33         | 5.37         | 8.32         | 9.13         | 4.67         | 10.55        |
| Net yield on interest-earning assets (taxable equivalent)      | 3.29         | 3.26         | 3.55         | 3.67         | 3.74         | 3.27         | 4.04         |
| Allowance for loan and lease losses to total loans and leases: |              |              |              |              |              |              |              |
| Acquired   | 2.64         | 3.54         | 5.20         | 5.01         | 5.30         | 2.64         | 5.30         |

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|   |       |       |       |       |       |       |       |
|---|-------|-------|-------|-------|-------|-------|-------|
| Originated  | 1.43  | 1.46  | 1.49  | 1.50  | 1.56  | 1.43  | 1.56  |
| Nonperforming assets to total<br>loans and leases and other real<br>estate at period end: |       |       |       |       |       |       |       |
| Acquired<br>covered   | 10.97 | 9.34  | 7.02  | 7.05  | 8.62  | 10.97 | 8.62  |
| Acquired not<br>covered   | 3.12  | 3.36  | —     | —     | —     | 3.12  | —     |
| Originated  | 0.58  | 0.66  | 0.74  | 0.90  | 0.91  | 0.58  | 0.91  |
| Tier 1<br>risk-based<br>capital ratio   | 14.61 | 14.56 | 14.92 | 15.04 | 14.91 | 14.61 | 14.91 |
| Total risk-based<br>capital ratio   | 15.95 | 16.05 | 16.42 | 16.54 | 16.41 | 15.95 | 16.41 |
| Leverage<br>capital ratio   | 9.71  | 9.66  | 9.82  | 9.84  | 9.68  | 9.71  | 9.68  |
| Dividend<br>payout ratio  | 10.87 | 12.88 | 10.60 | 7.04  | 6.58  | 11.79 | 5.80  |
| Average loans<br>and leases to<br>average<br>deposits                                     | 73.09 | 72.79 | 72.30 | 73.43 | 73.53 | 72.94 | 73.43 |

Average loan and lease balances include nonaccrual loans and leases.



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Table 4

## CONSOLIDATED TAXABLE EQUIVALENT RATE/VOLUME VARIANCE ANALYSIS - THREE MONTHS

|  | 2014               |                                |                | 2013               |                                |                | Increase (decrease) due to: |                |                 |
|--|--------------------|--------------------------------|----------------|--------------------|--------------------------------|----------------|-----------------------------|----------------|-----------------|
|  | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Rate | Volume                      | Yield/<br>Rate | Total<br>Change |
| (Dollars in thousands)                         |                    |                                |                |                    |                                |                |                             |                |                 |
| Assets   |                    |                                |                |                    |                                |                |                             |                |                 |
| Loans and leases                               | \$13,566,612       | \$164,794                      | 4.87 %         | \$13,167,580       | \$185,661                      | 5.66 %         | \$5,349                     | \$(26,216)     | \$(20,867)      |
| Investment securities:                         |                    |                                |                |                    |                                |                |                             |                |                 |
| U. S. Treasury                                 | 1,481,051          | 2,435                          | 0.66           | 681,893            | 486                            | 0.29           | 949                         | 1,000          | 1,949           |
| Government agency                              | 1,559,337          | 2,160                          | 0.55           | 2,947,308          | 3,197                          | 0.43           | (1,703 )                    | 666            | (1,037 )        |
| Mortgage-backed securities                     | 2,565,403          | 7,813                          | 1.22           | 1,512,268          | 4,506                          | 1.20           | 3,191                       | 116            | 3,307           |
| State, county and municipal                    | 186                | 4                              | 8.60           | 187                | 4                              | 8.58           | —                           | —              | —               |
| Other  | 23,490             | 220                            | 3.76           | 21,237             | 76                             | 1.44           | 15                          | 129            | 144             |
| Total investment securities                    | 5,629,467          | 12,632                         | 0.90           | 5,162,893          | 8,269                          | 0.64           | 2,452                       | 1,911          | 4,363           |
| Overnight investments                          | 1,108,698          | 756                            | 0.27           | 1,002,206          | 656                            | 0.26           | 72                          | 28             | 100             |
| Total interest-earning assets                  | 20,304,777         | \$178,182                      | 3.52 %         | 19,332,679         | \$194,586                      | 4.04 %         | \$7,873                     | \$(24,277)     | \$(16,404)      |
| Cash and due from banks                        | 464,877            |                                |                | 482,821            |                                |                |                             |                |                 |
| Premises and equipment                         | 882,256            |                                |                | 873,503            |                                |                |                             |                |                 |
| Receivable from FDIC for loss share agreements | 67,574             |                                |                | 182,766            |                                |                |                             |                |                 |
| Allowance for loan and lease losses            | (216,337 )         |                                |                | (264,978 )         |                                |                |                             |                |                 |
| Other real estate owned                        | 81,074             |                                |                | 128,152            |                                |                |                             |                |                 |
| Other assets                                   | 438,244            |                                |                | 489,469            |                                |                |                             |                |                 |
| Total assets                                   | \$22,022,465       |                                |                | \$21,224,412       |                                |                |                             |                |                 |
| Liabilities                                    |                    |                                |                |                    |                                |                |                             |                |                 |
| Interest-bearing deposits:                     |                    |                                |                |                    |                                |                |                             |                |                 |
| Checking with interest                         | \$2,553,941        | \$125                          | 0.02 %         | \$2,378,178        | \$166                          | 0.03 %         | \$16                        | \$(57 )        | \$(41 )         |
| Savings  | 1,200,145          | 152                            | 0.05           | 965,801            | 120                            | 0.05           | 31                          | 1              | 32              |
| Money market accounts                          | 6,182,997          | 1,540                          | 0.10           | 6,295,031          | 2,490                          | 0.16           | (27 )                       | (923 )         | (950 )          |

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|  |              |           |        |              |           |        |          |            |            |
|--|--------------|-----------|--------|--------------|-----------|--------|----------|------------|------------|
| Time deposits  | 2,999,262    | 4,189     | 0.56   | 3,285,435    | 6,221     | 0.76   | (468 )   | (1,564 )   | (2,032 )   |
| Total interest-bearing deposits                              | 12,936,345   | 6,006     | 0.19   | 12,924,445   | 8,997     | 0.32   | (448 )   | (2,543 )   | (2,991 )   |
| Short-term borrowings  | 685,520      | 1,551     | 0.91   | 589,888      | 680       | 0.46   | 159      | 712        | 871        |
| Long-term obligations  | 398,615      | 4,055     | 4.07   | 443,804      | 4,721     | 4.26   | (337 )   | (329 )     | (666 )     |
| Total interest-bearing liabilities                           | 14,020,480   | \$11,612  | 0.33 % | 13,958,137   | \$14,398  | 0.41 % | \$(626 ) | \$(2,160 ) | \$(2,786 ) |
| Demand deposits  | 5,625,582    |           |        | 4,984,260    |           |        |          |            |            |
| Other liabilities  | 251,164      |           |        | 352,394      |           |        |          |            |            |
| Shareholders' equity   | 2,125,239    |           |        | 1,929,621    |           |        |          |            |            |
| Total liabilities and shareholders' equity                   | \$22,022,465 |           |        | \$21,224,412 |           |        |          |            |            |
| Interest rate spread   |              |           | 3.19 % |              |           | 3.63 % |          |            |            |
| Net interest income and net yield on interest-earning assets |              | \$166,570 | 3.29 % |              | \$180,188 | 3.74 % | \$8,499  | \$(22,117) | \$(13,618) |

Loans and leases include acquired loans, originated loans, nonaccrual loans and loans held for sale. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only are stated on a taxable-equivalent basis assuming statutory federal income tax rates of 35.0 percent for each period and state income tax rates of 6.2 percent and 6.9 percent for 2014 and 2013, respectively. The taxable-equivalent adjustment was \$872 and \$660 for 2014 and 2013, respectively. The rate/volume variance is allocated equally between the changes in volume and rate.

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Table 5

## CONSOLIDATED TAXABLE EQUIVALENT RATE/VOLUME VARIANCE ANALYSIS - YEAR TO DATE

|  | 2014               |                                | 2013           |                    | Increase (decrease) due to:    |                |          |                |                 |
|--|--------------------|--------------------------------|----------------|--------------------|--------------------------------|----------------|----------|----------------|-----------------|
|  | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Rate | Average<br>Balance | Interest<br>Income/<br>Expense | Yield/<br>Rate | Volume   | Yield/<br>Rate | Total<br>Change |
| <b>Assets</b>                                  |                    |                                |                |                    |                                |                |          |                |                 |
| Loans and leases                               | \$13,513,580       | \$326,430                      | 4.87 %         | \$13,228,367       | \$397,932                      | 6.07 %         | \$7,900  | \$(79,402)     | \$(71,502)      |
| <b>Investment securities:</b>                  |                    |                                |                |                    |                                |                |          |                |                 |
| U.S. Treasury                                  | 1,131,539          | 3,521                          | 0.63           | 742,511            | 1,004                          | 0.27           | 856      | 1,661          | 2,517           |
| Government agency                              | 1,917,664          | 5,122                          | 0.53           | 3,021,622          | 6,663                          | 0.44           | (2,649 ) | 1,108          | (1,541 )        |
| Mortgage-backed securities                     | 2,545,457          | 15,576                         | 1.22           | 1,396,026          | 9,085                          | 1.31           | 7,290    | (799 )         | 6,491           |
| State, county and municipal                    | 186                | 7                              | 7.53           | 367                | 13                             | 7.14           | (7 )     | 1              | (6 )            |
| Other  | 23,311             | 316                            | 2.73           | 19,292             | 153                            | 1.60           | 43       | 120            | 163             |
| Total investment securities                    | 5,618,157          | 24,542                         | 0.87           | 5,179,818          | 16,918                         | 0.65           | 5,533    | 2,091          | 7,624           |
| Overnight investments                          | 1,090,681          | 1,368                          | 0.25           | 848,731            | 1,013                          | 0.24           | 300      | 55             | 355             |
| Total interest-earning assets                  | 20,222,418         | \$352,340                      | 3.51 %         | 19,256,916         | \$415,863                      | 4.36 %         | \$13,733 | \$(77,256)     | \$(63,523)      |
| Cash and due from banks                        | 471,424            |                                |                | 495,548            |                                |                |          |                |                 |
| Premises and equipment                         | 879,849            |                                |                | 877,242            |                                |                |          |                |                 |
| Receivable from FDIC for loss share agreements | 77,507             |                                |                | 208,575            |                                |                |          |                |                 |
| Allowance for loan and lease losses            | (220,714 )         |                                |                | (273,927 )         |                                |                |          |                |                 |
| Other real estate owned                        | 85,960             |                                |                | 139,448            |                                |                |          |                |                 |
| Other assets                                   | 431,374            |                                |                | 483,472            |                                |                |          |                |                 |
| Total assets                                   | \$21,947,818       |                                |                | \$21,187,274       |                                |                |          |                |                 |
| <b>Liabilities</b>                             |                    |                                |                |                    |                                |                |          |                |                 |
| <b>Interest-bearing deposits:</b>              |                    |                                |                |                    |                                |                |          |                |                 |
| Checking with interest                         | \$2,524,474        | \$278                          | 0.02 %         | \$2,331,192        | \$309                          | 0.03 %         | \$57     | \$(88 )        | \$(31 )         |
| Savings  | 1,190,250          | 443                            | 0.08           | 947,246            | 234                            | 0.05           | 64       | 145            | 209             |
| Money market accounts                          | 6,268,862          | 3,429                          | 0.11           | 6,378,644          | 5,675                          | 0.18           | (65 )    | (2,181 )       | (2,246 )        |

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|  |              |           |        |              |           |        |          |            |            |
|--|--------------|-----------|--------|--------------|-----------|--------|----------|------------|------------|
| Time deposits  | 3,056,296    | 8,682     | 0.57   | 3,372,716    | 13,092    | 0.78   | (1,061 ) | (3,349 )   | (4,410 )   |
| Total interest-bearing deposits                              | 13,039,882   | 12,832    | 0.20   | 13,029,798   | 19,310    | 0.30   | (1,005 ) | (5,473 )   | (6,478 )   |
| Short-term borrowings  | 615,078      | 2,136     | 0.70   | 574,852      | 1,384     | 0.49   | 126      | 626        | 752        |
| Long-term obligations  | 449,428      | 9,109     | 4.05   | 444,170      | 9,426     | 4.24   | 106      | (423 )     | (317 )     |
| Total interest-bearing liabilities                           | 14,104,388   | \$24,077  | 0.34 % | 14,048,820   | \$30,120  | 0.43 % | \$(773 ) | \$(5,270 ) | \$(6,043 ) |
| Demand deposits  | 5,487,429    |           |        | 4,984,260    |           |        |          |            |            |
| Other liabilities  | 245,468      |           |        | 251,977      |           |        |          |            |            |
| Shareholders' equity   | 2,110,533    |           |        | 1,902,217    |           |        |          |            |            |
| Total liabilities and shareholders' equity                   | \$21,947,818 |           |        | \$21,187,274 |           |        |          |            |            |
| Interest rate spread   |              |           | 3.17 % |              |           | 3.93 % |          |            |            |
| Net interest income and net yield on interest-earning assets |              | \$328,263 | 3.27 % |              | \$385,743 | 4.04 % | \$14,506 | \$(71,986) | \$(57,480) |

Loans and leases include acquired loans, originated loans, nonaccrual loans and loans held for sale. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only are stated on a taxable-equivalent basis assuming statutory federal income tax rates of 35.0 percent for each period and state income tax rates of 6.2 percent and 6.9 percent for 2014 and 2013, respectively. The taxable-equivalent adjustment was \$1,634 and \$1,333 for 2014 and 2013, respectively. The rate/volume variance is allocated equally between the changes in volume and rate.

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## RESULTS OF OPERATIONS

## Net Interest Income and Margins

## Second Quarter 2014

The second quarter results were good but show notable differences when compared to the first quarter of 2014 and the same quarter of 2013. The most significant impact on net interest income, net interest margin, and average asset yields resulted from changes in the acquired loan portfolio including loan resolutions, acceleration of payments, and overall portfolio run-off throughout the second quarter, albeit at a slower pace than prior quarters. Other significant drivers for quarterly changes are specifically noted below.

Net interest income increased \$4.8 million, or 3.0 percent, compared to the first quarter of 2014, principally due to increased loan and investment income and reduced deposit costs. Conversely, net interest income decreased \$13.8 million, or 7.7 percent, compared to the same period of 2013. Accretion income on acquired loans totaled \$30.5 million when compared to \$52.0 million during the second quarter of 2013. This reduction was partially offset by increases in loan interest income from the 1st Financial loan portfolio of \$4.2 million and \$4.3 million from improved investment interest income. Net interest income also benefited from decreased interest expense of \$2.8 million in comparison to the same quarter of the prior year, due to reduction in funding costs.

Net interest margin improved 3 basis points (bps) compared to the first quarter of 2014 primarily due to improvements in acquired loan yields and investment yields as well as reduced deposit costs over the same period. The increase in net interest margin and net income during the current quarter in comparison to the first quarter was primarily due to reduced acquired loan impact, and improvements in investment yields and deposits costs over the same period.

Originated loan growth, increased provision credit, improved investment yields, and lower interest expense contributed to higher net interest income after provision in comparison to the first quarter. While the non-acquired bank operations are helping earnings, our traditional banking products have much tighter margins; therefore, in a neutral interest rate environment, we anticipate continued pressure to replace the yield from the acquired portfolio runoff.

Net interest margin for the second quarter of 2014 was 3.29 percent, a decrease of 45 basis points from 3.74 percent recorded in the second quarter of 2013. The decrease was partially offset by modest improvements in investment yields and funding costs. While margin compression is a continuing concern in the current interest rate environment, the majority of BancShares' quarter-to-date margin compression was directly related to the acquired loan portfolio runoff. Net interest margin excluding acquired loans was 2.85 percent in comparison to 2.88 percent for the same quarter in 2013.

Average quarter-to-date interest earning assets increased \$165.6 million, or 0.8 percent, compared to the first quarter of 2014 which was primarily driven by the \$106.7 million increase in average outstanding loans. Interest-earning assets averaged \$20.3 billion, an increase of \$972.1 million compared to the second quarter of 2013. The increase is primarily the result of organic loan growth and the 1st Financial acquisition, offset by reductions in the acquired loan portfolios, while the increase in average investments is principally driven by the addition of the 1st Financial investment portfolio and redeployment of excess cash. Average loans and leases increased \$106.7 million and \$399.0 million when compared to the first quarter of 2014 and the second quarter of 2013, respectively.

Interest income totaled \$177.3 million, a \$3.9 million increase from the first quarter of 2014, and a \$16.6 million decrease from the second quarter of 2013. The taxable-equivalent yield for total loans remained unchanged when compared to the first quarter of 2014, but decreased by 79 basis points when compared to the same quarter in the prior year. The taxable-equivalent yield on earning assets was 3.52 percent, relatively unchanged in comparison to the first quarter of 2014, and a decline of 52 basis points in comparison to the second quarter of 2013.

Average investment securities increased \$22.7 million in comparison to the first quarter of 2014, with a 5 basis point increase in the taxable-equivalent yield. Average investment securities increased \$466.6 million in comparison to the second quarter of 2013, with a 26 basis point increase in the taxable-equivalent yield. Interest income earned on the investment securities portfolio totaled \$12.4 million when compared to \$11.7 million and \$8.1 million during the first quarter of 2014 and the same quarter of 2013, respectively. Average overnight investments increased \$106.5 million compared to the same quarter in the prior year. Interest income earned on overnight investments totaled \$0.8 million

during the second quarter compared to \$0.7 million during the second quarter of 2013. Average investment and overnight investment balances continue to increase as cash provided by acquired loan repayments and increased deposits are redeployed.

Average interest-bearing liabilities decreased \$168.7 million when compared to the first quarter of 2014. Conversely, average interest-bearing liabilities totaled \$14.0 billion, an increase of \$62.3 million when compared to the second quarter of 2013. Interest expense totaled \$11.6 million, a \$0.9 million and \$2.8 million decrease from the first quarter of 2014 and same quarter of 2013, respectively. The rate on interest-bearing liabilities was 0.33 percent, a decrease of 2 basis points and 8 basis points from the first quarter of 2014 and the second quarter of 2013, respectively. Average interest-bearing deposits equaled \$12.9

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billion, a decrease of \$208.2 million from the first quarter of 2014, and an increase of \$11.9 million from the second quarter of 2013.

## Year to Date 2014

Similar to the quarter over quarter comparison, the year-to-date 2014 results were good, but show notable differences when compared to the same period of 2013. The most significant impact on net interest income, net interest margin, and average asset yields resulted from changes in the acquired loan portfolio including loan resolutions, acceleration of payments, and overall portfolio run-off throughout the period ending June 30, 2014, albeit at a slower pace than prior periods. Other significant drivers for changes during the period are specifically noted below.

Net interest income for the first six months of 2014 totaled \$326.6 million, a decrease of \$57.8 million, or 15.0 percent, compared to the same period of 2013. Similar to quarter-to-date results, this reduction was partially offset by organic loan growth and \$8.6 million of interest income from the 1st Financial loan portfolio and improved investment interest income. Accretion income on acquired loans totaled \$60.7 million compared to \$131.9 million during the same period of 2013. Net interest income also benefited from decreased interest expense of \$6.0 million in comparison to the same six-month period of the prior year, due to reduction in funding costs.

The net interest margin amounted to 3.27 percent, compared to 4.04 percent for the same six-month period in 2013. The decrease in the year-to-date margin is predominately driven by reductions in the acquired loan portfolio yields, partially offset by modest improvements in investment yields and funding costs. Although the acquired loan portfolio performance and runoff continue to create margin volatility, the overall impact is expected to become less significant as that portfolio continues to decrease. Net interest margin excluding acquired loans was 2.84 percent in comparison to 2.89 percent for the same six-month period in 2013.

Interest-earning assets averaged \$20.2 billion, an increase of \$965.5 million in comparison to the same period of 2013 primarily due to increases in loans and investments. Average loans and leases increased \$285.2 million in comparison to the first six months of 2013 as a result of organic loan growth and the 1st Financial acquisition, offset by reductions in the acquired loan portfolios. Interest income earned from loans and leases decreased \$71.8 million as the taxable-equivalent yield for total loans also decreased by 120 basis points compared to the first six months in the prior year. As the acquired portfolio yield is being replaced with higher quality, lower yielding loan instruments, the yield on interest-earning assets declined in proportion, reaching 3.51 percent, compared to 4.36 percent for the same period of 2013. Interest income totaled \$350.7 million, a \$63.8 million decrease from the same period of 2013. The increase in average investments is primarily driven by the addition of the 1st Financial investment portfolio.

The repositioning of the investment portfolio during the year has helped improve overall investment yields helping to offset the decrease in loan yields. Average investment securities increased \$438.3 million in comparison to the first six months of 2013, with a 22 basis point increase in the taxable-equivalent yield. Interest income earned on the investment securities portfolio totaled \$24.2 million compared to \$16.6 million during the same period of 2013.

Average overnight investments increased \$242.0 million compared to the year-to-date average in the prior year. Interest income earned on overnight investments totaled \$1.4 million during the first six months compared to \$1.0 million during the same period of 2013. Average investment and overnight investment balances continue to increase as cash provided by acquired loan repayments and increased deposits are redeployed.

Average interest-bearing liabilities totaled \$14.1 billion, an increase of \$55.6 million when compared to the same period of 2013. Interest expense totaled \$24.1 million, a \$6.0 million decrease from the same period of 2013. The rate on interest-bearing liabilities fell 9 basis points from year-to-date 2013 to 0.34 percent during the six months ended June 30, 2014. Average interest-bearing deposits equaled \$13.0 billion, an increase of \$10.1 million from the same period of 2013. This increase includes deposits acquired in the 1st Financial merger, as well as recurring seasonal trends.

## Noninterest Income

The primary sources of noninterest income have traditionally consisted of cardholder services income, merchant services income, service charges on deposit accounts and revenues derived from wealth management services.

FDIC-assisted acquired loan recoveries and related adjustments in the FDIC receivable and payable is another source of noninterest income. As the loss share agreements begin to expire in the third quarter of 2014, we expect the impact on noninterest income to be reduced going forward.



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Noninterest Income

| (Dollars in thousands)                                   | Three months ended |           | Three-month |         | Six months ended June |           | Six-month |         |   |
|--|--------------------|-----------|-------------|---------|-----------------------|-----------|-----------|---------|---|
|  | June 30            | 2013      | change      | %       | 30                    | 2013      | change    | %       |   |
| Cardholder services                                      | \$13,257           | \$12,026  | \$1,231     | 10.2    | % \$25,089            | \$23,097  | \$1,992   | 8.6     | % |
| Merchant services  | 15,035             | 15,245    | (210 )      | (1.4 )  | 28,556                | 27,731    | 825       | 3.0     |   |
| Service charges on deposit accounts                      | 15,265             | 14,883    | 382         | 2.6     | 29,705                | 29,882    | (177 )    | (0.6 )  |   |
| Wealth management services                               | 15,815             | 15,097    | 718         | 4.8     | 30,695                | 29,612    | 1,083     | 3.7     |   |
| Fees from processing services                            | 5,682              | 5,051     | 631         | 12.5    | 10,543                | 10,670    | (127 )    | (1.2 )  |   |
| Other service charges and fees                           | 4,250              | 3,966     | 284         | 7.2     | 8,194                 | 7,732     | 462       | 6.0     |   |
| Mortgage income  | 1,210              | 3,669     | (2,459 )    | (67.0 ) | 2,165                 | 7,457     | (5,292 )  | (71.0 ) |   |
| Insurance commissions                                    | 2,253              | 2,394     | (141 )      | (5.9 )  | 5,540                 | 5,374     | 166       | 3.1     |   |
| ATM income   | 1,260              | 1,314     | (54 )       | (4.1 )  | 2,462                 | 2,482     | (20 )     | (0.8 )  |   |
| Adjustments to FDIC receivable for loss share agreements | (15,295 )          | (14,439 ) | (856 )      | 5.9     | (27,644 )             | (38,492 ) | 10,848    | (28.2 ) |   |
| Recoveries of acquired loans previously charged off      | 5,400              | 4,219     | 1,181       | 28.0    | 8,869                 | 5,850     | 3,019     | 51.6    |   |
| Other  | 1,250              | 1,570     | (320 )      | (20.4 ) | 2,389                 | 11,113    | (8,724 )  | (78.5 ) |   |
| Total noninterest income                                 | \$65,382           | \$64,995  | \$387       | 0.6     | % \$126,563           | \$122,508 | \$4,055   | 3.3     | % |

Noninterest income for the second quarter of 2014 equaled \$65.4 million, compared to \$65.0 million in the comparable period of 2013. The \$0.4 million increase during 2014 is primarily related to improvements in cardholder services resulting from higher volume, higher service charges on deposits due to seasonality, higher wealth management services income from trust asset management and annuity fees, and increases in recoveries of acquired loans previously charged off. These improvements are partially offset by a decline in mortgage income due to reduced mortgage originations and a decline in adjustments to the FDIC receivable for loss share agreements as a result of acquired portfolio performance.

For the six-month period, noninterest income equaled \$126.6 million for 2014, compared to \$122.5 million for 2013, primarily due to a \$2.8 million increase in cardholder and merchant services income, a \$10.8 million reduction in unfavorable adjustments to the FDIC loss share receivable, and a \$3.0 million increase in recoveries of acquired loans previously charged off. These increases are partially offset by a \$5.3 million decline in mortgage income as a result of reduced mortgage originations due to economic conditions, and a decrease in other resulting from a \$7.5 million gain generated from the sale of various service agreements during the first quarter of 2013.

During 2014, substantially all fees from processing services relate to payments received from FCB-SC. Following the proposed merger of BancShares and Bancorporation, anticipated to occur during the fourth quarter of 2014, no further fees from processing services will be recorded from Bancorporation. However, this reduction is not expected to have an impact on earnings as the associated processing expenses recorded by Bancorporation will also be eliminated upon consolidation.

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## Noninterest Expense

The primary components of noninterest expense are salaries and related employee benefits, occupancy costs and support facilities and equipment and software costs and our technology and operations infrastructure.

Table 7

## Noninterest Expense

|                                       | Three months ended |           | Three-month |        | Six months ended |           | Six-month change |        |   |
|---------------------------------------|--------------------|-----------|-------------|--------|------------------|-----------|------------------|--------|---|
|                                       | June 30            |           | change      |        | June 30          |           |                  |        |   |
| (Dollars in thousands)                | 2014               | 2013      | \$          | %      | 2014             | 2013      | \$               | %      |   |
| Salaries and wages                    | \$82,683           | \$75,802  | \$6,881     | 9.1    | %\$162,557       | \$151,921 | \$10,636         | 7.0    | % |
| Employee benefits                     | 19,772             | 23,228    | (3,456)     | (14.9) | 39,872           | 48,247    | (8,375)          | (17.4) | ) |
| Occupancy expense                     | 20,937             | 18,464    | 2,473       | 13.4   | 41,362           | 37,273    | 4,089            | 11.0   |   |
| Equipment expense                     | 19,686             | 18,698    | 988         | 5.3    | 38,477           | 37,644    | 833              | 2.2    |   |
| FDIC insurance expense                | 2,640              | 2,423     | 217         | 9.0    | 5,276            | 5,089     | 187              | 3.7    |   |
| Foreclosure-related expenses          | 3,858              | 3,467     | 391         | 11.3   | 9,268            | 7,772     | 1,496            | 19.2   |   |
| Merchant processing                   | 9,755              | 9,114     | 641         | 7.0    | 18,236           | 17,347    | 889              | 5.1    |   |
| Processing fees paid to third parties | 4,564              | 3,846     | 718         | 18.7   | 9,690            | 8,227     | 1,463            | 17.8   |   |
| Card processing                       | 3,033              | 3,682     | (649)       | (17.6) | 5,630            | 6,759     | (1,129)          | (16.7) | ) |
| Consultant                            | 3,921              | 2,465     | 1,456       | 59.1   | 6,152            | 4,091     | 2,061            | 50.4   |   |
| Collection                            | 2,647              | 5,104     | (2,457)     | (48.1) | 4,482            | 10,379    | (5,897)          | (56.8) | ) |
| Advertising                           | 1,773              | 1,107     | 666         | 60.2   | 3,062            | 1,405     | 1,657            | (a)    |   |
| Other                                 | 23,751             | 21,167    | 2,584       | 12.2   | 45,986           | 46,768    | (782)            | (1.7)  | ) |
| Total noninterest expense             | \$199,020          | \$188,567 | \$10,453    | 5.5    | %\$390,050       | \$382,922 | \$7,128          | 1.9    | % |

(a) not meaningful

Noninterest expense increased \$10.4 million in the second quarter of 2014 to \$199.0 million, compared to \$188.6 million in the second quarter of 2013. The second quarter 2014 increase is a result of higher salaries and wages of \$6.9 million, occupancy expenses of \$2.5 million, and consultant and other expenses which increased \$1.5 million and \$2.6 million, respectively, primarily due to merger-related consultant services expenses. This increase is partially offset by lower employee benefits of \$3.5 million primarily due to lower health care costs and pension expenses and reduced collection expenses of \$2.5 million due to lower nonperforming assets.

For the six-month period, noninterest expense totaled \$390.1 million, compared to \$382.9 million for the six-month period of 2013. The increase results from higher salaries and wages of \$10.6 million, higher occupancy expense of \$4.1 million, increases in foreclosure-related expenses of \$1.5 million, higher processing fees of \$1.5 million, a \$2.1 million increase in consultant fees resulting from merger-related expenses, and higher advertising expenses of \$1.7 million. The increase in salaries and wages is primarily related to annual merit increases and the increase in foreclosure-related expenses is due to increased resolutions of other real estate properties leading to the reduction in other real estate owned (OREO) property balance of \$46.5 million when compared to June 30, 2013. These increases are partially offset by lower employee benefit expenses of \$8.4 million reflecting lower pension costs resulting from a higher discount rate used to calculate pension expense during 2014, lower card processing fees of \$1.1 million, and reduced collection expenses of \$5.9 million associated with managing reduced nonperforming assets. The lower card processing fees in the first six months of 2014 are related to card incentive commissions recorded throughout the year, which offset the noninterest expense recognized during the period, whereas these commissions were recorded as a one-time adjustment in the third quarter of the prior year.

## Income Taxes

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

Income tax expense totaled \$12.8 million and \$25.3 million for the second quarter of 2014 and 2013, representing effective tax rates of 32.5 percent and 36.6 percent during the respective periods. Income tax expense totaled \$23.4 million and \$56.4 million for the six months ended June 30, 2014, and 2013, respectively. The effective tax rates were 32.4 percent and 36.2

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percent for the respective six-month periods. The decreased effective tax rate is the result of the impact of permanent differences on lower pre-tax earnings.

## BALANCE SHEET ANALYSIS

We focus on maintaining high-asset quality, which results in a loan and lease portfolio subjected to strenuous underwriting and monitoring procedures and corresponding tighter margins. We avoid high-risk industry concentrations, but we do maintain a concentration of owner-occupied real estate loans to borrowers in medical and medical-related fields. The credit department actively monitors all loan concentrations to ensure potential risks are identified timely and managed accordingly. Our focus on asset quality also influences the composition of our investment securities portfolio. At June 30, 2014, mortgage-backed securities represented 46.9 percent of investment securities available for sale, compared to U.S. Treasury and government agency securities, which represented 29.4 percent and 23.2 percent, respectively, of the portfolio. Investments in mortgage-backed securities primarily represent securities issued by government entities. The balance of the available-for-sale portfolio includes common stock of other financial institutions and municipal securities. Overnight investments include interest-bearing deposits at the Federal Reserve Bank and other financial institutions and federal funds sold.

## Investment Securities

Investment securities available for sale equaled \$5.54 billion at June 30, 2014, compared to \$5.39 billion and \$5.19 billion at December 31, 2013 and June 30, 2013, respectively. Available for sale securities are reported at their aggregate fair value, and unrealized gains and losses are included as a component of other comprehensive income, net of deferred taxes. As of June 30, 2014, investment securities available for sale had a net unrealized gain of \$26.8 million, compared to a net unrealized loss of \$16.6 million and \$6.7 million as of December 31, 2013 and June 30, 2013, respectively. In determining whether we had any other than temporary impairment for securities with unrealized losses we consider the amount and duration of the impairment, whether the impairment is industry wide or specific to the financial condition of the issuer, our ability to hold the investment for recovery, adverse actions by rating agencies, discontinuation of dividends on equity securities and deferred interest payments on debt securities. Management concluded that no other than temporary impairment existed as of June 30, 2014.

Changes in the amount of our investment securities portfolio result from balance sheet trends including loans and leases, deposits and short-term borrowings. When inflows arising from deposit and treasury services products exceed loan and lease demand, we invest excess funds in the securities portfolio. Conversely, when loan demand exceeds growth in deposits and short-term borrowings, we allow overnight investments to decline and use proceeds from maturing securities to fund loan demand.

Table 8

## Investment Securities

| (Dollars in thousands)                    | June 30, 2014 |             | December 31, 2013 |            | June 30, 2013 |            |
|---|---------------|-------------|-------------------|------------|---------------|------------|
|   | Cost          | Fair value  | Cost              | Fair value | Cost          | Fair Value |
| Investment securities available for sale: |               |             |                   |            |               |            |
| U.S. Treasury                             | \$1,623,564   | \$1,625,630 | \$373,223         | \$373,437  | \$598,625     | \$598,666  |
| Government agency                         | 1,281,724     | 1,283,566   | 2,543,223         | 2,544,229  | 2,725,227     | 2,721,379  |
| Mortgage-backed securities                | 2,605,333     | 2,596,286   | 2,486,297         | 2,446,873  | 1,866,204     | 1,843,323  |
| Equity securities                         | 543           | 32,498      | 543               | 22,147     | 543           | 20,593     |
| Municipal securities                      | 185           | 186         | 186               | 187        | 186           | 187        |
| Other                                     | —             | —           | 863               | 830        | 850           | 828        |
|   | 5,511,349     | 5,538,166   | 5,404,335         | 5,387,703  | 5,191,635     | 5,184,976  |

Total investment securities available  
for sale

Investment securities held to  
maturity:

|                             |             |             |             |             |             |             |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Mortgage-backed securities  | 693         | 729         | 907         | 974         | 1,130       | 1,200       |
| Total investment securities | \$5,512,042 | \$5,538,895 | \$5,405,242 | \$5,388,677 | \$5,192,765 | \$5,186,176 |

Since December 31, 2013, the proceeds from maturing government agency securities were primarily reinvested into U.S. Treasury securities at higher-yielding rates. As of June 30, 2014, equity securities included our investment in Bancorporation stock of \$0.5 million and \$32.0 million at cost and fair value, respectively. Pursuant to the Merger Agreement, the capital stock of Bancorporation will be retired.

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## Loans and Leases

We report our acquired and originated loan portfolios separately, and each portfolio is further divided into commercial and non-commercial based on the type of borrower, purpose, collateral, and/or our underlying credit management processes. Additionally, we have identified loan classes, which further disaggregate loans based upon common risk characteristics. See Note D to the Consolidated Financial Statements, "Loans and Leases," for definitions of each loan class.

Table 9

## Loans and Leases

| (Dollars in thousands)            | June 30, 2014 | December 31,<br>2013 | June 30, 2013 |
|-----------------------------------|---------------|----------------------|---------------|
| Acquired loans:                   |               |                      |               |
| Commercial:                       |               |                      |               |
| Construction and land development | \$80,827      | \$78,915             | \$160,733     |
| Commercial mortgage               | 637,481       | 642,891              | 859,038       |
| Other commercial real estate      | 34,688        | 41,381               | 81,904        |
| Commercial and industrial         | 33,851        | 17,254               | 37,336        |
| Other                             | 1,270         | 866                  | 1,018         |
| Total commercial loans            | 788,117       | 781,307              | 1,140,029     |
| Noncommercial:                    |               |                      |               |
| Residential mortgage              | 270,688       | 213,851              | 256,972       |
| Revolving mortgage                | 20,129        | 30,834               | 36,153        |
| Construction and land development | 28,759        | 2,583                | 9,009         |
| Consumer                          | 2,240         | 851                  | 1,173         |
| Total noncommercial loans         | 321,816       | 248,119              | 303,307       |
| Total acquired loans              | 1,109,933     | 1,029,426            | 1,443,336     |
| Originated loans and leases:      |               |                      |               |
| Commercial:                       |               |                      |               |
| Construction and land development | 342,021       | 319,847              | 305,789       |
| Commercial mortgage               | 6,367,096     | 6,362,490            | 6,135,068     |
| Other commercial real estate      | 178,899       | 178,754              | 176,031       |
| Commercial and industrial         | 1,292,213     | 1,081,158            | 997,504       |
| Lease financing                   | 413,422       | 381,763              | 352,818       |
| Other                             | 131,051       | 175,336              | 172,861       |
| Total commercial loans            | 8,724,702     | 8,499,348            | 8,140,071     |
| Noncommercial:                    |               |                      |               |
| Residential mortgage              | 1,071,089     | 982,421              | 884,020       |
| Revolving mortgage                | 2,122,675     | 2,113,285            | 2,123,814     |
| Construction and land development | 119,420       | 122,792              | 119,253       |
| Consumer                          | 377,137       | 386,452              | 388,311       |
| Total noncommercial loans         | 3,690,321     | 3,604,950            | 3,515,398     |
| Total originated loans and leases | 12,415,023    | 12,104,298           | 11,655,469    |
| Total loans and leases            | \$13,524,956  | \$13,133,724         | \$13,098,805  |

At June 30, 2014, total acquired loans increased \$80.5 million, or 7.8 percent, compared to December 31, 2013 and decreased \$333.4 million, or 23.1 percent compared to June 30, 2013. The increase in acquired loans from December 31, 2013 is attributable to the 1st Financial merger, which resulted in additional acquired loans totaling \$291.7 million at June 30, 2014, and is partially offset by continued loan run off. The decrease in the acquired portfolio from June 30, 2013 is due to continued loan run off.

Total originated loans increased \$310.7 million, or 2.6 percent, and \$759.6 million, or 6.5 percent compared to December 31, 2013 and June 30, 2013, respectively. The increases are primarily driven by increases in commercial mortgage, commercial and industrial and residential mortgage loans.

While the current economic conditions continue to suppress loan demand, we believe the 2014 growth to date points to general improvement in consumer confidence, and we expect originated loan growth to continue for the remainder of 2014.

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Allowance for Loan and Lease Losses

At June 30, 2014, the allowance for loan and lease losses allocated to originated loans totaled \$176.9 million, or 1.43 percent of originated loans and leases, compared to \$179.9 million, or 1.49 percent, and \$181.8 million, or 1.56 percent, at December 31, 2013 and June 30, 2013, respectively. An additional allowance of \$29.3 million relates to acquired loans at June 30, 2014, compared to \$53.5 million at December 31, 2013 and \$76.5 million at June 30, 2013.

Management considers the allowance adequate to absorb estimated inherent losses that relate to loans and leases outstanding at June 30, 2014, although future adjustments may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan and lease losses. Such agencies may require adjustments to the allowance based on information available to them at the time of their examination.

BancShares recorded a \$7.3 million credit to provision for loan and lease losses during the second quarter of 2014, compared to a credit to provision expense of \$13.2 million in the same quarter of 2013. For the six months ended June 30, 2014, the credit to provision for loan and lease losses totaled \$9.2 million in comparison to \$31.8 million credit for the same period of 2013. The credit for acquired loans totaled \$9.5 million and \$11.8 million during the second quarter and first six months of 2014, respectively, compared to credits of \$15.5 million and \$38.1 million for the same periods of 2013. The quarter over quarter and year-to-date change is the result of loan runoff and repayments. Provision expense for originated loans totaled \$2.2 million and \$2.6 million during the second quarter and first six months of 2014, respectively, compared to \$2.2 million and \$6.2 million during the same periods of 2013, the result of credit quality improvements in the originated loan portfolio and a reduction in net charge-offs.

Net charge-offs for originated loans equaled \$3.3 million and \$5.6 million during the second quarter and first six months of 2014, respectively, compared to \$4.4 million and \$10.9 million during the same periods of 2013. On an annualized basis, net charge-offs represented 0.11 percent and 0.09 percent of average originated loans and leases during the second quarter and first six months of 2014, respectively, compared to 0.15 percent and 0.19 percent during the same periods of 2013. Net charge-offs on acquired loans equaled \$6.1 million and \$12.4 million in the second quarter and first six months of 2014, respectively, compared to \$4.5 million and \$25.3 million recorded in the same periods of 2013. Loss estimates for most acquired loans are made at the individual loan level using loan-specific information. Therefore, fluctuations in charge-off levels on acquired loans are indicative of updated cash flow information but are not indicative of future performance of other acquired loans.



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Table 10

## Allowance for Loan and Lease Losses (ALLL)

| (Dollars in thousands)  | 2014           |               | 2013           |               | Six months ended June 30 |             |             |
|---|----------------|---------------|----------------|---------------|--------------------------|-------------|-------------|
|   | Second Quarter | First Quarter | Fourth Quarter | Third Quarter | Second Quarter           | 2014        | 2013        |
| ALLL at beginning of period   | \$222,942      | \$233,394     | \$237,799      | \$258,316     | \$273,019                | \$233,394   | \$319,018   |
| Reclassification of reserve due to implementation of enhanced model (1) | —              | —             | —              | —             | 7,368                    | —           | 7,368       |
| Provision (credit) for loan and lease losses:                           |                |               |                |               |                          |             |             |
| Acquired loans  | (9,529)        | (2,273)       | (834)          | (12,615)      | (15,473)                 | (11,802)    | (38,095)    |
| Originated loans  | 2,230          | 370           | 8,110          | 4,932         | 2,231                    | 2,600       | 6,247       |
| Net charge-offs of loans and leases:                                    |                |               |                |               |                          |             |             |
| Charge-offs   | (10,904)       | (10,676)      | (13,494)       | (14,628)      | (10,960)                 | (21,580)    | (39,904)    |
| Recoveries  | 1,507          | 2,127         | 1,813          | 1,794         | 2,131                    | 3,634       | 3,682       |
| Net charge-offs of loans and leases                                     | (9,397)        | (8,549)       | (11,681)       | (12,834)      | (8,829)                  | (17,946)    | (36,222)    |
| ALLL at end of period   | \$206,246      | \$222,942     | \$233,394      | \$237,799     | \$258,316                | \$206,246   | \$258,316   |
| ALLL at end of period allocated to loans and leases:                    |                |               |                |               |                          |             |             |
| Acquired  | \$29,331       | \$44,993      | \$53,520       | \$59,517      | \$76,534                 | \$29,331    | \$76,534    |
| Originated  | 176,915        | 177,949       | 179,874        | 178,282       | 181,782                  | 176,915     | 181,782     |
| ALLL at end of period   | \$206,246      | \$222,942     | \$233,394      | \$237,799     | \$258,316                | \$206,246   | \$258,316   |
| Net charge-offs of loans and leases:                                    |                |               |                |               |                          |             |             |
| Acquired  | \$6,133        | \$6,254       | \$5,163        | \$4,402       | \$4,466                  | \$12,387    | \$25,343    |
| Originated  | 3,264          | 2,295         | 6,518          | 8,432         | 4,363                    | 5,559       | 10,879      |
| Total net charge-offs   | \$9,397        | \$8,549       | \$11,681       | \$12,834      | \$8,829                  | \$17,946    | \$36,222    |
| Reserve for unfunded commitments <sup>(1)</sup>                         | \$380          | \$324         | \$357          | \$375         | \$376                    | \$380       | \$376       |
| Average loans and leases:   |                |               |                |               |                          |             |             |
| Acquired  | \$1,183,464    | \$1,282,816   | \$1,086,469    | \$1,310,010   | \$1,535,796              | \$1,249,989 | \$1,616,348 |
| Originated  | 12,383,148     | 12,177,129    | 12,002,167     | 11,801,700    | 11,631,784               | 12,263,591  | 11,612,019  |
| Loans and leases at period-end:   |                |               |                |               |                          |             |             |
| Acquired  | 1,109,933      | 1,270,818     | 1,029,426      | 1,188,281     | 1,443,336                | 1,109,933   | 1,443,336   |
| Originated  | 12,415,023     | 12,200,226    | 12,104,298     | 11,884,585    | 11,655,469               | 12,415,023  | 11,655,469  |
| Ratios  |                |               |                |               |                          |             |             |

## Net charge-offs

(annualized) to average  
loans and leases:

|                                 |      |        |        |        |        |        |        |   |
|---------------------------------|------|--------|--------|--------|--------|--------|--------|---|
| Acquired                        | 2.08 | % 1.98 | % 1.89 | % 1.33 | % 1.17 | % 2.00 | % 3.16 | % |
| Originated                      | 0.11 | 0.08   | 0.22   | 0.28   | 0.15   | 0.09   | 0.19   |   |
| ALLL to total loans and leases: |      |        |        |        |        |        |        |   |
| Acquired                        | 2.64 | 3.54   | 5.20   | 5.01   | 5.30   | 2.64   | 5.30   |   |
| Originated                      | 1.43 | 1.46   | 1.49   | 1.50   | 1.56   | 1.43   | 1.56   |   |

<sup>(1)</sup> During the second quarter of 2013, BancShares enhanced its ALLL model that included estimated losses on unfunded commitments. As a result of these modifications, \$7.4 million of the balance previously reported as a reserve of unfunded commitments was reclassified to the ALLL.

## Asset Quality

Asset quality continues to be very strong as we continue to ensure appropriate underwriting standards are followed and all nonperforming assets are managed appropriately. Nonperforming assets include nonaccrual loans and leases and OREO resulting from both acquired and originated loans.

As of June 30, 2014, BancShares' nonperforming assets amounted to \$175.8 million, a decrease of \$62.0 million from \$237.8 million at June 30, 2013. Nonperforming assets as a percentage of total loans and leases plus OREO amounted to 1.29 percent, compared to 1.80 percent at June 30, 2013. Of the \$175.8 million in nonperforming assets at June 30, 2014, \$94.2 million related to acquired covered loans and OREO, \$9.4 million related to acquired non-covered loans and OREO, and \$72.2 million relates to originated loans and OREO. Acquired nonperforming assets for the second quarter decreased \$28.1 million, or 21.4 percent, when compared to the second quarter of 2013. Acquired covered nonperforming assets represent 10.97 percent of acquired covered loans and OREO, compared to 7.02 percent and 8.62 percent as of December 31, 2013 and June 30, 2013,

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respectively. Originated nonperforming assets represented 0.58 percent of originated loans and leases plus OREO as of June 30, 2014, in comparison to 0.74 percent and 0.91 percent as of December 31, 2013 and June 30, 2013, respectively, due to a reduction in originated nonaccrual loans.

Nonperforming assets as a percentage of total loans and leases plus OREO amounted to 1.29 percent at June 2014 compared to 1.25 percent at December 31, 2013. Total originated nonperforming assets decreased \$17.8 million during the second quarter of 2014 in comparison to December 31, 2013. Originated nonperforming assets represented 0.58 percent of originated loans and leases plus OREO as of June 30, 2014, in comparison to 0.74 percent at December 31, 2013. The change is primarily a result of overall reduction in originated OREO balances. Acquired covered nonperforming assets represented 10.97 percent of originated loans and leases plus OREO as of June 30, 2014, in comparison to 7.02 percent at December 31, 2013.

Table 11  
Nonperforming Assets

| (Dollars in thousands)   | 2014              |                  | 2013              |                  | Second<br>Quarter |   |
|--|-------------------|------------------|-------------------|------------------|-------------------|---|
|  | Second<br>Quarter | First<br>Quarter | Fourth<br>Quarter | Third<br>Quarter |                   |   |
| Risk Elements  |                   |                  |                   |                  |                   |   |
| Nonaccrual loans and leases:   |                   |                  |                   |                  |                   |   |
| Acquired   | \$54,036          | \$52,108         | \$28,493          | \$29,194         | \$46,892          |   |
| Originated   | 46,485            | 46,952           | 53,170            | 66,840           | 69,133            |   |
| Other real estate:   |                   |                  |                   |                  |                   |   |
| Acquired covered   | 40,136            | 41,855           | 47,081            | 58,769           | 84,833            |   |
| Acquired not covered   | 9,406             | 10,664           | —                 | —                | —                 |   |
| Originated   | 25,745            | 33,840           | 36,898            | 40,338           | 36,942            |   |
| Total nonperforming assets   | \$175,808         | \$185,419        | \$165,642         | \$195,141        | \$237,800         |   |
| Nonperforming assets:  |                   |                  |                   |                  |                   |   |
| Acquired covered   | \$94,172          | \$93,963         | \$75,574          | \$87,963         | \$131,725         |   |
| Acquired not covered   | 9,406             | 10,664           | —                 | —                | —                 |   |
| Originated   | 72,230            | 80,792           | 90,068            | 107,178          | 106,075           |   |
| Total nonperforming assets   | \$175,808         | \$185,419        | \$165,642         | \$195,141        | \$237,800         |   |
| Accruing loans and leases greater than 90 days past due:               |                   |                  |                   |                  |                   |   |
| Acquired   | \$69,660          | \$137,102        | \$193,892         | \$205,847        | \$253,935         |   |
| Originated   | 9,872             | 9,471            | 8,784             | 9,363            | 11,187            |   |
| Nonperforming assets to total loans and leases plus other real estate: |                   |                  |                   |                  |                   |   |
| Acquired covered   | 10.97             | % 9.34           | % 7.02            | % 7.05           | % 8.62            | % |
| Acquired not covered   | 3.12              | 3.36             | —                 | —                | —                 |   |
| Originated   | 0.58              | 0.66             | 0.74              | 0.90             | 0.91              |   |
| Total  | 1.29              | 1.37             | 1.25              | 1.48             | 1.80              |   |

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## Troubled Debt Restructurings

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

Table 12

## Troubled Debt Restructurings

| (Dollars in thousands) | June 30, 2014 | December 31, 2013 | June 30, 2013 |
|------------------------|---------------|-------------------|---------------|
| Accruing TDRs:         |               |                   |               |
| Acquired               | \$62,592      | \$90,829          | \$131,156     |
| Originated             | 93,904        | 85,126            | 84,617        |
| Total accruing TDRs    | 156,496       | 175,955           | 215,773       |
| Nonaccruing TDRs:      |               |                   |               |
| Acquired               | 17,861        | 11,479            | 27,338        |
| Originated             | 21,564        | 19,322            | 34,490        |
| Total nonaccruing TDRs | 39,425        | 30,801            | 61,828        |
| All TDRs:              |               |                   |               |
| Acquired               | 80,453        | 102,308           | 158,494       |
| Originated             | 115,468       | 104,448           | 119,107       |
| Total TDRs             | \$195,921     | \$206,756         | \$277,601     |

## Interest-Bearing Liabilities

Interest-bearing liabilities include interest-bearing deposits, short-term borrowings and long-term obligations. Interest-bearing liabilities totaled \$13.88 billion as of June 30, 2014, and June 30, 2013, and an increase of \$230.1 million since December 31, 2013. The increase from December 31, 2013 is primarily due to the increase in interest-bearing deposits as a result of organic growth and the 1st Financial acquisition.

## Deposits

At June 30, 2014, total deposits equaled \$18.56 billion, an increase of \$682.7 million, or 3.8 percent, since December 31, 2013 and an increase of \$538.7 million, or 3.0 percent, since June 30, 2013. The increase from both periods resulted from the 1<sup>st</sup> Financial merger and additional organic growth in legacy markets.

Due to our focus on maintaining a strong liquidity position, core deposit retention remains a key business objective. We believe that traditional bank deposit products remain an attractive option for many customers, but as economic conditions improve, we recognize that our liquidity position could be adversely affected as bank deposits are withdrawn and invested elsewhere. Our ability to fund future loan growth is dependent on our success at retaining existing deposits and generating new deposits at a reasonable cost.

## Short-Term Borrowings

At June 30, 2014, short-term borrowings totaled \$788.5 million compared to \$581.9 million and \$511.4 million as of June 30, 2013 and December 31, 2013, respectively. The increase in short-term borrowings is due to subordinated debt with maturities less than one year being reclassified from long-term obligations.

## Long-Term Obligations

Long-term obligations equaled \$314.5 million at June 30, 2014, down \$128.8 million and \$196.2 million from June 30, 2013 and December 31, 2013, respectively. The decrease is primarily the result of subordinated debt of \$125.0 million with maturities less than one year being reclassified to short-term borrowings.

At June 30, 2014, December 31, 2013 and June 30, 2013, long-term obligations included \$96.4 million in junior subordinated debentures representing obligations to FCB/NC Capital Trust III, a special purpose entity and the grantor trust for \$93.5 million of trust preferred securities. FCB/NC Capital Trust III's trust preferred securities mature in 2036 and may be redeemed at par in whole or in part at any time. BancShares has guaranteed all obligations of FCB/NC Capital Trust III. The proceeds from the trust preferred securities were used to purchase the junior subordinated debentures issued by BancShares.

#### Shareholders' Equity and Capital Adequacy

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

In accordance with accounting principles generally accepted in the United States of America (GAAP), unrealized gains and losses on certain assets and liabilities and adjustment for pension funded status, net of deferred taxes, are included in accumulated other comprehensive income within shareholder's equity and directly impact the calculation of our capital ratios. In the aggregate, these items represented a net increase in shareholders' equity of \$4.1 million at June 30, 2014, compared to net reductions of \$100.2 million at June 30, 2013. The \$104.2 million favorable impact on shareholders' equity from June 30, 2013, reflects the combined impact of changes in the funded status of the pension plan and unrealized gains on investment securities available for sale.

Table 13  
Analysis of Capital Adequacy

|                           | June 30, 2014 | December 31,<br>2013 | June 30, 2013 | Regulatory<br>minimum | Well-capitalized<br>requirement |   |
|---------------------------|---------------|----------------------|---------------|-----------------------|---------------------------------|---|
| <b>BancShares</b>         |               |                      |               |                       |                                 |   |
| Risk-based capital ratios |               |                      |               |                       |                                 |   |
| Tier 1 capital            | 14.61         | % 14.92              | % 14.91       | % 4.00                | % 6.00                          | % |
| Total capital             | 15.95         | 16.42                | 16.41         | 8.00                  | 10.00                           |   |
| Tier 1 leverage ratio     | 9.71          | 9.82                 | 9.68          | 3.00                  | 5.00                            |   |
| <b>Bank</b>               |               |                      |               |                       |                                 |   |
| Risk-based capital ratios |               |                      |               |                       |                                 |   |
| Tier 1 capital            | 13.88         | % 14.14              | % 14.42       | % 4.00                | % 6.00                          | % |
| Total capital             | 15.13         | 15.57                | 15.86         | 8.00                  | 10.00                           |   |
| Tier 1 leverage ratio     | 9.28          | 9.36                 | 9.43          | 3.00                  | 5.00                            |   |

BancShares continues to exceed minimum capital standards and FCB remains well-capitalized.

In July 2013, Bank regulatory agencies approved new global regulatory capital guidelines (Basel) aimed at strengthening existing capital requirements for bank holding companies through a combination of higher minimum capital requirements, new capital conservation buffers and more conservative definitions of capital and balance sheet exposure. BancShares will be subject to the requirements of Basel effective January 1, 2015, subject to a transition period for several aspects of the rule.

Under the revised rules, BancShares' tier 1 common equity ratio based on the current tier 1 capital and risk-weighted assets calculations, excluding trust preferred securities, would be 13.96 percent at June 30, 2014, compared to the fully phased-in, well-capitalized minimum of 9.0 percent, which includes the 2.5 percent minimum conservation buffer. Management continues to monitor Basel developments and remains committed to managing our capital levels in a prudent manner. The proposed tier 1 common equity ratio is calculated in Table 14.

Table 14

Tier 1 Common Equity

(Dollars in thousands)

|                               | June 30, 2014 |  |
|-------------------------------|---------------|--|
| Tier 1 capital                | \$2,125,528   |  |
| Less: restricted core capital | 93,500        |  |
| Tier 1 common equity          | \$2,032,028   |  |
| Risk-adjusted assets          | \$14,551,757  |  |

|                            |       |   |
|----------------------------|-------|---|
| Tier 1 common equity ratio | 13.96 | % |
|----------------------------|-------|---|

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## Table 15

## BASEL Capital Requirements

This table describes the minimum and well-capitalized requirements for the transitional period beginning during 2016 and the fully phased-in requirements that become effective during 2019.

| Basel final rules                            | Basel minimum | Basel            | Basel minimum | Basel            |
|--|---------------|------------------|---------------|------------------|
|  | requirement   | well-capitalized | requirement   | well-capitalized |
|  | 2016          | 2016             | 2019          | 2019             |
| Leverage ratio                               | 4.00          | % 5.00           | % 4.00        | % 5.00           |
| Common equity tier 1                         | 4.50          | 6.50             | 4.50          | 6.50             |
| Common equity plus conservation buffer       | 5.13          | 7.13             | 7.00          | 9.00             |
| Tier 1 capital ratio                         | 6.00          | 8.00             | 6.00          | 8.00             |
| Total capital ratio                          | 8.00          | 10.00            | 8.00          | 10.00            |
| Total capital ratio plus conservation buffer | 8.63          | 10.63            | 10.50         | 12.50            |

## RISK MANAGEMENT

Effective risk management is critical to our success. The board of directors has established a Risk Committee that provides oversight of enterprise-wide risk management. The Risk Committee is responsible for establishing risk appetite and supporting tolerances for credit, market and operational risk and ensuring that risk is managed within those tolerances, monitoring compliance with laws and regulations, reviewing the investment securities portfolio to ensure that portfolio returns are managed within market risk tolerance and monitoring our legal activity and associated risk. With guidance from and oversight by the Risk Committee, management continually refines and enhances its risk management policies and procedures to maintain effective risk management programs and processes.

Mortgage reform rules mandated by the Dodd-Frank Act became effective in January 2014, requiring lenders to make a reasonable, good faith determination of a borrower's ability to repay any consumer credit transaction secured by a dwelling and to limit prepayment penalties. Increased risks of legal challenge, private right of action and regulatory enforcement are presented by these rules. BancShares implemented the required system, process, procedural and product changes prior to the effective date of the new rules. We have also modified our underwriting standards to ensure compliance with the ability to repay requirements and have determined that we will continue to offer both qualified and non-qualified mortgage products. Historical performance and conservative underwriting of impacted loan portfolios mitigates the risks of non-compliance.

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

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

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



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Table 16

## Net Interest Income Sensitivity Simulation Analysis

This table provides the impact on net interest income resulting from various interest rate shock scenarios as of June 30, 2014 and December 31, 2013.

| Change in interest rate (basis point) | Estimated increase in net interest income |                   |   |
|---------------------------------------|---|-------------------|---|
|                                       | June 30, 2014                             | December 31, 2013 |   |
| +100                                  | 3.37                                      | % 2.95            | % |
| +200                                  | 4.33                                      | 4.56              |   |
| +300                                  | 1.22                                      | 3.62              |   |

Table 17

## Economic Value of Equity Modeling Analysis

Long-term interest rate risk exposure is measured using the economic value of equity (EVE) sensitivity analysis to study the impact of long-term cash flows on earnings and capital. EVE involves discounting cash flows of balance sheet items under different interest rate scenarios. EVE represents the difference between the sum of the present value of all asset cash flows and the sum of the present value of the liability cash flows. Cash flows will vary by interest rate scenario, resulting in variations in EVE. The amount of base-case measurement and its sensitivity to shifts in the yield curve allow management to measure longer-term repricing and option risk in the balance sheet. This table presents the EVE profile as of June 30, 2014 and December 31, 2013.

| Change in interest rate (basis point) | Estimated increase (decrease) in EVE |                   |   |
|---------------------------------------|--------------------------------------|-------------------|---|
|                                       | June 30, 2014                        | December 31, 2013 |   |
| +100                                  | 3.55                                 | % 2.68            | % |
| +200                                  | 2.84                                 | 0.70              |   |
| +300                                  | (1.13                                | ) (3.05           | ) |

We do not typically utilize interest rate swaps, floors, collars or other derivative financial instruments to attempt to hedge our overall balance sheet rate sensitivity and interest rate risk. However, we have entered into an interest rate swap to synthetically convert the variable rate on \$93.5 million of junior subordinated debentures to a fixed rate of 5.50 percent through June 2016. The interest rate swap qualifies as a hedge under GAAP. See Note K to the Consolidated Financial Statements, "Derivatives," for additional discussion of this interest rate swap.

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

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

- Tactical liquidity measures the risk of a negative cash flow position whereby cash outflows exceed cash inflows over a short-term horizon out to nine weeks;
- Structural liquidity measures the amount by which illiquid assets are supported by long-term funding; and
-

Contingent liquidity utilizes cash flow stress testing across three crisis scenarios to determine the adequacy of our liquidity.

We aim to maintain a diverse mix of existing and potential liquidity sources to support the liquidity management function. At its core is a reliance on the retail deposit book, due to the generally stable balances and low cost it offers. Other sources of liquidity include asset-based liquidity in the form of cash and unencumbered securities, as well as access to wholesale funding from external counterparties, primarily FHLB advances and Federal Funds lines. We aim to avoid funding concentrations by diversifying our external funding with respect to maturities, counterparties and nature (i.e. secured versus unsecured).

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One of our principal sources of noncore funding is advances from the Federal Home Loan Bank (FHLB) of Atlanta. Outstanding FHLB advances equaled \$250.3 million as of June 30, 2014, and we had sufficient collateral pledged to secure \$1.11 billion of additional borrowings. Additionally, we maintain Federal Funds lines and other borrowing facilities. At June 30, 2014, BancShares had access to \$665.0 million in unsecured borrowings through various sources.

Free liquidity includes cash on deposit at various banks, overnight investments and the unpledged portion of investment securities available for sale, all of which can be easily converted to cash. Free liquidity totaled \$3.73 billion at June 30, 2014 compared to \$3.39 billion at December 31, 2013.

### CRITICAL ACCOUNTING POLICIES

There have been no significant changes in our Critical Accounting Policies as described in our 2013 Annual Report on Form 10-K.

### FORWARD-LOOKING STATEMENTS

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

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

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

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

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

Market risk is the potential economic loss resulting from changes in market prices and interest rates. This risk can either result in diminished current fair values of financial instruments or reduced net interest income in future periods. As of June 30, 2014, BancShares’ market risk profile has not changed significantly from December 31, 2013, as discussed in the Form 10-K. Changes in fair value that result from movement in market rates cannot be predicted with any degree of certainty. Therefore, the impact that future changes in market rates will have on the fair values of financial instruments is uncertain.

### Item 4. Controls and Procedures

BancShares’ management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of BancShares’ disclosure controls and procedures as of the

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

No change in BancShares' internal control over financial reporting occurred during the second quarter of 2014 that had materially affected or is reasonably likely to materially affect, BancShares' internal control over financial reporting.

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PART II

Item 1. Legal Proceedings

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

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

Item 1A. Risk Factors

Except as discussed below, there have been no material changes from the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2013.

Additional risks and uncertainties that are not currently known or that management does not currently deem to be material could also have a material adverse impact on our financial condition, the results of our operations or our business. If such risks and uncertainties were to become reality or the likelihood of those risks was to increase, the market price of our common stock could decline significantly.

Proposed merger with First Citizens Bancorporation, Inc.

On June 10, 2014, BancShares entered into an Agreement and Plan of Merger (the "Merger Agreement") with First Citizens Bancorporation, Inc., a Bancorporation Carolina corporation ("Bancorporation"), pursuant to which Bancorporation will merge with and into BancShares. The Merger Agreement provides that each share of Bancorporation common stock will be converted into the right to receive 4.00 shares of BancShares' Class A common stock and \$50.00 cash, unless the holder elects for each share of such holder's Bancorporation common stock to be converted into the right to receive 3.58 shares of BancShares' Class A common stock and 0.42 shares of BancShares' Class B common stock.

The Merger Agreement has been approved by the independent members of the Board of Directors of each company following a recommendation by a special committee of independent members the board of each company. Subject to certain conditions, including the receipt of shareholder and regulatory approvals, the merger is expected to be completed in the fourth quarter of 2014.

On July 17, 2014, as amended August 6, 2014, BancShares filed a Registration Statement on Form S-4 with the Securities and Exchange Commission. Within that Form S-4, BancShares has identified various risk factors that are related to the proposed Merger.

Certain Risk Factors Relating to the Proposed Merger

The market price of BancShares common stock may fluctuate, which could affect the approval of the merger by Bancorporation's shareholders. Under the terms of the Merger Agreement, each share of Bancorporation common stock outstanding immediately prior to the effective time of the merger (with certain exceptions) will be converted into the right to receive 4.0 shares of BancShares Class A common stock and \$50.00 in cash, unless the holder of such share elects, pursuant to a letter of transmittal that will be delivered after closing of the merger, for each share of such holder's Bancorporation common stock to be converted into the right to receive 3.58 shares of BancShares Class A common stock and 0.42 shares of BancShares Class B common stock. Cash will be paid in lieu of issuing fractional shares of BancShares common stock. The value of the shares of BancShares Class A common stock and BancShares Class B common stock to be issued to Bancorporation shareholders in the merger may fluctuate between now and the

closing date of the merger due to a variety of factors, including general market and economic conditions, changes in the parties' respective businesses, operations and prospects, and regulatory considerations, among other things. Many of these factors are beyond the control of BancShares and Bancorporation. A decrease in the value of BancShares' common stock could cause Bancorporation's shareholders to withhold their approval of the merger. There can be no assurance as to whether or when the merger will be completed.

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BancShares may fail to realize all of the anticipated benefits and cost savings of the merger.

The success of the merger will depend on, among other things, BancShares' ability to realize anticipated cost savings and to combine the businesses of BancShares and Bancorporation in a manner that does not materially disrupt the existing customer relationships of either BancShares or Bancorporation or result in decreased revenues from customers of either of them. If BancShares is not able to successfully achieve these objectives, then the anticipated benefits and cost savings of the merger may not be realized fully, if at all, or may take longer to realize than expected. BancShares and Bancorporation have operated and, until the completion of the merger, will continue to operate, independently. It is possible that the integration process could result in the loss of key employees, the disruption of either BancShares' or Bancorporation's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect the ability of BancShares or Bancorporation to maintain relationships with their respective clients, customers, depositors and employees or to achieve the anticipated benefits and cost savings of the merger. The loss of key employees could adversely affect BancShares' ability to successfully conduct its business in the markets in which Bancorporation now operates, which could have an adverse effect on BancShares' financial results and the value of its stock. Integration efforts by BancShares and Bancorporation will also divert management attention and resources. These integration matters could have an adverse effect on each of BancShares and Bancorporation during the transition period and on the combined company for an undetermined period following completion of the merger. Additionally, the actual benefits and cost savings of the merger could be less than anticipated.

Completion of the merger is subject to many conditions and if these conditions are not satisfied or, where permissible, waived, the merger will not be completed.

The obligations of BancShares and Bancorporation to complete the merger are subject to satisfaction or, where permissible, waiver of a number of conditions, including, among others: (i) the adoption of the merger agreement by BancShares stockholders and Bancorporation shareholders, (ii) the approval of the BancShares charter amendment proposal by BancShares stockholders, (iii) receipt of approval of various governmental authorities without the imposition of a burdensome condition, (iv) the authorization for listing on the NASDAQ Global Select Market of the shares of BancShares Class A common stock to be issued in the merger, (v) the effectiveness of the Registration Statement on Form S-4 filed by BancShares and the absence of any stop order suspending the effectiveness of that Registration Statement (or proceedings for that purpose initiated or threatened by the SEC and not withdrawn), (vi) the absence of any order, injunction or decree by any court or agency of competent jurisdiction or other legal restraint or prohibition preventing the consummation of the merger, the bank merger or any of the other material transactions contemplated by the merger agreement, (vii) the absence of any statute, rule, regulation, order, injunction or decree enacted, entered, promulgated or enforced by any governmental entity that prohibits or makes illegal consummation of the merger, the bank merger or any of the other material transactions contemplated by the merger agreement, (viii) the accuracy of the representations and warranties of each other party in the merger agreement as of the day on which the merger is completed, subject to the materiality standards provided in the merger agreement and the performance of the other party in all material respects of all obligations required to be performed by it at or prior to the effective time of the merger under the merger agreement (and the receipt by each party of certificates from the other party to such effect), (ix) receipt by each party of an opinion of legal counsel as to certain tax matters, (x) the absence of any events or occurrences that, individually or in the aggregate, have had or would reasonably be expected to have a material adverse effect on the other party, and (xi) a majority of the shares held by the minority holders of Bancorporation common stock must not have voted against the merger. There can be no assurance that the conditions to closing of the merger will be satisfied or, where permissible, waived, or that the merger will be completed. Further, it is possible that one or more of the conditions to closing the merger will not be met and that the board of directors of the party for whom the condition exists will waive the condition, allowing the merger to be completed.

Termination of the merger agreement or failure to complete the merger after approval by Bancorporation shareholders could negatively impact BancShares or Bancorporation.

If the merger agreement is terminated, there may be various consequences. For example, BancShares' or Bancorporation's businesses may have been affected adversely by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the

merger. Additionally, if the merger agreement is terminated, the market price of BancShares' or Bancorporation's common stock could decline to the extent that the current market prices reflect a market assumption that the merger will be completed. If the merger agreement is terminated under specified circumstances, Bancorporation has agreed to pay BancShares a termination fee of \$6,450,000, \$10,000,000 or \$22,574,000 (and in certain instances, BancShares' documented expenses), depending on the timing and circumstances of the termination.



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BancShares and Bancorporation will be subject to business uncertainties and contractual restrictions while the merger is pending.

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on BancShares and/or Bancorporation. These uncertainties may impair BancShares and/or Bancorporation's ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with Bancorporation to seek to change existing business relationships with Bancorporation. Retention of certain employees by Bancshares or Bancorporation may be challenging while the merger is pending, as certain employees may experience uncertainty about their future roles with Bancorporation or BancShares. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with Bancorporation or BancShares, Bancorporation's and/or BancShares' businesses could be harmed.

BancShares and Bancorporation will incur significant transaction and merger-related costs in connection with the merger.

BancShares expects to incur a number of costs associated with the merger and combining the operations of the two companies. The substantial majority of expenses will be comprised of transaction costs related to the merger. The significant costs associated with the merger include, among others, fees and expenses of financial advisors and other advisors and representatives, certain employment-related costs relating to employees of Bancorporation, filing fees and printing costs required by applicable law and regulations. Some of these costs have already been incurred or may be incurred regardless of whether the merger is consummated, including a portion of the fees and expenses of financial advisors and other advisors and representatives and filing fees. BancShares also will incur transaction fees and costs related to formulating and implementing integration plans with respect to the two companies, including facilities and systems consolidation costs. BancShares continues to assess the magnitude of these costs, and additional unanticipated costs may be incurred in the merger and the integration of the two companies' businesses. Although BancShares expects that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, should allow BancShares to offset integration-related costs over time, this net benefit may not be achieved in the near term or at all.

The merger will result in an increase in the number of shares of BancShares Class A common stock and BancShares Class B common stock available for trading, which could depress the price of such shares and increase the volatility of the price of such shares, both before and after completion of the merger.

The merger will increase the number of shares of BancShares Class A common stock and BancShares Class B common stock available for sale in the public markets. As of June 30, 2014, approximately 8,586,058 shares of BancShares Class A common stock and 1,032,883 shares of BancShares Class B common stock were outstanding. Because Bancorporation shareholders are entitled to elect whether to exchange their shares of Bancorporation common stock for BancShares Class A common stock and cash or a combination of BancShares Class A common stock and BancShares Class B common stock, the number of new shares of BancShares Class A common stock and new shares of BancShares Class B common stock that will be issued to holders of Bancorporation common stock and become immediately available for sale following the merger is unknown.

Sales of large amounts of shares of BancShares Class A common stock or BancShares Class B common stock could depress the market price of BancShares Class A common stock or BancShares Class B common stock, respectively. In addition, the potential that such sales may occur could depress prices, even in advance of such sales. Neither BancShares nor Bancorporation can predict the effects that any such sales, or the perception that such sales could occur, will have on the price of BancShares common stock, either before or after completion of the merger.

Regulatory approvals may not be received, may take longer than expected or may impose conditions that are not presently anticipated or cannot be met.

Before the transactions contemplated by the merger agreement, including the BancShares and Bancorporation merger and the bank merger, may be completed, various approvals must be obtained from bank regulatory authorities. These governmental entities may impose conditions on the granting of such approvals. Such conditions and the process of obtaining regulatory approvals could have the effect of delaying consummation of the merger(s) or of imposing additional costs or limitations on BancShares following the merger(s). The regulatory approvals may not be received at all, may not be received in a timely fashion, and may contain conditions on the completion of the merger that are

not anticipated or cannot be met. If the consummation of the merger(s) is delayed, including by a delay in receipt of necessary governmental approvals, the business, financial condition and results of operations of each company may also be materially adversely affected.

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BancShares is, and Bancorporation may be, subject to litigation in connection with the merger; an adverse ruling in any such lawsuit may prevent the merger from being completed.

BancShares and Bancorporation, and their respective directors and officers, may be subject to lawsuits challenging the merger. Following announcement of the merger, BancShares received a shareholder demand from the City of Providence pursuant to Section 220 of the Delaware General Corporation Law ("DGCL") for access to certain books and records of BancShares. The purported basis for the demand was to investigate potential breaches of fiduciary duty and other wrongdoing by BancShares' officers and directors in connection with the merger. The City of Providence concurrently filed a putative class action lawsuit in the Delaware Court of Chancery against BancShares and its directors challenging Article X, Section 8 of BancShares' bylaws, which requires certain litigation to be brought only in North Carolina courts to the fullest extent permitted by law. That Delaware complaint, captioned City of Providence v. First Citizens BancShares, Inc., et al., C. A. No. 9795, alleges that the bylaw violates the DGCL and that adoption of the bylaw constituted a breach of fiduciary duty by BancShares' directors. While not directly challenging the merger, the complaint contains allegations referencing the merger and seeks a declaration that any stockholder action regarding the merger may be brought in the Delaware Court of Chancery. On July 31, 2014, the City of Providence filed a second litigation in Delaware Court of Chancery challenging the merger and seeking to enjoin the BancShares stockholder vote, captioned City of Providence V. Holding, et al., C. A. No. 9988. BancShares and its directors have moved to dismiss both complaints.

If any litigation challenging the merger is successful, the relevant court may issue an order enjoining completion of the merger, which could prevent the merger from being completed or from being completed within the expected time-frame. Regardless of whether any claims are successful, such litigation is often expensive and diverts management's attention and resources, which could adversely affect the operation of BancShares' and/or Bancorporation's businesses.

### Risk Factors Relating to Technology:

Certain information security risks continue to receive attention from regulators and financial statement users and therefore have been included in the 10-Q.

We are subject to information security risks

We maintain and transmit large amounts of sensitive information electronically, including personal and financial information of our customers. In addition to our own systems, we also rely on external vendors to provide certain services and are, therefore, exposed to their information security risk. While we seek to mitigate internal and external information security risks, the volume of business conducted through electronic devices continues to grow, and our computer systems and network infrastructure, as well as the systems of external vendors and customers, present security risks and could be susceptible to hacking or identity theft.

We are also subject to risks arising from a broad range of attacks by doing business on the Internet, which arise from both domestic and international sources and seek to obtain customer information for fraudulent purposes or, in some cases, to disrupt business activities. Information security risks could result in reputational damage and lead to a material adverse impact on our business, financial condition and financial results of operations.

We continue to encounter technological change for which we expect to incur significant expense

The financial services industry continues to experience an increase in technological complexity required to provide a competitive array of products and services to customers. Our future success requires that we maintain technology and associated facilities that will support our ability to provide products and services that satisfactorily meet the banking and other financial needs of our customers. In 2013, we undertook projects to modernize our systems and associated facilities, strengthen our business continuity and disaster recovery efforts and reduce operational risk. As the projects have evolved over time, we have identified other areas that require infrastructure improvement. As a result of the expanded scope, BancShares has increased the total projected spend to approximately \$130 million. The projects will be implemented in phases over the next several years. If the projects' objectives are not achieved or if the cost of the projects is materially in excess of the estimate, our business, financial condition and financial results could be adversely impacted.

We rely on external vendors

Third party vendors provide key components of our business infrastructure, including certain data processing and information services. A number of our vendors are large national entities with dominant market presence in their respective fields, and their services could be difficult to quickly replace in the event of failure or other interruption in service. Failures of certain vendors to provide services for any reason could adversely affect our ability to deliver products and services to our customers. External

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vendors also present information security risk. We monitor vendor risks, including the financial stability of critical vendors. The failure of a critical external vendor could disrupt our business and cause us to incur significant expense.

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

**PURCHASES OF COMMON STOCK**

During the second quarter of 2013, our board granted authority to purchase up to 100,000 and 25,000 shares of Class A and Class B common stock, respectively, beginning on July 1, 2013 and continuing through June 30, 2014. As of June 30, 2014, no purchases had occurred pursuant to that authorization. This authorization terminated on June 30, 2014 and was not extended.

Item 6. Exhibits

31.1 Certification of Chief Executive Officer (filed herewith)

31.2 Certification of Chief Financial Officer (filed herewith)

32.1 Certification of Chief Executive Officer (filed herewith)

32.2 Certification of Chief Financial Officer (filed herewith)

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

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

Date: August 8, 2014

FIRST CITIZENS BANCSHARES, INC.  
(Registrant)

By: /s/ GLENN D. MCCOY  
Glenn D. McCoy  
Vice President and Chief Financial Officer