INTERNATIONAL BANCSHARES CORP
Form 10-Q
May 06, 2010

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended March 31, 2010**

**OR**

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

**For the transition period from to**

**Commission file number 000-09439**

# INTERNATIONAL BANCSHARES CORPORATION

(Exact name of registrant as specified in its charter)

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

**1200 San Bernardo Avenue, Laredo, Texas 78042-1359**

(Address of principal executive offices)

(Zip Code)

**(956) 722-7611**

(Registrant s telephone number, including area code)

**None**

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

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

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

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

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

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

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

| **Class** | **Shares Issued and Outstanding** |
|---|---|
| Common Stock, $1.00 par value | 68,103,977 shares outstanding at May 3, 2010 |

**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Condition (Unaudited)**

**(Dollars in Thousands)**

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 376,820 | $ 224,638 |
| Total cash and cash equivalents | 376,820 | 224,638 |
| Investment securities: | | |
| Held-to-maturity (Market value of $2,450 on March 31, 2010 and $2,450 on December 31, 2009) | 2,450 | 2,450 |
| Available-for-sale (Amortized cost of $3,584,389 on March 31, 2010 and $4,541,851 on December 31, 2009) | 3,665,904 | 4,644,083 |
| Total investment securities | 3,668,354 | 4,646,533 |
| Loans, net of unearned discounts | 5,567,985 | 5,667,262 |
| Less allowance for probable loan losses | (95,838) | (95,393) |
| Net loans | 5,472,147 | 5,571,869 |
| Bank premises and equipment, net | 484,917 | 490,375 |
| Accrued interest receivable | 35,945 | 41,731 |
| Other investments | 316,917 | 359,404 |
| Identified intangible assets, net | 21,101 | 22,358 |
| Goodwill, net | 282,532 | 282,532 |
| Other assets | 124,933 | 123,103 |
| Total assets | $ 10,783,666 | $ 11,762,543 |

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Condition, continued (Unaudited)**

**(Dollars in Thousands)**

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| **Liabilities and Shareholders Equity** | | |
| Liabilities: | | |
| Deposits: | | |
| Demand non-interest bearing | $ 1,588,972 | $ 1,516,799 |
| Savings and interest bearing demand | 2,334,051 | 2,262,552 |
| Time | 3,527,933 | 3,398,656 |
| Total deposits | 7,450,956 | 7,178,007 |
| Securities sold under repurchase agreements | 1,478,768 | 1,441,817 |
| Other borrowed funds | 99,575 | 1,347,625 |
| Junior subordinated deferrable interest debentures | 201,091 | 201,082 |
| Other liabilities | 141,242 | 186,542 |
| Total liabilities | 9,371,632 | 10,355,073 |
| Commitments, Contingent Liabilities and Other Tax Matters (Note 10) | | |
| Shareholders equity: | | |
| Series A Cumulative perpetual preferred shares, $.01 par value, $1,000 per share liquidation value. Authorized 25,000,000 shares; issued 216,000 shares on March 31, 2010, net of discount of $9,690 and issued 216,000 shares on December 31, 2009, net of discount of $10,258 | 206,310 | 205,742 |
| Common shares of $1.00 par value. Authorized 275,000,000 shares; issued 95,711,111 shares on March 31, 2010 and 95,711,111 shares on December 31, 2009 | 95,711 | 95,711 |
| Surplus | 161,410 | 161,258 |
| Retained earnings | 1,139,491 | 1,122,290 |
| Accumulated other comprehensive income | 52,521 | 65,878 |
| | 1,655,443 | 1,650,879 |
| Less cost of shares in treasury, 27,607,171 shares on March 31, 2010 and 27,607,171 shares on December 31, 2009 | (243,409) | (243,409) |
| Total shareholders equity | 1,412,034 | 1,407,470 |
| Total liabilities and shareholders equity | $ 10,783,666 | $ 11,762,543 |

See accompanying notes to consolidated financial statements.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Income (Unaudited)**

**(Dollars in Thousands, except per share data)**

| | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| Interest income: | | |
| Loans, including fees | $ 80,614 | $ 83,626 |
| Investment securities: | | |
| Taxable | 37,333 | 55,432 |
| Tax-exempt | 1,634 | 970 |
| Other interest income | 241 | 188 |
| Total interest income | 119,822 | 140,216 |
| Interest expense: | | |
| Savings deposits | 2,481 | 2,949 |
| Time deposits | 13,053 | 17,851 |
| Securities sold under repurchase agreements | 11,052 | 11,361 |
| Other borrowings | 311 | 6,685 |
| Junior subordinated interest deferrable debentures | 3,030 | 3,224 |
| Total interest expense | 29,927 | 42,070 |
| Net interest income | 89,895 | 98,146 |
| Provision for probable loan losses | 7,229 | 12,225 |
| Net interest income after provision for probable loan losses | 82,666 | 85,921 |
| Non-interest income: | | |
| Service charges on deposit accounts | 24,280 | 24,082 |
| Other service charges, commissions and fees | | |
| Banking | 11,620 | 10,397 |
| Non-banking | 1,668 | 1,427 |
| Investment securities transactions, net | 28,264 | 561 |
| Other investments, net | 3,357 | 3,432 |
| Other income | 2,408 | 2,113 |
| Total non-interest income | 71,597 | 42,012 |

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Income, continued (Unaudited)**

**(Dollars in Thousands, except per share data)**

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2010 | | 2009 | |
| Non-interest expense: | | | | |
| Employee compensation and benefits | $ | 31,664 | $ | 32,156 |
| Occupancy | | 8,518 | | 8,717 |
| Depreciation of bank premises and equipment | | 9,012 | | 9,036 |
| Professional fees | | 3,982 | | 2,606 |
| Deposit insurance assessments | | 2,544 | | 367 |
| Stationery and supplies | | 993 | | 837 |
| Amortization of identified intangible assets | | 1,301 | | 1,309 |
| Advertising | | 2,614 | | 2,613 |
| Litigation expense | | 21,803 | | |
| Impairment charges (Total other-than-temporary impairment charges, $19,095, net of $11,892 included in other comprehensive income) | | 7,203 | | |
| Other | | 15,943 | | 12,585 |
| Total non-interest expense | | 105,577 | | 70,226 |
| Income before income taxes | | 48,686 | | 57,707 |
| Provision for income taxes | | 16,640 | | 20,179 |
| Net income | $ | 32,046 | $ | 37,528 |
| Preferred Stock Dividends | | 3,268 | | 3,233 |
| Net income available to common shareholders | $ | 28,778 | $ | 34,295 |
| Basic earnings per common share: | | | | |
| Weighted average number of shares outstanding: | | 68,103,940 | | 68,602,478 |
| Net income | $ | .42 | $ | .50 |
| Fully diluted earnings per common share: | | | | |
| Weighted average number of shares outstanding: | | 68,205,891 | | 68,617,573 |
| Net income | $ | .42 | $ | .50 |

See accompanying notes to consolidated financial statements.

4

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Comprehensive Income (Unaudited)**

**(Dollars in Thousands)**

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Net income | $ 32,046 | $ 37,528 |
| Other comprehensive income, net of tax: | | |
| Net unrealized holding gains on securities available for sale arising during period (tax effects of $179 and $15,078) | 333 | 28,002 |
| Reclassification adjustment for gains on securities available for sale included in net income (tax effects of $(9,892) and $(196)) | (18,372) | (365) |
| Reclassification adjustment for impairment charges on available for sale securities included in net income (tax effects of $2,521 and $0) | 4,682 | |
| Comprehensive income | $ 18,689 | $ 65,165 |

See accompanying notes to consolidated financial statements.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows (Unaudited)**

**(Dollars in Thousands)**

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|---|---|
| Operating activities: | | |
| Net income | $ 32,046 | $ 37,528 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Provision for probable loan losses | 7,229 | 12,225 |
| Accretion of time deposit discounts | (4) | (4) |
| Depreciation of bank premises and equipment | 9,012 | 9,036 |
| (Gain) loss on sale of bank premises and equipment | (337) | 68 |
| Depreciation and amortization of leased assets | | 120 |
| Accretion of investment securities discounts | (428) | (505) |
| Amortization of investment securities premiums | 2,441 | 1,562 |
| Investment securities transactions, net | (28,264) | (561) |
| Impairment charges on available-for-sale investment securities | 7,203 | |
| Amortization of junior subordinated debenture discounts | 9 | 8 |
| Amortization of identified intangible assets | 1,301 | 1,309 |
| Stock based compensation expense | 152 | 142 |
| Earnings from affiliates and other investments | (2,723) | (3,148) |
| Deferred tax (expense) benefit | (11,510) | 4,403 |
| Decrease in accrued interest receivable | 5,786 | 4,025 |
| Net increase in other assets | (1,874) | (16,288) |
| Net decrease in other liabilities | (56,417) | (78,298) |
| Net cash used in operating activities | (36,378) | (28,378) |
| Investing activities: | | |
| Proceeds from maturities of securities | 200 | 8,236 |
| Proceeds from sales of available for sale securities | 945,670 | 18,675 |
| Purchases of available for sale securities | (200,133) | (21,448) |
| Principal collected on mortgage-backed securities | 247,833 | 281,768 |
| Net decrease in loans | 92,493 | 87,021 |
| Purchases of other investments | (14) | (3,674) |
| Distributions of other investments | 45,224 | 4,467 |
| Purchases of bank premises and equipment | (4,656) | (17,090) |
| Proceeds from sale of bank premises and equipment | 1,439 | 68 |
| Net cash provided by investing activities | 1,128,056 | 358,023 |

6

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows, continued (Unaudited)**

**(Dollars in Thousands)**

| | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| Financing activities: | | |
| Net increase in non-interest bearing demand deposits | $ 72,173 | $ 15,992 |
| Net increase in savings and interest bearing demand deposits | 71,499 | 4,284 |
| Net increase (decrease) in time deposits | 129,281 | (21,070) |
| Net increase in securities sold under repurchase agreements | 36,951 | 31,805 |
| Net decrease in other borrowed funds | (1,248,050) | (407,886) |
| Purchase of treasury stock | | (68) |
| Proceeds from stock transactions | | 68 |
| Payments of dividends on preferred stock | (1,350) | (1,560) |
| Net cash used in financing activities | (939,496) | (378,435) |
| Increase (decrease) in cash and cash equivalents | 152,182 | (48,790) |
| Cash and cash equivalents at beginning of period | 224,638 | 298,720 |
| Cash and cash equivalents at end of period | $ 376,820 | $ 249,930 |
| Supplemental cash flow information: | | |
| Interest paid | $ 29,716 | $ 45,309 |
| Income taxes paid | 4,120 | 6,100 |
| Accrued dividends, preferred shares | 1,350 | 1,140 |
| Dividends declared, not yet paid | 11,578 | |
| Purchases of available-for-sale securities not yet settled | 17,061 | 60,417 |

See accompanying notes to consolidated financial statements.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**(Unaudited)**

**Note 1 - Basis of Presentation**

The accounting and reporting policies of International Bancshares Corporation ( Corporation ) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company ) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo ( IBC ), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, IBC Capital Corporation and Premier Tierra Holdings, Inc. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2009 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

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

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

Effective June 30, 2009, the Company adopted Statement of Financial Accounting Standards No. 165 ( SFAS No. 165 ), Subsequent Events. SFAS No. 165 is currently included in the Codification under ASC Topic 855, Subsequent Events ( ASC 855 ). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855 defines (i) the period after the balance sheet date during which a reporting entity s management should evaluate events or

transactions that may occur for potential recognition or disclosure in the financial statements (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The adoption of the accounting standard did not have an impact on the Company s consolidated financial statements. The Company has evaluated all events or transactions that occurred through the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

**Note 2 Fair Value Measurements**

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

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

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

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

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

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value as of March 31, 2010 by level within the fair value measurement hierarchy:

| | | Fair Value Measurements at Reporting Date Using (in thousands) | | |
|---|---|---|---|---|
| | **Assets/Liabilities Measured at Fair Value March 31, 2010** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| *Measured on a recurring basis:* | | | | |
| Assets: | | | | |
| U.S. Treasury securities | | | | |
| Available-for-sale | $ 1,327 | $ | $ 1,327 | $ |
| Mortgage-backed securities | | | | |
| Available-for-sale | 3,495,566 | | 3,443,136 | 52,430 |
| States and political subdivisions | | | | |

| | | | | |
|---|---|---|---|---|
| Available-for-sale | 154,424 | | 154,424 | |
| Other | | | | |
| Available-for-sale | 14,587 | 14,587 | | |
| | | | | |
| *Measured on a non-recurring basis:* | | | | |
| Assets: | | | | |
| Impaired Loans | 73,060 | | | 73,060 |

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value as of December 31, 2009 by level within the fair value measurement hierarchy:

| | | Fair Value Measurements at Reporting Date Using (in thousands) | | |
|---|---|---|---|---|
| | **Assets/Liabilities Measured at Fair Value December 31, 2009** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| *Measured on a recurring basis:* | | | | |
| Assets: | | | | |
| U.S. Treasury securities | | | | |
| Available-for-sale | $ 1,327 | $ | $ 1,327 | $ |
| Residential mortgage-backed securities | | | | |
| Available-for-sale | 4,491,764 | | 4,432,195 | 59,569 |
| States and political subdivisions | | | | |
| Available-for-sale | 136,866 | | 136,866 | |
| Other | | | | |
| Available-for-sale | 14,126 | 626 | 13,500 | |
| | | | | |
| *Measured on a non-recurring basis:* | | | | |
| Assets: | | | | |
| Impaired Loans | 76,225 | | | 76,225 |

Investment securities available-for-sale are classified within level 2 and level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within level 1. For investments classified as level 2 in the fair value hierarchy, the Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. Investment securities classified as level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in in-active markets and markets that have experienced significant decreases in volume and level of activity, as exhibited by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company used a discounted cash flow model to determine fair value. Inputs in the model included both historical performance and expected future performance based on information currently available. Assumptions used in the discounted cash flow model included estimates on future principal prepayment rates, default and loss severity rates. The Company estimates that future principal prepayment rates will range from 4-5% and used a 13% discount rate.

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

| | | |
|---|---|---|
| Balance at December 31, 2009 | $ | 59,569 |
| Principal paydowns, net of discount amortization | | (3,111) |
| Total unrealized gains (losses) included in: | | |
| Other comprehensive income | | 3,175 |
| Net income | | (7,203) |
| | | |
| Balance at March 31, 2010 | $ | 52,430 |

As of March 31, 2010, the Company s financial instruments measured at fair value on a non-recurring basis are limited to impaired loans. Impaired loans are classified within level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, Receivables . The fair value of impaired loans is based on the fair value of the collateral, as determined through an external appraisal process, discounted based on internal criteria. Impaired loans are primarily comprised of collateral-dependent commercial loans.

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

The fair value estimates, methods, and assumptions for the Company s financial instruments at March 31, 2010 and December 31, 2009 are outlined below.

***Cash and Due From Banks and Federal Funds Sold***

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

*Time Deposits with Banks*

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

*Investment securities held-to-maturity*

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

***Investment Securities***

For investment securities, which include U. S. Treasury securities, obligations of other U. S. government agencies, obligations of states and political subdivisions and mortgage pass through and related securities, fair values are based on quoted market prices or dealer quotes. Fair values are based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership of a financial instrument, probable tax ramifications, or estimated transaction costs. See disclosures of fair value of investment securities in Note 6.

***Loans***

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

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. At March 31, 2010, and December 31, 2009, the carrying amount of fixed rate performing loans was $1,293,400,000 and $1,303,049,000 respectively, and the estimated fair value was $1,161,447,000 and $1,200,343,000, respectively.

*Accrued Interest*

The carrying amounts of accrued interest approximate fair value.

***Deposits***

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of March 31, 2010 and December 31, 2009. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. At March 31, 2010 and December 31, 2009, the carrying amount of time deposits was $3,527,933,000 and $3,398,656,000, respectively, and the estimated fair value was $3,537,891,000 and $3,412,538,000, respectively.

*Securities Sold Under Repurchase Agreements and Other Borrowed Funds*

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at March 31, 2010 and December 31, 2009. The fair value of the long-term instruments is based on established market spreads. At March 31, 2010 and December 31, 2009, the carrying amount of long-term repurchase agreements was $1,000,000,000 and the estimated fair value was $1,101,860,000 and $1,099,064,000, respectively. Other borrowed funds are short-term Federal Home Loan Bank borrowings. Due to the contractual terms of these financial instruments, the carrying amounts approximated fair value at March 31, 2010 and December 31, 2009.

*Junior Subordinated Deferrable Interest Debentures*

The Company currently has fixed and floating junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at March 31, 2010 and December 31, 2009. The fair value of the fixed junior subordinated deferrable interest debentures is based on established market spreads to the debentures. At March 31, 2010 and December 31, 2009, the carrying amount of fixed junior subordinated deferrable interest debentures was $139,233,000 and $139,224,000, respectively, and the estimated fair value was $69,947,000 and $65,762,000, respectively.

*Commitments to Extend Credit and Letters of Credit*

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

*Limitations*

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

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

**Note 3 Loans**

A summary of net loans, by loan type at March 31, 2010 and December 31, 2009 is as follows:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in Thousands) | |
| Commercial, financial and agricultural | $ 2,665,638 | $ 2,703,379 |
| Real estate mortgage | 950,638 | 954,010 |
| Real estate construction | 1,568,916 | 1,583,057 |
| Consumer | 140,524 | 146,331 |
| Foreign | 242,269 | 280,485 |
| Total loans | $ 5,567,985 | $ 5,667,262 |

**Note 4 - Allowance for Probable Loan Losses**

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

| | March 31, 2010 | March 31, 2009 |
|---|---|---|
| | (Dollars in Thousands) | |
| Balance at December 31, | $ 95,393 | $ 73,461 |
| Losses charged to allowance | (7,235) | (10,502) |
| Recoveries credited to allowance | 451 | 210 |
| Net losses charged to allowance | (6,784) | (10,292) |
| Provision charged to operations | 7,229 | 12,225 |
| Balance at March 31, | $ 95,838 | $ 75,394 |

The losses charged to the allowance decreased by $3,267,000 for the three months ended March 31, 2010 versus the same period of 2009. The nationwide recession and its consequences are being felt in the Company s markets, but not to the extent being seen in the nation as a whole. These factors, as well as other economic issues, have elevated the Company s provisions as well as charge-offs. The increase in the allowance for probable loan losses from March 31, 2009 to March 31, 2010 can be attributed to the nationwide recession and the effects it has on the Company s loan portfolio.

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

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

| | | March 31, 2010 | | December 31, 2009 |
|---|---|---|---|---|
| | | (Dollars in Thousands) | | |
| Balance of impaired loans where there is a related allowance for loan loss | $ | 101,099 | $ | 106,780 |
| Balance of impaired loans where there is no related allowance for loan loss | | 23,522 | | 11,494 |
| Total impaired loans | $ | 124,621 | $ | 118,274 |
| Allowance allocated to impaired loans | $ | 28,039 | $ | 30,555 |

The impaired loans included in the table above are primarily comprised of collateral dependent commercial loans, which have not been fully charged off. The average recorded investment in impaired loans was $131,673,000 and $149,528,000 for the three months ended March 31, 2010 and December 31, 2009, respectively. The interest recognized on impaired loans was not significant. A portion of the impaired loans have adequate collateral and credit enhancements not requiring a related allowance for loan loss. The level of impaired loans is reflective of the economic weakness that has been created by the financial crisis and the subsequent economic downturn. Management is confident the Company s loss exposure regarding these credits will be significantly reduced due to the Company s long-standing practices that emphasize secured lending with strong collateral positions and guarantor support. Management is likewise confident the reserve for probable loan losses is adequate. The Company has no direct exposure to sub-prime loans in its loan portfolio, but the sub-prime crisis has affected the credit markets on a national level, and as a result, the Company has experienced an increasing amount of impaired loans; however, management s decision to place loans in this category does not necessarily mean that the Company will experience significant losses from these loans or significant increases in impaired loans from these levels.

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

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

While management of the Company considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. It is the judgment of the Company s management that the allowance for probable loan losses at March 31, 2010 was adequate to absorb probable losses from loans in the portfolio at that date.

**Note 5 Stock Options**

On April 1, 2005, the Board of Directors adopted the 2005 International Bancshares Corporation Stock Option Plan (the 2005 Plan ). Effective May 19, 2008, the 2005 Plan was amended to increase the number of shares available for stock option grants under the 2005 Plan by 300,000 shares. The 2005 Plan replaced the 1996 International Bancshares Corporation Key Contributor Stock Option Plan (the 1996 Plan ). Under the 2005 Plan, both qualified incentive stock options ( ISOs ) and non-qualified stock options ( NQSOs ) may be granted. Options granted may be exercisable for a period of up to 10 years from the date of grant, excluding ISOs granted to 10% shareholders, which may be exercisable for a period of up to only five years. As of March 31, 2010, 148,422 shares were available for future grants under the 2005 Plan.

A summary of option activity under the stock option plans for the three months ended March 31, 2010 is as follows:

| | Number of options | | Weighted average exercise price | Weighted average remaining contractual term (years) | | Aggregate intrinsic value ($) (Dollars in Thousands) |
|---|---|---|---|---|---|---|
| Options outstanding at December 31, 2009 | 823,592 | $ | 20.54 | | | |
| Plus: Options granted | | | | | | |
| Less: | | | | | | |
| Options exercised | | | | | | |
| Options expired | | | | | | |
| Options forfeited | 5,500 | | 16.40 | | | |
| Options outstanding at March 31, 2010 | 818,092 | $ | 20.57 | 4.57 | $ | 3,051 |
| | | | | | | |
| Options fully vested and exercisable at March 31, 2010 | 309,561 | $ | 24.08 | 2.80 | $ | 54 |

Stock-based compensation expense included in the consolidated statements of income for the three months ended March 31, 2010 and March 31, 2009 was approximately $152,000 and $142,000, respectively. As of March 31, 2010, there was approximately $1,047,000 of total unrecognized stock-based compensation cost related to non-vested options granted under the Company plans that will be recognized over a weighted average period of 1.5 years.

**Note 6 - Investment Securities**

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

The amortized cost and estimated fair value by type of investment security at March 31, 2010 are as follows:

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

**Available for Sale**

| | Amortized cost | Gross unrealized gains | Gross unrealized losses (Dollars in Thousands) | Estimated fair value | Carrying value (1) |
|---|---|---|---|---|---|
| U.S. Treasury securities | $ 1,327 | $ | $ | $ 1,327 | $ 1,327 |
| Mortgage-backed securities | 3,418,593 | 88,867 | (11,894) | 3,495,566 | 3,495,566 |
| Obligations of states and political subdivisions | 150,644 | 3,979 | (199) | 154,424 | 154,424 |
| Equity securities | 13,825 | 801 | (39) | 14,587 | 14,587 |
| Total investment securities | $ 3,584,389 | $ 93,647 | $ (12,132) | $ 3,665,904 | $ 3,665,904 |

(1) Included in the carrying value of mortgage-backed securities are $1,294,294 of mortgage-backed securities issued by Ginnie Mae, $2,148,842 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and $52,430 issued by non-government entities

The amortized cost and estimated fair value by type of investment security at December 31, 2009 are as follows:

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

| | Available for Sale | | | | |
|---|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value | Carrying value (1) |
| | (Dollars in Thousands) | | | | |
| U.S. Treasury securities | $ 1,327 | $ | $ | $ 1,327 | $ 1,327 |
| Mortgage-backed securities | 4,393,731 | 113,138 | (15,105) | 4,491,764 | 4,491,764 |
| Obligations of states and political subdivisions | 132,968 | 4,102 | (204) | 136,866 | 136,866 |
| Equity securities | 13,825 | 343 | (42) | 14,126 | 14,126 |
| Total investment securities | $ 4,541,851 | $ 117,583 | $ (15,351) | $ 4,644,083 | $ 4,644,083 |

(1) Included in the carrying value of mortgage-backed securities are $1,898,905 of mortgage-backed securities issued by Ginnie Mae, $2,533,290 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and $59,569 issued by non-government entities

The amortized cost and estimated fair value of investment securities at March 31, 2010, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

| | Held to Maturity | | Available for Sale | |
|---|---|---|---|---|
| | Amortized Cost | Estimated fair value | Amortized Cost | Estimated fair value |
| | (Dollars in Thousands) | | | |
| Due in one year or less | $ 1,625 | $ 1,625 | $ 1,327 | $ 1,327 |
| Due after one year through five years | 825 | 825 | 547 | 551 |
| Due after five years through ten years | | | 9,671 | 9,797 |
| Due after ten years | | | 140,426 | 144,076 |
| Mortgage-backed securities | | | 3,418,593 | 3,495,566 |
| Equity securities | | | 13,825 | 14,587 |
| Total investment securities | $ 2,450 | $ 2,450 | $ 3,584,389 | $ 3,665,904 |

Mortgage-backed securities are securities issued by the Freddie Mac, Fannie Mae, Ginnie Mae or non-government entities. Investments in mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U.S. Government. Investments in mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. Government, but carry an implied AAA rating with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008.

The amortized cost and fair value of available for sale investment securities pledged to qualify for fiduciary powers, to secure public monies as required by law, repurchase agreements and short-term fixed borrowings was $2,571,228,000 and $2,648,407,000 at March 31, 2010.

Proceeds from the sale of securities available-for-sale were $945,670,000 for the three months ended March 31, 2010, which included $943,304,000 of mortgage-backed securities. Gross gains of $28,268,000 and gross losses of $(3,000) were realized on the sales for the three months ended March 31, 2010, respectively. During the first quarter, the Company recorded an impairment charge of $7,203,000, before tax, representing the credit loss on non-agency mortgage-backed securities.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2010, were as follows:

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (Dollars in Thousands) | | | | | |
| Available for sale: | | | | | | |
| Mortgage-backed securities | $ 92,665 | $ (2) | $ 52,429 | $ (11,892) | $ 145,094 | $ (11,894) |
| Obligations of states and political subdivisions | 14,284 | (150) | 638 | (49) | 14,922 | (199) |
| Other equity securities | 4,979 | (21) | 57 | (18) | 5,036 | (39) |
| | $ 111,928 | $ (173) | $ 53,124 | $ (11,959) | $ 165,052 | $ (12,132) |

The unrealized losses on investments in mortgage-backed securities are primarily caused by changes in market interest rates. Mortgage-backed securities are primarily securities issued by the Freddie Mac, Fannie Mae and Ginnie Mae. The contractual cash obligations of the securities issued by Ginnie Mae are fully guaranteed by the U.S. Government. The contractual cash obligations of the securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. Government; however, the securities carry an implied AAA rating with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008. The decrease in fair value on mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae is due to market interest rates. The Company has no intent to sell and will more than likely not be required to sell before a market price recovery or maturity of the securities; therefore, it is the conclusion of the Company that the investments in mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae are not considered other-than-temporarily impaired. In addition, the Company has a small investment in non-agency mortgage-backed securities that have strong credit backgrounds and include additional credit enhancements to protect the Company from losses arising from high foreclosure rates. These securities have additional market volatility beyond economically induced interest rate events. The Company has received principal and interest payments in line with expected cash flows at the time of purchase. The Company has no intent to sell and will more than likely not be required to sell the non-agency mortgage-backed securities before recovery of amortized cost. It is the conclusion of the Company that the investments in non-agency mortgage-backed securities are other-than-temporarily impaired due to both credit and other than credit issues. An impairment charge of $7,203,000, $4,682,000 after tax, was recorded in the first quarter 2010 on the non-agency mortgage backed securities, representing the credit related impairment on the securities.

The unrealized losses on investments in other securities are caused by fluctuations in market interest rates. The underlying cash obligations of the securities are guaranteed by the entity underwriting the debt instrument. It is the belief of the Company that the entity issuing the debt will honor its interest payment schedule, as well as the full debt at maturity. The securities are purchased by the Company for their economic value. The decrease in fair value is primarily due to market interest rates and not other factors, and because the Company has no intent to sell and will more than likely not be required to sell before a market price recovery or maturity of the securities, it is the conclusion of the Company that the investments are not considered other-than-temporarily impaired.

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investment recognized in earnings (Dollars in Thousands):

| | | |
|---|---|---|
| Balance at December 31, 2009 | $ | |
| Impairment charges recognized during period | | 7,203 |
| Balance at March 31, 2010 | $ | 7,203 |

**Note 7 Other Borrowed Funds**

Other borrowed funds include Federal Home Loan Bank borrowings, which are short-term borrowings issued by the Federal Home Loan Bank of Dallas at the market price offered at the time of funding. These borrowings are secured by mortgage-backed investment securities and a portion of the Company s loan portfolio. At March 31, 2010, other borrowed funds totaled $99,575,000, a decrease of 92.6% from $1,347,625,000 at December 31, 2009. The decrease in other borrowed funds can be attributed to the use of funds generated from the sale of mortgage-backed securities to facilitate a re-positioning of the Company s investment portfolio.

**Note 8 Junior Subordinated Interest Deferrable Debentures**

The Company has formed eight statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. The eight statutory business trusts formed by the Company (the Trusts ) have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the Debentures ) issued by the Company. As of March 31, 2010, the principal amount of debentures outstanding totaled $201,091,000. As a result of the participation in the TARP Capital Purchase Program, the Company may not, without the consent of the Treasury Department, redeem any of the Debentures until the earlier to occur of December 23, 2011, or the date on which the Company has redeemed all of the Series A Preferred Stock issued under the Capital Purchase Program or the date on which the Treasury has transferred all of the Series A Preferred Stock to third parties not affiliated with the Treasury.

The Debentures are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the respective indentures) of the Company, and are *pari passu* with one another. The interest rate payable on, and the payment terms of the Debentures are the same as the distribution rate and payment terms of the respective issues of Capital and Common Securities issued by the Trusts. The Company has fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. The Company has the right, unless an Event of Default (as defined in the Indentures) has occurred and is continuing, to defer payment of interest on the Debentures for up to ten consecutive semi-annual periods on Trust I and for up to twenty consecutive quarterly periods on Trusts VI, VII, VIII, IX, X, XI and XII. If interest payments on any of the Debentures are deferred, distributions on both the Capital and Common Securities related to that Debenture would also be deferred. The redemption prior to maturity of any of the Debentures may require the prior approval of the Federal Reserve and/or other regulatory bodies.

For financial reporting purposes, the Trusts are treated as investments of the Company and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. For March 31, 2010, the total $201,091,000, of the Capital Securities outstanding qualified as Tier 1 capital.

In March 2005, the Federal Reserve Board issued a final rule that allowed the inclusion of trust preferred securities in Tier 1 capital, but placed stricter quantitative limits. Under the final rule, after a transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. On March 16, 2009, the Federal Reserve Board extended for two years the transition period. The Company believes that substantially all of the current trust preferred securities will be included in Tier 1 capital after the transition period ending on March 31, 2011.

The following table illustrates key information about each of the Capital and Common Securities and their interest rate at March 31, 2010:

| | Junior Subordinated Deferrable Interest Debentures (In Thousands) | Repricing Frequency | Interest Rate | Interest Rate Index | Maturity Date | Optional Redemption Date |
|---|---|---|---|---|---|---|
| Trust I | $ 10,365 | Fixed | 10.18% | Fixed | June 2031 | June 2011 |
| Trust VI | $ 25,774 | Quarterly | 3.70% | LIBOR+ 3.45 | November 2032 | August 2010 |
| Trust VII | $ 10,310 | Quarterly | 3.50% | LIBOR+ 3.25 | April 2033 | July 2010 |
| Trust VIII | $ 25,774 | Quarterly | 3.30% | LIBOR+ 3.05 | October 2033 | July 2010 |
| Trust IX | $ 41,238 | Fixed | 7.10%(1) | Fixed | October 2036 | October 2011 |
| Trust X | $ 34,021 | Fixed | 6.66%(1) | Fixed | February 2037 | February 2012 |
| Trust XI | $ 32,990 | Fixed | 6.82%(1) | Fixed | July 2037 | July 2012 |
| Trust XII | $ 20,619 | Fixed | 6.85%(1) | Fixed | September 2037 | September 2012 |
| | $ 201,091 | | | | | |

(1) Trust IX, X, XI and XII accrue interest at a fixed rate for the first five years, then floating at LIBOR + 1.62%, 1.65%, 1.62% and 1.45% thereafter, respectively.

**Note 9 Preferred Stock, Common Stock and Dividends**

The Company has outstanding 216,000 shares of Series A cumulative perpetual preferred stock, issued to the US Treasury under the Company s participation in the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program ). The Series A shares have a par value of $.01 per share (the Senior Preferred Stock ), and a liquidation preference of $1,000 per share, for a total price of $216,000,000. The Senior Preferred Stock will pay dividends at a rate of 5% per year for the first five years and 9% per year thereafter. The Senior Preferred Stock has no maturity date and ranks senior to the Company s common stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. In conjunction with the purchase of the Senior Preferred Stock, the US Treasury received a warrant (the Warrant ) to purchase 1,326,238 shares of the Company s common stock (the Warrant Shares ) at $24.43 per share, which would represent an aggregate common stock investment in the Company on exercise of the warrant in full equal to 15% of the Senior Preferred Stock investment. The term of the Warrant is ten years and was immediately exercisable. Both the Senior Preferred Stock and Warrant are included as components of Tier 1 capital. As of March 31, 2010, none of the Warrants had been exercised. The Company paid dividends on the Senior Preferred Stock on February 16, 2010, in the amount of $2,700,000 and will pay a dividend on the Senior Preferred Stock on May 15, 2010, in the amount of $2,700,000.

Upon issuance, the fair value of the Series A shares and the associated warrants were computed as if the instruments were issued on a stand-alone basis. The fair value of the Series A shares were estimated based on discounted cash flows, resulting in a stand-alone fair value of approximately $130.9 million. The Company used the Black-Sholes-Merton option pricing model to estimate the fair value of the warrants, resulting in a stand-alone fair value of approximately $8.0 million. The fair values of both were then used to record the Series A shares and Warrants on a relative fair value basis, with the warrants being recorded in Surplus as permanent equity and the Series A shares being recorded at a discount of approximately $12.4 million. Accretion of the discount associated with the preferred stock is recognized as an increase to preferred stock dividends in determining net income available to common shareholders. The discount is being amortized over a five year period from the respective issuance date using the effective-yield method and totaled $568,000 for the three months ended March 31, 2010.

The Company paid cash dividends to the common shareholders of $.17 per share on April 19, 2010 to all holders of record on April 1, 2010. Cash dividends to common shareholders were paid on May 11, and November 2, 2009 to all holders of record on April 27, 2009 and October 19, 2009, respectively.

The Company terminated its stock repurchase program on December 19, 2008, in connection with participating in the TARP Capital Purchase Program, which program prohibited stock repurchases, except for repurchases made in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices. On April 7, 2009, the Company obtained consent from the Treasury to repurchase shares of the Company s common stock; provided, however, that in no event will the aggregate amount of cash dividends and common stock repurchases for a given semi-annual period exceed the aggregate amount that would be used to pay the originally permitted semi-annual cash dividend of $.33 per share. The Company also received consent from the Treasury to pay quarterly dividends. The Company will determine on an ongoing basis the best use of the funds and whether a more frequent dividend program and expanded repurchase program are warranted and beneficial to its shareholders. Following receipt of the Treasury Department s consent, the Board of Directors established a formal stock repurchase program that authorized the repurchase of up to $40 million of common stock within the following twelve months and on March 9, 2010, the Board of Directors extended the repurchase program and again authorized the repurchase of up to $40 million of common stock during the twelve month period expiring on April 9, 2011, which repurchase cap the Board is inclined to increase over time, subject to the limitations imposed by the Treasury Department s consent. Stock repurchases may be made from time to time, on the open market or through private transactions. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of May 3, 2010, a total of 6,913,284 shares had been repurchased under all programs at a cost of $243,409,000.

**Note 10 - Commitments and Contingent Liabilities and Other Tax Matters**

The Company is involved in various legal proceedings that are in various stages of litigation. Some of these actions allege lender liability claims on a variety of theories and claim substantial actual and punitive damages. The Company has determined, based on discussions with its counsel that any material loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to the consolidated financial position or results of operations of the Company. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

The Company s lead bank subsidiary has invested in partnerships, which have entered into several lease-financing transactions. The Internal Revenue Service issued a Notice of Final Partnership Administrative Adjustments ( FPAA ) on two of the partnerships. In both partnerships, the lead bank subsidiary was the owner of a ninety-nine percent (99%) limited partnership interest. In connection with the two partnerships through the first quarter of 2006, the Company expensed approximately $25.7 million, which amount represents the total of the tax adjustments due and the interest due on such adjustments for both FPAAs. Management will continue to evaluate the correspondence with the IRS on the FPAAs and make any appropriate revisions to the amounts as deemed necessary.

The Company is involved in a dispute related to certain tax matters that were inherited by the Company in its 2004 acquisition of LFIN. The dispute involves claims by the former controlling shareholders of LFIN related to approximately $14 million of tax refunds received by the Company based on deductions taken in 2003 by LFIN in connection with losses on loans acquired from a failed thrift and a dispute LFIN had with the FDIC regarding the tax benefits related to the failed thrift acquisition which originated in 1988. On March 5, 2010, judgment was entered on a jury verdict rendered against the Company in the U.S. District Court for the Western District of Oklahoma (the Court ). Other than the tax refunds that are in dispute, the Company does not have any other disputes regarding tax refunds received by the Company in connection with the LFIN acquisition. While judgment has been entered in the case, certain additional issues related to fees and other matters are to be determined by the Court in the future prior to the judgment becoming final and appealable. Company management is currently reviewing the judgment, its implications and the Company s intention to appeal, as well as take other paths of action to mitigate the impact of the judgment. The Company is disappointed with the judgment but believes it has a number of valid grounds for appeal which it intends to pursue. As of March 31, 2010, the Company recorded an additional reserve of $21.8 million related to this matter. Management will continue to review the developments in this dispute and make appropriate adjustments to the amount reserved, as needed.

**Note 11 Capital Ratios**

The Company had a Tier 1 capital to average total asset (leverage) ratio of 11.44% and 10.95%, risk-weighted Tier 1 capital ratio of 18.66% and 17.74% and risk-weighted total capital ratio of 19.91% and 18.99% at March 31, 2010 and December 31, 2009, respectively. The identified intangibles and goodwill of $303,633,000 as of March 31, 2010, recorded in connection with the acquisitions made by the Company, are deducted from the sum of core capital elements when determining the capital ratios of the Company. Under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold qualifies as Tier 2 capital. As of March 31, 2010, the total of $201,091,000 of the Capital Securities outstanding qualified as Tier 1 capital. The Company actively monitors the regulatory capital ratios to ensure that the Company s bank subsidiaries are well capitalized under the regulatory framework.

In March 2005, the Federal Reserve Board issued a final rule that allowed the inclusion of trust preferred securities in Tier 1 capital, but placed stricter quantitative limits. Under the final rule, after a transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. On March 16, 2009, the Federal Reserve Board extended for two years the transition period. The Company believes that substantially all of the current trust preferred securities will be included in Tier 1 capital after the transition period ending on March 31, 2011.

**Item 2 - Management s Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with the Company s consolidated financial statements, and notes thereto, for the year-ended December 31, 2009, included in the Company s 2009 Form 10-K. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results for the year ending December 31, 2010, or any future period.

**Special Cautionary Notice Regarding Forward Looking Information**

Certain matters discussed in this report, excluding historical information, include forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by these sections. Although the Company believes such forward-looking statements are based on reasonable assumptions, no assurance can be given that every objective will be reached. The words estimate, expect, intend, believe and project, as wel other words or expressions of a similar meaning are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this report. Such statements are based on current expectations, are inherently uncertain, are subject to risks and should be viewed with caution. Actual results and experience may differ materially from the forward-looking statements as a result of many factors.

Risk factors that could cause actual results to differ materially from any results that are projected, forecasted, estimated or budgeted by the Company in forward-looking statements include, among others, the following possibilities:

- Local, regional, national and international economic business conditions and the impact they may have on the Company, the Company s customers, and such customers ability to transact profitable business with the Company, including the ability of its borrowers to repay their loans according to their terms or a change in the value of the related collateral.
- Volatility and disruption in national and international financial markets.
- Government intervention in the U.S. financial system.
- Changes in consumer spending, borrowings and savings habits.
- Changes in interest rates and market prices, which could reduce the Company s net interest margins, asset valuations and expense expectations.
- Changes in the capital markets utilized by the Company and its subsidiaries, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations to which the Company and its subsidiaries, as well as their customers, competitors and potential competitors, are subject, including, without limitation, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance and employment laws and regulations.
- Changes in U.S. Mexico trade, including, without limitation, reductions in border crossings and commerce resulting from the Homeland Security Programs called US-VISIT, which is derived from Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.

- The loss of senior management or operating personnel.

- Increased competition from both within and outside the banking industry.

- The timing, impact and other uncertainties of the Company s potential future acquisitions including the Company s ability to identify suitable potential future acquisition candidates, the success or failure in the integration of their operations and the Company s ability to maintain its current branch network and to enter new markets successfully and capitalize on growth opportunities.

- Changes in the Company s ability to pay dividends on its Preferred Stock or Common Stock.

- The effects of the proceedings pending with the Internal Revenue Service regarding the Company s lease financing transactions.

- Additions to the Company s loan loss allowance as a result of changes in local, national or international conditions which adversely affect the Company s customers.

- Greater than expected costs or difficulties related to the development and integration of new products and lines of business.

- Changes in the soundness of other financial institutions with which the Company interacts.

- Political instability in the United States or Mexico.

- Technological changes.

- Acts of war or terrorism.

- Natural disasters.

- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale portfolio following a determination that the securities are other-than-temporarily impaired.

- The effect of changes in accounting policies and practices as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.

- The costs and effects of regulatory developments, including the resolution of regulatory or other governmental inquiries and the results of regulatory examinations or reviews.

- The effect of final rules amending Regulation E that prohibit financial institutions from charging consumer fees for paying overdrafts on ATM and one-time debit card transactions, unless the consumer consents or opts-in to the overdraft service for those types of transactions.

- The Company s success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. It is not probable to foresee or identify all such factors. The Company makes no commitment to update any forward-looking statement, or to disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement, unless required by law.

**Recent Developments**

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

**Overview**

The Company, which is headquartered in Laredo, Texas, with 279 facilities and more than 430 ATMs, provides banking services for commercial, consumer and international customers of South, Central and Southeast Texas and the State of Oklahoma. The Company is one of the largest independent commercial bank holding companies headquartered in Texas. The Company, through its bank subsidiaries, is in the business of gathering funds from various sources and investing those funds in order to earn a return. The Company either directly or through a bank subsidiary owns two insurance agencies, a liquidating subsidiary, a broker/dealer and a fifty percent interest in an investment banking unit that owns a broker/dealer. The Company s primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, the Company generates income from fees on products offered to commercial, consumer and international customers.

The Company is very active in facilitating trade along the United States border with Mexico. The Company does a large amount of business with customers domiciled in Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit

base of the Company s bank subsidiaries. The Company also serves the growing Hispanic population through the Company s facilities located throughout South, Central and Southeast Texas and the State of Oklahoma.

Expense control is an essential element in the Company s long-term profitability. As a result, the Company monitors the efficiency ratio, which is a measure of non-interest expense to net interest income plus non-interest income closely. The Company s efficiency ratio has been negatively impacted over the last few years because of the Company s branch expansion which has added a total of 19 branches during 2009 and 2010. During rapid expansion periods, the Company s efficiency ratio will suffer but the long-term benefits of the expansion should be realized in future periods and the benefits should positively impact the efficiency ratio in future periods. The Company monitors this ratio over time to assess the Company s efficiency relative to its peers taking into account the Company s branch expansion. The Company uses this measure as one factor in determining if the Company is accomplishing its long-term goals of providing superior returns to the Company s shareholders.

**Results of Operations**

**Summary**

Consolidated Statements of Condition Information

| | March 31, 2010 | December 31, 2009 | Percent Increase (Decrease) |
|---|---|---|---|
| | (Dollars in Thousands) | | |
| Assets | $ 10,783,666 | $ 11,762,543 | (8.3)% |
| Net loans | 5,472,147 | 5,571,869 | (1.8) |
| Deposits | 7,450,956 | 7,178,007 | 3.8 |
| Other borrowed funds | 99,575 | 1,347,625 | (92.6) |
| Junior subordinated deferrable interest debentures | 201,091 | 201,082 | |
| Shareholders equity | 1,412,034 | 1,407,470 | .3 |

**Consolidated Statements of Income Information**

| | Quarter Ended March 31, 2010 | Quarter Ended March 31, 2009 | Percent Increase (Decrease) |
|---|---|---|---|
| | (Dollars in Thousands) | | |
| Interest income | $ 119,822 | $ 140,216 | (14.5)% |
| Interest expense | 29,927 | 42,070 | (28.9) |
| Net interest income | 89,895 | 98,146 | (8.4) |
| Provision for probable loan losses | 7,229 | 12,225 | (40.9) |
| Non-interest income | 71,597 | 42,012 | 70.4 |
| Non-interest expense | 105,577 | 70,226 | 50.3 |
| Net income available to common shareholders | 28,778 | 34,295 | (16.1) |
| | | | |
| Per common share: | | | |
| Basic | $ .42 | $ .50 | (16.0)% |
| Diluted | .42 | .50 | (16.0) |

**Net Income**

Net income available to common shareholders for the first quarter of 2010 decreased by 16.1% as compared to the same period in 2009. Net income was negatively affected by a dispute related to certain tax matters that were inherited by the Company in its 2004 acquisition of LFIN. The dispute involves claims by the former controlling shareholders of LFIN related to approximately $14 million of tax refunds received by the Company based on deductions taken in 2003 by LFIN in connection with losses on loans acquired from a failed thrift and a dispute LFIN had with the FDIC regarding the tax benefits related to the failed thrift acquisition which originated in 1988. On March 5, 2010, judgment was entered on a jury verdict rendered against the Company in the U.S. District Court for the Western District of Oklahoma. Other than the tax refunds that are in dispute, the Company does not have any other disputes regarding tax refunds received by the Company in connection with the LFIN acquisition. While judgment has been entered in the case, certain additional issues related to fees and other matters are to be determined by the Court in the future prior to the judgment becoming final and appealable. Company management is currently reviewing the judgment, its implications and the Company s intention to appeal, as well as, take other paths of action to mitigate the impact of the judgment. The Company is disappointed with the judgment but believes it has a number of valid grounds for appeal which it intends to pursue. As of March 31, 2010, the Company recorded an additional reserve of $14.2 million, after tax, related to this matter. Management will continue to review the developments in this dispute and make appropriate adjustments to the amount reserved, as needed.

**Net Interest Income**

| | Quarter Ended March 31, 2010 | Quarter Ended March 31, 2009 | Percent Increase (Decrease) |
|---|---|---|---|
| | (in Thousands) | | |
| Interest income: | | | |
| Loans, including fees | $ 80,614 | $ 83,626 | (3.6)% |
| Investment securities: | | | |
| Taxable | 37,333 | 55,432 | (32.7) |
| Tax-exempt | 1,634 | 970 | 68.5 |
| Other interest income | 241 | 188 | 28.2 |
| Total interest income | 119,822 | 140,216 | (14.5) |
| Interest expense: | | | |
| Savings deposits | 2,481 | 2,949 | (15.9) |
| Time deposits | 13,053 | 17,851 | (26.9) |
| Securities sold under repurchase agreements | 11,052 | 11,361 | (2.7) |
| Other borrowings | 311 | 6,685 | (95.3) |
| Junior subordinated interest deferrable debentures | 3,030 | 3,224 | (6.0) |
| Total interest expense | 29,927 | 42,070 | (28.9) |
| Net interest income | $ 89,895 | $ 98,146 | (8.4)% |

Net interest income is the spread between income on interest earning assets, such as loans and securities, and the interest expense on liabilities used to fund those assets, such as deposits, repurchase agreements and funds borrowed. Net interest income is the Company s largest source of revenue and increased substantially because of the reduction in the Federal Reserve prime interest rate. The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Company s loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate that loan rates are indexed from, ended 2007 at 7.25%. During 2008, the prime interest rate decreased 400 basis points to end the year at 3.25% where it has remained as of March 31, 2010. The Company s goal is to manage the net interest income in periods of rising and falling rates. Net interest income decreased 8.4% in the first quarter of 2010 compared to the same period in 2009 because of the sale of mortgage-backed securities to facilitate a re-positioning of the

Company s investment portfolio.

As part of its strategy to manage interest rate risk, the Company strives to manage both assets and liabilities so that interest sensitivities match. One method of calculating interest rate sensitivity is through gap analysis. A gap is the difference between the amount of interest rate sensitive assets and interest rate sensitive liabilities that re-price or mature in a given time period. Positive gaps occur when interest rate sensitive assets exceed interest rate sensitive liabilities, and negative gaps occur when interest rate sensitive liabilities exceed interest rate sensitive assets. A positive gap position in a period of rising interest rates should have a positive effect on net interest income as assets will re-price faster than liabilities. Conversely, net interest income should contract somewhat in a period of falling interest rates. Management can quickly change the Company s interest rate position at any given point in time as market conditions dictate. Additionally, interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Analytical techniques employed by the Company to supplement gap analysis include simulation analysis to quantify interest rate risk exposure. The gap analysis prepared by management is reviewed by the Investment Committee of the Company twice a year (see table on page 29 for the March 31, 2010 gap analysis). Management currently believes that the Company is properly positioned for interest rate changes; however if management determines at any time that the Company is not properly positioned, it will strive to adjust the interest rate sensitive assets and liabilities in order to manage the effect of interest rate changes.

**Non-Interest Income**

| | | Quarter Ended March 31, 2010 | | Quarter Ended March 31, 2009 | Percent Increase (Decrease) |
|---|---|---|---|---|---|
| | | (in Thousands) | | | |
| Service charges on deposit accounts | $ | 24,280 | $ | 24,082 | .8% |
| Other service charges, commissions and fees | | | | | |
| Banking | | 11,620 | | 10,397 | 11.8 |
| Non-banking | | 1,668 | | 1,427 | 16.9 |
| Investment securities transactions, net | | 28,264 | | 561 | 4,938.1 |
| Other investments, net | | 3,357 | | 3,432 | (2.2) |
| Other income | | 2,408 | | 2,113 | 14.0 |
| Total non-interest income | $ | 71,597 | $ | 42,012 | 70.4 |

The increase in investment securities transactions for the three months ended March 31, 2010 can be attributed to the sale of investment securities to facilitate the re-positioning of the Company s investment portfolio.

**Non-Interest Expense**

| | | Quarter Ended March 31, 2010 | | Quarter Ended March 31, 2009 | Percent Increase (Decrease) |
|---|---|---|---|---|---|
| | | (in Thousands) | | | |
| Employee compensation and benefits | $ | 31,664 | $ | 32,156 | (1.5)% |
| Occupancy | | 8,518 | | 8,717 | (2.3) |
| Depreciation of bank premises and equipment | | 9,012 | | 9,036 | (0.3) |
| Professional fees | | 3,982 | | 2,606 | 52.8 |
| Deposit insurance assessments | | 2,544 | | 367 | 593.2 |
| Stationery and supplies | | 993 | | 837 | 18.6 |
| Amortization of identified intangible assets | | 1,301 | | 1,309 | (0.6) |
| Advertising | | 2,614 | | 2,613 | |
| Litigation expense | | 21,803 | | | 100.0 |

| | | | | | |
|---|---|---|---|---|---|
| Impairment charges (Total other-than-temporary impairment charges, $19,095, net of $11,892 included in other comprehensive income) | | 7,203 | | | 100.0 |
| Other | | 15,943 | | 12,585 | 26.7 |
| Total non-interest expense | $ | 105,577 | $ | 70,226 | 50.3 |

Non-interest expense was affected by the de novo branching activity that has added 3 new branches in 2010 and 16 branches in 2009. Included in litigation expense is a reserve for a dispute related to certain tax deductions that were inherited by the Company s 2004 acquisition of LFIN. The dispute involves claims by the former controlling shareholders of LFIN related to approximately $14 million of tax refunds received by the Company based on deductions taken in 2003 by LFIN in connection with losses on loans acquired from a failed thrift and a dispute LFIN had with the FDIC regarding tax benefits related to the failed thrift acquisition, which originated in 1988. The Company recorded an other-than-temporary impairment charge of $7.2 million on non-agency mortgage-backed securities, representing the credit related impairment on the securities.

**Financial Condition**

**Allowance for Probable Loan Losses**

The allowance for probable loan losses increased .5% to $95,838,000 at March 31, 2010 from $95,393,000 at December 31, 2009. The provision for probable loan losses charged to expense decreased 40.9% to $7,229,000 for the three months ended March 31, 2010 from $12,225,000 for the same period in 2009. The allowance for probable loan losses was 1.7% of total loans at March 31, 2010 and December 31, 2009. The increase in the allowance was prompted by the analysis of management regarding the general weakness in the economy and the impact of that weakness on the Company s loan portfolio and the related allowance for probable loan losses. The increase is not necessarily an indicator that more credits will worsen to the point that the Company will have to continue to record substantial provisions for probable loan losses at similar levels in future periods.

**Investment Securities**

Mortgage-backed securities are securities primarily issued by the Federal Home Loan Mortgage Corporation ( Freddie Mac ), Federal National Mortgage Association ( Fannie Mae ), and the Government National Mortgage Association ( Ginnie Mae ). Investments in mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U.S. Government. Investments in mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. Government, but carry an implied AAA rating with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008.

**Loans**

Net loans decreased 1.8% to $5,472,147,000 at March 31, 2010, from $5,571,869,000 at December 31, 2009. The decrease in loans can be attributed to the lack of demand for loans that the Company is experiencing as the result of the negative economic conditions.

**Deposits**

Deposits increased by 3.8% to $7,450,956,000 at March 31, 2010, from $7,178,007,000 at December 31, 2009. The increase in deposits is the result of the increased demand for deposits and the aggregate pricing that is occurring in the market for deposits. Even though the Company

increased its deposits, the Company is still experiencing a substantial amount of competition for deposits at higher than market rates. As a result, the Company has attempted to maintain certain deposit relationships but has allowed certain deposits to leave as the result of aggressive pricing.

**Foreign Operations**

On March 31, 2010, the Company had $10,783,666,000 of consolidated assets, of which approximately $242,269,000, or 2.2%, was related to loans outstanding to borrowers domiciled in foreign countries, compared to $280,485,000, or 2.4%, at December 31, 2009. Of the $242,269,000, 82.4% is directly or indirectly secured by U.S. assets, certificates of deposits and real estate; 17.0% is secured by foreign real estate; and 0.6% is unsecured.

**Critical Accounting Policies**

The Company has established various accounting policies which govern the application of accounting principles in the preparation of the Company s consolidated financial statements. The significant accounting policies are described in the notes to the consolidated financial statements. Certain accounting policies involve significant subjective judgments and assumptions by management which have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies.

The Company considers its Allowance for Probable Loan Losses as a policy critical to the sound operations of the bank subsidiaries. The allowance for probable loan losses consists of the aggregate loan loss allowances of the bank subsidiaries. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each bank subsidiary is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance is derived from the following elements: (i) allowances established on specific loans and (ii) allowances based on historical loss experience on the Company s remaining loan portfolio, which includes general economic conditions and other qualitative risk factors both internal and external to the Company. See also discussion regarding the allowance for probable loan losses and provision for probable loan losses included in the results of operations and Provision and Allowance for Probable Loan Losses included in Notes 1 and 5 of the notes to Consolidated Financial Statements in the Company s latest Annual Report on Form 10-K for further information regarding the Company s provision and allowance for probable loan losses policy.

**Liquidity and Capital Resources**

The maintenance of adequate liquidity provides the Company s bank subsidiaries with the ability to meet potential depositor withdrawals, provide for customer credit needs, maintain adequate statutory reserve levels and take full advantage of high-yield investment opportunities as they arise. Liquidity is afforded by access to financial markets and by holding appropriate amounts of liquid assets. The Company s bank subsidiaries derive their liquidity largely from deposits of individuals and business entities. Deposits from persons and entities domiciled in Mexico comprise a stable portion of the deposit base of the Company s bank subsidiaries. Other important funding sources for the Company s bank subsidiaries during 2010 and 2009 were borrowings from FHLB, securities sold under repurchase agreements and large certificates of deposit, requiring management to closely monitor its asset/liability mix in terms of both rate sensitivity and maturity distribution. Primary liquidity of the Company and its subsidiaries has been maintained by means of increased investment in shorter-term securities, certificates of deposit and repurchase agreements. As in the past, the Company will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities and respond accordingly to anticipated fluctuations in interest rates over reasonable periods of time.

The Company maintains an adequate level of capital as a margin of safety for its depositors and shareholders. At March 31, 2010, shareholders equity was $1,412,034,000 compared to $1,407,470,000 at December 31, 2009, an increase of $4,564,000, or .3%. The increase is primarily due to the retention of earnings, offset by dividends paid to the preferred and common shareholders.

The Company had a leverage ratio of 11.44% and 10.95%, risk-weighted Tier 1 capital ratio of 18.66% and 17.74% and risk-weighted total capital ratio of 19.91% and 18.99% at March 31, 2010 and December 31, 2009, respectively. The identified intangibles and goodwill of $303,633,000 as of March 31, 2010, recorded in connection with the Company s acquisitions, are deducted from the sum of core capital elements when determining the capital ratios of the Company.

As in the past, the Company will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities, and respond accordingly to anticipate fluctuations in interest rates by adjusting the balance between sources and uses of funds as deemed appropriate. The net-interest rate sensitivity as of March 31, 2010 is illustrated in the table on the following page. This information reflects the balances of assets and liabilities for which rates are subject to change. A mix of assets and liabilities that are roughly equal in volume and re-pricing characteristics represents a matched interest rate sensitivity position. Any excess of assets or liabilities results in an interest rate sensitivity gap.

The Company undertakes an interest rate sensitivity analysis to monitor the potential risk on future earnings resulting from the impact of possible future changes in interest rates on currently existing net asset or net liability positions. However, this type of analysis is as of a point-in-time position, when in fact that position can quickly change as market conditions, customer needs, and management strategies change. Thus, interest rate changes do not affect all categories of asset and liabilities equally or at the same time. As indicated in the table, the Company is liability sensitive during the early time periods and asset sensitive in the longer periods. The Company s Asset and Liability Committee semi-annually reviews the consolidated position along with simulation and duration models, and makes adjustments as needed to control the Company s interest rate risk position. The Company uses modeling of future events as a primary tool for monitoring interest rate risk.

**Interest Rate Sensitivity**

(Dollars in Thousands)

| | | | Rate/Maturity | | |
|---|---|---|---|---|---|
| **March 31, 2010** | **3 Months or Less** | **Over 3 Months to 1 Year** | **Over 1 Year to 5 Years** | **Over 5 Years** | **Total** |
| Rate sensitive assets | | | | | |
| Investment securities | $ 583,062 | $ 1,028,157 | $ 2,004,706 | $ 52,429 | $ 3,668,354 |
| Loans, net of non-accruals | 4,184,911 | 221,979 | 367,099 | 724,182 | 5,498,171 |
| Total earning assets | $ 4,767,973 | $ 1,250,136 | $ 2,371,805 | $ 776,611 | $ 9,166,525 |
| Cumulative earning assets | $ 4,767,973 | $ 6,018,109 | $ 8,389,914 | $ 9,166,525 | |
| Rate sensitive liabilities | | | | | |
| Time deposits | $ 1,442,323 | $ 1,773,718 | $ 310,728 | $ 1,164 | $ 3,527,933 |
| Other interest bearing deposits | 2,334,051 | | | | 2,334,051 |
| Securities sold under repurchase agreements | 421,180 | 56,933 | 655 | 1,000,000 | 1,478,768 |
| Other borrowed funds | 99,575 | | | | 99,575 |
| Junior subordinated deferrable interest debentures | 61,858 | | 128,868 | 10,365 | 201,091 |
| Total interest bearing liabilities | $ 4,358,987 | $ 1,830,651 | $ 440,251 | $ 1,011,529 | $ 7,641,418 |
| Cumulative sensitive liabilities | $ 4,358,987 | $ 6,189,638 | $ 6,629,889 | $ 7,641,418 | |
| Repricing gap | $ 408,986 | $ (580,515) | $ 1,931,554 | $ (234,918) | $ 1,525,107 |
| Cumulative repricing gap | 408,986 | (171,529) | 1,760,025 | 1,525,107 | |
| Ratio of interest-sensitive assets to liabilities | 1.09 | .68 | 5.39 | .77 | 1.20 |
| Ratio of cumulative, interest-sensitive assets to liabilities | 1.09 | .97 | 1.27 | 1.20 | |

**Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>**

During the first three months of 2010, there were no material changes in market risk exposures that affected the quantitative and qualitative disclosures regarding market risk presented under the caption Liquidity and Capital Resources located on pages 18 through 24 of the Company s 2009 Annual Report as filed as an exhibit to the Company s Form 10-K for the year ended December 31, 2009.

**Item 4. Controls and Procedures**

*Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within specified time periods. As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company s principal executive officer and principal financial officer evaluated, with the participation of the Company s management, the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act rules 13a-15(e) and 15d-15(e)). Based on the evaluation, which disclosed no material weaknesses, the Company s principal executive officer and principal financial officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this report.

*Internal Control Over Financial Reporting*

There were no changes in the Company s internal control over financial reporting that occurred during the Company s most recent fiscal quarter that have materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is involved in various legal proceedings that are in various stages of litigation. Some of these actions allege lender liability claims on a variety of theories and claim substantial actual and punitive damages. The Company has determined, based on discussions with its counsel that any material loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to the consolidated financial position or results of operations of the Company. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

The Company s lead bank subsidiary has invested in partnerships, which have entered into several lease-financing transactions. The Internal Revenue Service issued a Notice of Final Partnership Administrative Adjustments ( FPAA ) on two of the partnerships. In both partnerships, the lead bank subsidiary was the owner of a ninety-nine percent (99%) limited partnership interest. In connection with the two partnerships through the first quarter of 2006, the Company expensed approximately $25.7 million, which amount represents the total of the tax adjustments due and the interest due on such adjustments for both FPAAs. Management will continue to evaluate the correspondence with the IRS on the FPAAs and make any appropriate revisions to the amounts as deemed necessary.

The Company is involved in a dispute related to certain tax matters that were inherited by the Company in its 2004 acquisition of LFIN. The dispute involves claims by the former controlling shareholders of LFIN related to approximately $14 million of tax refunds received by the Company based on deductions taken in 2003 by LFIN in connection with losses on loans acquired from a failed thrift and a dispute LFIN had

with the FDIC regarding the tax benefits related to the failed thrift acquisition which originated in 1988. On March 5, 2010, judgment was entered on a jury verdict rendered against the Company in the U.S. District Court for the Western District of Oklahoma (the Court ). Other than the tax refunds that are in dispute, the Company does not have any other disputes regarding tax refunds received by the Company in connection with the LFIN acquisition. While judgment has been entered in the case, certain additional issues related to fees and other matters are to be determined by the Court in the future prior to the judgment becoming final and appealable. Company management is currently reviewing the judgment, its implications and the Company s intention to appeal, as well as take other paths of action to mitigate the impact of the judgment. The Company is disappointed with the judgment but believes it has a number of valid grounds for appeal which it intends to pursue. As of March 31, 2010, the Company recorded an additional reserve of $21.8 million related to this matter. Management will continue to review the developments in this dispute and make appropriate adjustments to the amount reserved, as needed.

**1A. Risk Factors**

There were no material changes in the risk factors as previously disclosed in Item 1A to Part I of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

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

From time to time, the Company s Board of Directors has authorized stock repurchase plans. The Company terminated its stock repurchase program on December 19, 2008, in connection with participating in the TARP Capital Purchase Program, which program prohibited stock repurchases, except for repurchases made in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices. On April 7, 2009, the Company obtained consent from the Treasury to repurchase shares of the Company s common stock; provided, however, that in no event will the aggregate amount of cash dividends and common stock repurchases for a given semi-annual period exceed the aggregate amount that would be used to pay the originally permitted semi-annual cash dividend of $.33 per share. The Company also received consent from the Treasury to pay quarterly dividends. The Company will determine on an ongoing basis the best use of the funds and whether a more frequent dividend program and expanded repurchase program are warranted and beneficial to its shareholders. Following receipt of the Treasury Department s consent, the Board of Directors established a formal stock repurchase program that authorized the repurchase of up to $40 million of common stock within the following twelve months and on March 9, 2010, the Board of Directors extended the repurchase program and again authorized the repurchase of up to $40 million of common stock during the twelve month period expiring on April 9, 2011, which repurchase cap the Board is inclined to increase over time, subject to the limitations imposed by the Treasury Department s consent. Stock repurchases may be made from time to time, on the open market or through private transactions. During the first quarter, the Company s Board of Directors adopted a Rule 10b5-1 plan and intends to adopt additional Rule 10b5-1 trading plans that will allow the Company to purchase its shares of common stock during certain trading blackout periods when the Company ordinarily would not be in the market due to trading restrictions in its internal trading policy. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of May 3, 2010, a total of 6,913,284 shares had been repurchased under all programs at a cost of $243,409,000. The Company is not obligated to repurchase shares under its stock purchase program or to enter into additional Rule 10b5-1 plans. The timing, actual number and value of shares purchased will depend on many factors, including the Company s cash flow and the liquidity and price performance of its shares of common stock.

Except for repurchases in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices, common stock repurchases are only conducted under publicly announced repurchase programs approved by the Board of Directors. The following table includes information about common stock share repurchases for the quarter ended March 31, 2010.

| | Total Number of Shares Purchased | Average Price Paid Per Share | Shares Purchased as Part of a Publicly-Announced Program | Approximate Dollar Value of Shares Available for Repurchase (1) |
|---|---|---|---|---|
| January 1 January 31, 2010 | | | | $ 30,722,000 |
| February 1 February 28, 2010 | | | | 30,722,000 |
| March 1 March 31, 2010 | | | | 30,722,000 |

(1) The repurchase program was extended on March 9, 2010 and allows for the repurchase of up to an additional $40,000,000 of treasury stock through April 9, 2011.

**Item 6. Exhibits**

The following exhibits are filed as a part of this Report:

31(a) Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31(b) Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32(a) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32(b) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

## 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.

INTERNATIONAL BANCSHARES CORPORATION

| | | |
|---|---|---|
| Date: | May 6, 2010 | /s/ Dennis E. Nixon<br>Dennis E. Nixon<br>President |
| Date: | May 6, 2010 | /s/ Imelda Navarro<br>Imelda Navarro<br>Treasurer |