FIRST CITIZENS BANCSHARES INC /DE/
Form 10-K
February 28, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

Commission File Number 0-16471

FIRST CITIZENS BANCSHARES, INC.

(Exact name of Registrant as specified in the charter)

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

4300 Six Forks Road

Raleigh, North Carolina 27609

(Address of Principal Executive Offices, Zip Code)

(919) 716-7000

(Registrant s Telephone Number, including Area Code)

Securities registered pursuant to:	
Section 12(b) of the Act:	**Class A Common Stock, Par Value $1**
Section 12(g) of the Act:	**Class B Common Stock, Par Value $1**
	(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨	Smaller reporting company ¨

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

The aggregate market value of the Registrant s common equity held by nonaffiliates computed by reference to the price at which the common equity was last sold as of the last business day of the Registrant s most recently completed second fiscal quarter was $985,718,225.

On February 28, 2008, there were 8,756,778 outstanding shares of the Registrant s Class A Common Stock and 1,677,675 outstanding shares of the Registrant s Class B Common Stock.

Portions of the Registrant s definitive Proxy Statement for the 2008 Annual Meeting of Shareholders are incorporated in Part III of this report.

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CROSS REFERENCE INDEX

* Information required by Item 10 is incorporated herein by reference to the information that appears under the headings or captions Proposal 1: Election of Directors, Code of Ethics, Committees of our Board General, and Audit and Compliance Committee , Executive Officers Section 16(a) Beneficial Ownership Reporting Compliance from the Registrant s Proxy Statement for the 2008 Annual Meeting of Shareholders (2008 Proxy Statement) .

Information required by Item 11 is incorporated herein by reference to the information that appears under the headings or captions Compensation Discussion and Analysis, Compensation Committee Report, Executive Compensation, and Director Compensation, of the 2008 Proxy Statement.

Information required by Item 12 is incorporated herein by reference to the information that appears under the heading Beneficial Ownership of Our Common Stock of the 2008 Proxy Statement.

Information required by Item 13 is incorporated herein by reference to the information that appears under the headings or captions Corporate Governance Director Independence and Transactions with Related Persons of the 2008 Proxy Statement.

Information required by Item 14 is incorporated by reference to the information that appears under the caption Services and Fees During 2007 and 2006 of the 2008 Proxy Statement.

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Business

First Citizens BancShares, Inc. (BancShares) was incorporated under the laws of Delaware on August 7, 1986, to become the holding company of First-Citizens Bank & Trust Company (First Citizens Bank or FCB), its banking subsidiary. FCB opened in 1898 as the Bank of Smithfield, Smithfield, North Carolina, and through a series of mergers and name changes, it later became First-Citizens Bank & Trust Company. As of December 31, 2007, FCB operated 340 offices in North Carolina, Virginia, West Virginia, Maryland and Tennessee.

On April 28, 1997, BancShares launched Atlantic States Bank (ASB), a federally chartered thrift institution. During 2004, ASB changed its name to IronStone Bank (ISB). ISB branches were initially concentrated within the metropolitan Atlanta, Georgia market. In 1999, ISB expanded its presence into Florida, focusing initially on selected markets in southwest Florida. The targeted market areas within Florida now include Jacksonville, West Palm Beach and Fort Lauderdale.

During 2002, ISB continued its expansion into high-growth markets by opening offices in Austin, Texas. During 2003, ISB opened offices in Scottsdale, Arizona, the San Diego, Newport Beach and LaJolla communities in Southern California and Sacramento in Northern California. ISB continued its expansion in 2004 and 2005 by opening branch facilities in Denver, Colorado; Albuquerque, New Mexico; Santa Fe, New Mexico; Portland, Oregon; and Seattle, Washington. These markets were selected based on their strong anticipated economic growth rates and the desire to bring a bank with a focus on customer service in these communities. At December 31, 2007, ISB had 56 offices. During 2006, ISB received approval to expand into Houston, Texas. During 2007, ISB received regulatory approval to open branch offices in Dallas, Texas; Oklahoma City, Oklahoma; Kansas City, Missouri; and Kansas City, Kansas.

BancShares executive offices are located at 4300 Six Forks Road, Raleigh, North Carolina 27609, and its telephone number is (919) 716-7000. Although BancShares does not maintain a dedicated website, information regarding BancShares is available at FCB s website, www.firstcitizens.com. At December 31, 2007, BancShares and its subsidiaries employed a full-time staff of 4,014 and a part-time staff of 767 for a total of 4,781 employees.

BancShares subsidiary banks seek to meet the needs of both consumers and commercial entities in their respective market areas. These services, offered at most offices, include taking of deposits, cashing of checks, and providing for individual and commercial cash needs; numerous checking and savings plans; commercial, business and consumer lending; a full-service trust department; and other activities incidental to commercial banking. First Citizens Investor Services, Inc. (FCIS) and IronStone Securities (ISS) provide various investment products, including annuities, discount brokerage services and third-party mutual funds to customers. Various other subsidiaries are not material to BancShares consolidated financial position or to consolidated net income.

On January 1, 2007, American Guaranty Insurance Company, a wholly-owned subsidiary of BancShares that provides property and casualty insurance, and Triangle Life Insurance Company, a wholly-owned subsidiary of FCB that provides credit-related life insurance, were sold to a third party.

The business and operations of BancShares and its subsidiary banks are subject to significant federal and state governmental regulation and supervision. BancShares is a financial holding company registered with the Federal Reserve Board (FRB) under the Bank Holding Company Act of 1956, as amended. It is subject to supervision and examination by, and the regulations and reporting requirements of, the FRB.

FCB is a state-chartered bank, subject to supervision and examination by, and the regulations and reporting requirements of, the Federal Deposit Insurance Corporation (FDIC) and the North Carolina Commissioner of Banks. ISB is a federally-chartered thrift institution supervised by the Office of Thrift Supervision. Deposit obligations of FCB and ISB are insured by the FDIC.

The various regulatory authorities supervise all areas of the banking subsidiaries, including their reserves, loans, mergers, the payment of dividends, various compliance matters and other aspects of their operations. The regulators conduct regular examinations, and the banking subsidiaries must furnish periodic reports to their regulators containing detailed financial and other information regarding their affairs.

There are many statutes and regulations that apply to and restrict the activities of the banking subsidiaries, including limitations on the ability to pay dividends, capital requirements, reserve requirements, deposit insurance requirements and restrictions on transactions with related parties. The impact of these statutes and regulations is discussed below and in the accompanying audited consolidated financial statements.

The Gramm-Leach-Bliley Act (GLB Act) adopted by Congress during 1999 expanded opportunities for banks and bank holding companies to provide services and engage in other revenue-generating activities that previously were prohibited to them. The GLB Act permits bank holding companies to become financial holding companies and expands activities in which banks and bank holding companies may participate, including opportunities to affiliate with securities firms and insurance companies. During 2000, BancShares became a financial holding company. The GLB Act also contains extensive customer privacy protection provisions which require banks to adopt and implement policies and procedures for the protection of the financial privacy of their customers, including procedures that allow customers to elect that certain financial information not be disclosed to certain persons.

Under Delaware law, BancShares is authorized to pay dividends declared by its Board of Directors, provided that no distribution results in its insolvency on a going concern or balance sheet basis. The ability of the banking subsidiaries to pay dividends to BancShares is governed by statutes of each entity s chartering jurisdiction and rules and regulations issued by each entity s respective regulatory authority. Under federal law, and as insured banks, each of the banking subsidiaries is prohibited from making any capital distributions, including paying a cash dividend, if it is, or after making the distribution it would become, undercapitalized as that term is defined in the Federal Deposit Insurance Act (FDIA).

BancShares is required to comply with the capital adequacy standards established by the FRB, and the banking subsidiaries are required to comply with the capital adequacy standards established by the FDIC. The FRB and FDIC have promulgated risk-based capital and leverage capital guidelines for determining the adequacy of the capital of a bank holding company or a bank, and all applicable capital standards must be satisfied for a bank holding company or a bank to be considered in compliance with these capital requirements.

Current federal law establishes a system of prompt corrective action to resolve the problems of undercapitalized banks. Under this system, the FDIC has established five capital categories (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized), and it is required to take certain mandatory supervisory actions, and is authorized to take other discretionary actions, with respect to banks in the three undercapitalized categories.

Under the FDIC s rules implementing the prompt corrective action provisions, an insured, state-chartered bank that has a Total Capital Ratio of 10.0% or greater, a Tier 1 Capital Ratio of 6.0% or greater, a Leverage Ratio of 5.0% or greater, and is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC, is considered to be well-capitalized. Each of BancShares banking subsidiaries is well-capitalized.

Under regulations of the FRB, all FDIC-insured banks must maintain average daily reserves against their transaction accounts. Because required reserves must be maintained in the form of vault cash or in a non-interest-bearing account at a Federal Reserve Bank, the effect of the reserve requirement is to reduce the amount of the Banks interest-earning assets.

Under the Federal Deposit Insurance Reform Act of 2005 (FDIRA), the FDIC uses a risk-based assessment system to determine the amount of a bank s deposit insurance assessment based on an evaluation of the probability that the deposit insurance fund (DIF) will incur a loss with respect to that bank. The evaluation considers risks attributable to different categories and concentrations of the bank s assets and liabilities and other factors the FDIC considers to be relevant, including information obtained from the bank s federal and state banking regulators.

The FDIC is responsible for maintaining the adequacy of the DIF, and the amount paid by a bank for deposit insurance is influenced not only by the assessment of the risk it poses to the DIF, but also by the adequacy of the insurance fund to cover the risk posed by all insured institutions. FDIC insurance assessments could be increased substantially in the future if the FDIC finds such an increase to be necessary in order to adequately maintain the DIF. Additionally, under the FDIA, the FDIC may terminate a bank s deposit insurance if it finds that the bank has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated applicable laws, regulations, rules, or orders.

Each of the banking subsidiaries is subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of certain transactions with affiliate entities. The total amount of the transactions by any of the banking subsidiaries with a single affiliate is limited to 10% of the banking subsidiary s capital and surplus and, for all affiliates, to 20% of the banking subsidiary s capital and surplus. Each of the transactions among affiliates must also meet

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specified collateral requirements and must comply with other provisions of Section 23A designed to avoid transfers of low-quality assets between affiliates.

The banking subsidiaries are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibits the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the banking subsidiary or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The USA Patriot Act of 2001 (Patriot Act) is intended to strengthen the ability of U.S. law enforcement and the intelligence community to work cohesively to combat terrorism on a variety of fronts. The Patriot Act contains sweeping anti-money laundering and financial transparency laws which require various new regulations, including standards for verifying customer identification at account opening, and rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. The Patriot Act has required financial institutions to adopt new policies and procedures to combat money laundering, and it grants the Secretary of the Treasury broad authority to establish regulations and impose requirements and restrictions on financial institutions operations.

Under the Community Reinvestment Act, as implemented by regulations of the federal bank regulatory agencies, an insured bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods.

The Sarbanes-Oxley Act of 2002 (SOX Act) mandated important new corporate governance, financial reporting and disclosure requirements intended to enhance the accuracy and transparency of public companies reported financial results. It established new responsibilities for corporate chief executive officers, chief financial officers and audit committees in the financial reporting process, and it created a new regulatory body to oversee auditors of public companies. The SOX Act also mandated new enforcement tools, increased criminal penalties for federal mail, wire and securities fraud, and created new criminal penalties for document and record destruction in connection with federal investigations. Additionally, the SOX Act increased the opportunity for private litigation by lengthening the statute of limitations for securities fraud claims and providing new federal corporate whistleblower protection.

The SOX Act requires various securities exchanges, including The Nasdaq Stock Market, to prohibit the listing of the stock of an issuer unless that issuer maintains an independent audit committee. In addition, the securities exchanges have imposed various corporate governance requirements, including the requirement that various corporate matters (including executive compensation and board nominations) be approved, or recommended for approval by the issuer s full board of directors, by directors of the issuer who are independent as defined by the exchanges rules or by committees made up of independent directors. Since BancShares Class A common stock is a listed stock, BancShares is subject to those provisions of the Act and to corporate governance requirements of The Nasdaq Stock Market.

The economic and operational effects of this new legislation on public companies, including BancShares, have been and will continue to be significant in terms of the time, resources and costs associated with complying with the new law.

FCIS and ISS are registered broker-dealers and investment advisers. Broker-dealer activities are subject to regulation by the Financial Industry Regulatory Authority (FINRA), a self-regulatory organization to which the Securities and Exchange Commission (SEC) has delegated regulatory authority for broker-dealers, as well as by the state securities authorities of the various states in which FCIS and ISS operate. Investment advisory activities are subject to direct regulation by the SEC, and investment advisory representatives must register with the state securities authorities of the various states in which they operate.

FCIS and ISS are also licensed as insurance agencies in connection with various investment products, such as annuities, that are regulated as insurance products. FCIS and ISS insurance sales activities are subject to concurrent regulation by securities regulators and by the insurance regulators of the various states in which FCIS and ISS do business.

Statistical information regarding our business activities is found in Management s Discussion and Analysis.

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Risk Factors

Certain risk factors that we believe apply to our business and to an investment in our common stock are described below. In addition to those risk factors and investment risks that apply to any financial institution, our business, financial condition and operating results could be harmed by other risks, including risks we have not yet identified or that we may currently believe are immaterial or unlikely.

As a publicly-traded security, the value of our stock moves up and down based on trends or market expectations that may affect a broad range of equity investments, specific industries, or individual securities. These movements may result from external disclosures about various topics, such as economic growth, interest rates, employment or inflation.

Movements in our stock price may also result from our own activities, by our earnings or by changes in strategies or management. In conjunction with our investment in ISB, we have entered new markets that are not adjacent to our existing footprint. Losses generated by ISB as it continues its de novo growth have adversely impacted net income. In addition to the impact on net income, the geographic dispersion of these markets represents additional shareholder risk.

In addition to the capital requirements mandated by regulatory authorities, our ability to grow is limited by the amount of capital we generate. In recent years, we have focused on earnings retention and have used non-equity capital sources to support our growth. We have not traditionally issued capital stock to support balance sheet growth. Capital adequacy is therefore a significant risk factor.

To the extent that we are dependent on our banking subsidiaries lending and deposit gathering functions to generate income, shareholders are also exposed to credit risk, interest rate risk and liquidity risk.

Properties

As of December 31, 2007, BancShares subsidiary financial institutions operated branch offices at 396 locations in North Carolina, Virginia, West Virginia, Maryland, Tennessee, Florida, Georgia, Texas, Arizona, California, New Mexico, Colorado, Oregon and Washington. BancShares owns many of the buildings and leases other facilities from third parties. In early 2007, ISB announced plans to expand into four new markets: Dallas, Texas; Oklahoma City, Oklahoma; Kansas City, Missouri; and Kansas City, Kansas.

Additional information relating to premises, equipment and lease commitments is set forth in Note E of BancShares consolidated financial statements.

Market for Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

BancShares Class A and Class B common stock is traded in the over-the-counter market, and the Class A common stock is listed on the NASDAQ Global Select Market under the symbol FCNCA. The Class B common stock is quoted on the OTC Bulletin Board under the symbol FCNCB. As of December 31, 2007, there were 2,122 holders of record of the Class A common stock, and 391 holders of record of the Class B common stock.

The per share cash dividends declared by BancShares and the high and low sales prices for each quarterly period during 2007 and 2006 are set forth in Table 17 under the caption Per Share of Stock of this report. A cash dividend of 27.5 cents per share was declared by the Board of Directors on January 28, 2008, payable April 7, 2008, to holders of record as of March 17, 2008. Payment of dividends is made at the discretion of the Board of Directors and is contingent upon satisfactory earnings as well as projected future capital needs. BancShares principal source of liquidity for payment of shareholder dividends is the dividend it receives from FCB. FCB is subject to various requirements under federal and state banking laws that restrict the payment of dividends and its ability to lend to BancShares. Subject to the foregoing, it is currently management s expectation that comparable cash dividends will continue to be paid in the future.

During the fourth quarter of 2007, BancShares did not issue, sell or repurchase any Class A or Class B common stock.

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The following graph compares the cumulative total shareholder return (CTSR) of our Class A common stock during the previous five years with the CTSR over the same measurement period of the Nasdaq-U.S. index and the Nasdaq Banks index. Each trend line assumes that $100 was invested on December 31, 2002, and that dividends were reinvested for additional shares.

Controls and Procedures

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

Management s Annual Report on Internal Control Over Financial Reporting is included on page 38 of this Report. The report of BancShares independent accountants regarding BancShares internal control over financial reporting is included on page 39 of this Report.

As previously reported, during the third quarter of 2007, we identified a significant deficiency in the design and operation of our internal controls over financial reporting in our Working Capital Finance lending function. As a result of changes and enhancements in internal controls within the Working Capital Finance lending function, no significant deficiency existed as of December 31, 2007. Except for the changes made within the Working Capital Finance lending group, no change in BancShares internal control over financial reporting was identified during the evaluation that occurred during the fourth quarter of 2007 that has materially affected, or is reasonably like to materially affect, BancShares internal control over financial reporting.

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Available Information

BancShares does not have its own separate Internet website. However, FCB s Internet website (www.firstcitizens.com) includes a hyperlink to the SEC s website where the public may obtain copies of BancShares annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Interested parties may also directly access the SEC s Internet website that contains reports and other information that BancShares files electronically with the SEC. The address of the SEC s website is www.sec.gov.

Management s Discussion and Analysis of Financial Condition and Results of Operations

This discussion and related financial data should be read in conjunction with the audited consolidated financial statements and related footnotes of First Citizens BancShares, Inc. (BancShares), presented on pages 37 through 66 of this report. Intercompany accounts and transactions have been eliminated. Although certain amounts for prior years have been reclassified to conform to statement presentations for 2007, the reclassifications have no effect on shareholders equity or net income as previously reported.

OVERVIEW

BancShares is a financial holding company headquartered in Raleigh, North Carolina that offers full-service banking through two wholly-owned banking subsidiaries, First-Citizens Bank & Trust Company (FCB), a North Carolina-chartered bank, and IronStone Bank (ISB), a federally-chartered thrift institution. FCB operates branches in North Carolina, Virginia, Maryland, Tennessee and West Virginia. ISB operates branches in Florida, Georgia, Texas, New Mexico, Arizona, California, Colorado, Oregon and Washington. ISB also operates a loan production office in Missouri and plans to open similar offices in Kansas and Oklahoma in early 2008. Beyond the traditional branch network, we offer customer access through telephone and online banking and our extensive ATM network.

BancShares earnings and cash flows are primarily derived from the commercial banking activities conducted by its banking subsidiaries. We offer commercial and consumer loans, deposit and cash management products, cardholder, merchant, wealth management services as well as various other products and services typically offered by commercial banks. FCB and ISB gather interest-bearing and noninterest-bearing deposits from retail and commercial customers. BancShares and its subsidiaries also secure funding through various non-deposit sources. We invest the liquidity generated from these funding sources in interest-earning assets such as loans and leases, investment securities and overnight investments. We also invest in the bank premises, furniture and equipment used to conduct the subsidiaries commercial banking business.

Various external factors influence customer demand for our loan and deposit products. In an effort to control the rate of economic growth and inflation, monetary actions by the Federal Reserve are significant to the business environment in which we operate. During 2007, the Federal Reserve decreased the discount rate and the federal funds rate by 100 basis points, compared to increases totaling 100 basis points during 2006, movements that triggered corresponding adjustments to the prime rate. During early 2008, in response to significant world-wide market turbulence and economic weakness, the Federal Reserve further reduced the discount rate and Federal funds rate by 125 basis points, again prompting reductions in the prime rate. Interest rate decisions by the Federal Reserve have a significant impact on the pricing of and demand for loan, deposit and cash management products.

The general strength of the economy also influences the quality and collectibility of our loan and lease portfolio. External economic indicators such as consumer bankruptcy rates and business debt service capacity closely follow trends in the economic cycle. Demand for our deposit and cash management products is also dependent on the current and anticipated volatility of alternative investment markets.

Although we are unable to control the external factors that influence our business, by managing our liquidity and interest rate exposures and by closely monitoring asset quality, we seek to minimize the potentially adverse risks of unforeseen and unfavorable economic trends and take advantage of favorable economic conditions when appropriate.

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Financial institutions frequently focus their strategic and operating emphasis on maximizing profitability and therefore measure their relative success by reference to profitability measures such as return on average assets or return on average shareholders equity. BancShares return on average assets and return on average equity have historically compared unfavorably to the returns of similar-sized financial holding companies. Instead, we have placed primary emphasis upon asset quality, balance sheet liquidity and capital conservation, even when those priorities may be detrimental to short-term profitability.

Based on our competitive position and strategic focus within the financial services industry, we believe opportunities for significant long-term growth and expansion exist. We operate in diverse and growing geographic markets and believe that by offering competitive products and superior customer service, we can increase our business volumes and profitability. We continue to concentrate our marketing efforts on business owners, medical and other professionals and financially active individuals. We seek to increase fee income in areas such as wealth management, cardholder and merchant services, insurance and cash management. Leveraging on our investments in technology, we also focus on opportunities to generate income by providing various processing services to other banks.

We attempt to mitigate certain of the risks that can endanger our profitability and growth prospects. While we are attentive to all areas of risk, economic risk is especially problematic due to the potential for material financial impact and our lack of control over the various risks including recession, rapid movements in interest rates, changes in the yield curve and significant shifts in inflationary expectations.

PERFORMANCE SUMMARY

BancShares reported net income of $108.6 million during 2007, compared to $126.5 million in 2006. Net income for 2007 declined 14.1 percent when compared to 2006. Return on average assets was 0.68 percent for 2007 compared to 0.83 percent for 2006. Return on average shareholders equity was 7.92 percent and 10.19 percent for 2007 and 2006, respectively. Net income per share for 2007 totaled $10.41, compared to $12.12 for 2006.

Significant items contributing to the $17.9 million decrease in net income during 2007 included higher levels of noninterest expense and provision for credit losses, partially offset by higher noninterest income. Net interest income during 2007 increased only $3.8 million, or 0.8 percent versus 2006. Although average interest-earning assets grew by $654.9 million or 4.8 percent during 2007, the combined impact of a flat yield curve and highly competitive loan and deposit pricing caused the taxable-equivalent net yield on interest-earning assets to decline 13 basis points to 3.41 percent during 2007, when compared to 2006.

During 2007 average interest-earning assets grew by $654.9 million or 4.8 percent, with such growth funded through a $621.0 million or 5.5 percent increase in average interest-bearing liabilities. Loan growth was moderate at $523.8 million or 5.2 percent. Short-term borrowings increased $373.0 million due to strong growth in cash management. Average interest-bearing deposits increased $292.5 million due to growth in time deposits and money market accounts.

The provision for credit losses increased $12.7 million or 60.6 percent during 2007. Net charge-offs for 2007 totaled $28.0 million, compared to $18.0 million recorded during the same period of 2006. Net charge-offs as a percentage of average loans and leases equaled 0.27 percent and 0.18 percent respectively for 2007 and 2006. Nonperforming assets equaled 0.18 percent of total loans and leases and other real estate as of December 31, 2007, down from 0.20 percent as of December 31, 2006.

Noninterest income increased $24.1 million or 8.9 percent during 2007. Cardholder and merchant services income and income from wealth advisory services continued to display robust growth trends during 2007. Service charges on deposit accounts increased $5.3 million or 7.3 percent in 2007, reversing a two-year decline.

Noninterest expense increased $43.6 million or 8.2 percent during 2007. Much of the increase resulted from continued growth and expansion of the branch network.

Table 2 details business combinations during 2007, 2006 and 2005. During 2007 and 2006, BancShares sold three entities two insurance companies and a transaction processing company. The 2005 branch acquisition was accounted for as a purchase, with the results of operations included with BancShares consolidated financial statements since the respective acquisition date. No material purchase transactions occurred during the three-year period presented.

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Table 1

FINANCIAL SUMMARY AND SELECTED AVERAGE BALANCES AND RATIOS

	2007	2006	2005	2004	2003
			(thousands, except share data and ratios)		
SUMMARY OF OPERATIONS					
Interest income	$ 904,056	$ 830,315	$ 669,540	$ 524,013	$ 512,857
Interest expense	423,714	353,737	218,151	133,826	148,537
Net interest income	480,342	476,578	451,389	390,187	364,320
Provision for credit losses	33,594	20,922	33,514	34,690	24,617
Net interest income after provision for credit losses	446,748	455,656	417,875	355,497	339,703
Noninterest income	295,470	271,367	257,666	245,884	237,725
Noninterest expense	574,664	531,077	496,871	477,186	460,827
Income before income taxes	167,554	195,946	178,670	124,195	116,601
Income taxes	58,937	69,455	65,808	49,352	41,414
Net income	$ 108,617	$ 126,491	$ 112,862	$ 74,843	$ 75,187
Net interest income, taxable equivalent	$ 488,019	$ 482,927	$ 455,687	$ 392,242	$ 366,381
SELECTED AVERAGE BALANCES					
Total assets	$ 15,919,222	$ 15,240,327	$ 13,905,260	$ 12,856,102	$ 12,245,840
Investment securities	3,144,052	3,028,384	2,533,161	2,157,367	2,585,376
Loans and leases	10,513,599	9,989,757	9,375,249	8,901,628	7,893,621
Interest-earning assets	14,292,322	13,637,388	12,503,877	11,493,005	10,939,526
Deposits	12,659,236	12,452,955	11,714,569	10,961,380	10,433,781
Interest-bearing liabilities	11,883,421	11,262,423	10,113,999	9,327,436	9,163,960
Long-term obligations	405,758	450,272	353,885	287,333	255,379
Shareholders equity	$ 1,370,617	$ 1,241,254	$ 1,131,066	$ 1,053,860	$ 996,578
Shares outstanding	10,434,453	10,434,453	10,434,453	10,435,247	10,452,523
SELECTED PERIOD-END BALANCES					
Total assets	$ 16,212,107	$ 15,729,697	$ 14,639,392	$ 13,265,711	$ 12,566,961
Investment securities	3,236,835	3,221,048	2,929,516	2,125,524	2,469,447
Loans and leases	10,963,904	10,273,043	9,656,230	9,364,822	8,333,073
Interest-earning assets	14,466,948	13,842,688	13,066,758	11,874,089	11,096,925
Deposits	12,928,544	12,743,324	12,173,858	11,350,798	10,711,332
Interest-bearing liabilities	12,118,967	11,612,372	10,745,696	9,641,368	9,251,903
Long-term obligations	404,392	401,198	408,987	285,943	289,277
Shareholders equity	$ 1,441,208	$ 1,310,819	$ 1,181,059	$ 1,086,310	$ 1,029,305
Shares outstanding	10,434,453	10,434,453	10,434,453	10,434,453	10,436,345
PROFITABILITY RATIOS (averages)					
Rate of return on:					
Total assets	0.68%	0.83%	0.81%	0.58%	0.61%
Shareholders equity	7.92	10.19	9.98	7.10	7.54
Dividend payout ratio	10.57	9.08	10.17	15.34	15.30

LIQUIDITY AND CAPITAL RATIOS (averages)					
Loans and leases to deposits	83.05%	80.22%	80.03%	81.21%	75.65%
Shareholders equity to total assets	8.61	8.14	8.13	8.20	8.14
Time certificates of $100,000 or more to total deposits	17.33	15.34	12.57	11.05	10.33
PER SHARE OF STOCK					
Net income	$ 10.41	$ 12.12	$ 10.82	$ 7.17	$ 7.19
Cash dividends	1.10	1.10	1.10	1.10	1.10
Market price at December 31 (Class A)	145.85	202.64	174.42	148.25	120.50
Book value at December 31	138.12	125.62	113.19	104.11	98.63
Tangible book value at December 31	127.72	115.02	102.35	93.12	87.56

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Table 2

BUSINESS COMBINATIONS

Year	Description of transaction	Total Loans	Total Deposits
		(thousands)	
2007	Sale of American Guaranty Insurance Company, a property and casualty insurance company	$	$
2007	Sale of Triangle Life Insurance Company, an accident and life insurance company		
2006	Sale of T-TECH, Inc., a payments processing company		
2006	Sale of one branch by FCB	(36)	(20,553)
2005	Purchase of one branch by FCB	11	20,957

CRITICAL ACCOUNTING POLICIES

Information included in our audited financial statements and management s discussion and analysis is derived from our accounting records, which are maintained in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry. While much of the information is definitive, certain accounting issues are highly dependent upon estimates and assumptions made by management. An understanding of these estimates and assumptions is vital to understanding BancShares financial statements. Critical accounting policies are those policies that are most important to the determination of our financial condition and results of operations or that require management to make assumptions and estimates that are subjective or complex.

We periodically evaluate our critical accounting policies, including those related to the allowance for credit losses, pension plan assumptions and income taxes. While we base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, actual results may differ from these estimates under different assumptions or outcomes.

Allowance for credit losses. The allowance for credit losses, which consists of the allowance for loan and lease losses and the liability for unfunded credit commitments, reflects the estimated losses resulting from the inability of our customers to make required payments. The allowance for credit losses reflects management s evaluation of the risk characteristics of the loan and lease portfolio under current economic conditions and considers such factors as the financial condition of the borrower, fair market value of collateral and other items that, in our opinion, deserve current recognition in estimating possible loan and lease losses. Our evaluation process is based on historical evidence and current trends among delinquencies, defaults and nonperforming assets.

Management considers the established allowance adequate to absorb losses that relate to loans and leases as well as unfunded loan commitments outstanding at December 31, 2007, although future additions may be necessary based on changes in economic conditions and other factors. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for credit losses. These agencies may require the recognition of additions to the allowance based on their judgments of information available to them at the time of their examination. If the financial condition of our borrowers were to deteriorate, resulting in an impairment of their ability to make payments, our estimates would be updated, and additions to the allowance may be required.

Pension plan assumptions. BancShares offers a defined benefit pension plan to qualifying employees. The calculation of the obligation, future plan asset value, funded status and related pension expense under the pension plan requires the use of actuarial valuation methods and assumptions. The valuations and assumptions used to determine the future value of pension plan assets and liabilities are subject to management judgment and may differ significantly depending upon the assumption used. The discount rate used to estimate the present value of the benefits to be paid under the pension plan reflects the interest rate that could be obtained for a suitable investment used to fund the obligations. The assumed discount rate equaled 6.25 percent at December 31, 2007, compared to 5.75 percent at December 31, 2006 due to changes in market interest rates. Assuming other variables remain unchanged, an increase in the assumed discount rate would reduce the calculated benefit obligations, which would result in reduced expense. Conversely, a reduction in the assumed discount rate would cause an increase in obligations, thereby resulting in higher employee benefits expense.

We also estimate a long-term rate of return on pension plan assets that is used to calculate the value of plan assets over time. We consider such factors as the actual return earned on plan assets, historical returns on the various asset classes in the plan assets and projections of future returns on various asset classes. Based on these factors, we estimated the expected long-term return on plan assets to be 8.50 percent for 2007 and 2006. Assuming other variables remain unchanged, an increase in the long-term rate of return on plan assets reduces pension expense.

The assumed rate of future compensation increases is reviewed annually based on actual experience and future salary expectations. The compensation increase assumption was 4.25 percent during 2007 and 2006. Assuming other variables remain unchanged, a reduction in the rate of future compensation increases results in lower pension expense.

Income taxes. Management estimates income tax expense using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the amount of assets and liabilities reported in the consolidated financial statements and their respective tax bases. In estimating the liabilities and related expense related to income taxes, management assesses the relative merits and risks of various tax positions considering statutory, judicial and regulatory guidance. Because of the complexity of tax laws and regulations, interpretation is difficult and subject to differing judgments.

Changes in the estimate of income tax liabilities occur periodically due to changes in actual or estimated future tax rates and projections of taxable income, interpretations of tax laws, the complexities of multi-state income tax reporting, the status of examinations being conducted by various taxing authorities and the impact of newly enacted legislation or guidance as well as income tax accounting pronouncements.

INTEREST-EARNING ASSETS

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

We have historically focused on maintaining high asset quality, which results in a loan and lease portfolio subjected to strenuous underwriting and monitoring procedures. That focus on asset quality also influences our investment securities portfolio. At December 31, 2007, United States Treasury and government agency securities represented 97.8 percent of our investment securities portfolio. Overnight investments are selectively made with other financial institutions that are within our risk tolerance.

Changes in our interest-earning assets reflect the impact of liquidity generated by deposits and short-term borrowings, the majority of which arises from various cash management products. The size of the investment securities portfolio changes based on trends among loans, deposits and short-term borrowings. When demand for deposit and cash management products exceeds loan and lease demand, we invest excess funds in the securities portfolio. Conversely, when loan demand exceeds growth in deposits and short-term borrowings, we allow overnight investments to decline and use proceeds from maturing securities to fund loan demand.

Interest-earning assets averaged $14.29 billion during 2007, an increase of $654.9 million or 4.8 percent over 2006 levels, compared to a $1.13 billion or 9.1 percent increase in 2006 over 2005 levels. The increase among interest-earning assets during 2007 and 2006 resulted from growth in loans, leases and investment securities.

Loans and leases. As of December 31, 2007, loans and leases outstanding equaled $10.96 billion, a 6.7 percent increase over the December 31, 2006 balance of $10.27 billion. The $690.9 million increase in loans and leases during 2007 resulted from growth among commercial mortgage, commercial and industrial and revolving mortgage loans. FCB loans and leases increased $489.1 million or 5.8 percent, while ISB loans and leases increased $201.8 million or 10.8 percent during 2007. Loan balances for the last five years are presented in Table 3.

Loans secured by real estate totaled $7.46 billion at December 31, 2007, compared to $7.03 billion at December 31, 2006. Loans secured by commercial mortgages totaled $3.98 billion at December 31, 2007, a $256.7 million or 6.9 percent increase from December 31, 2006. Although we continued to see adequate growth in commercial mortgage lending during 2007, competition for high quality commercial mortgage loans remains strong. In 2006 commercial mortgage loans increased 5.9 percent over 2005. The sustained growth reflects our continued focus on small business customers, particularly among medical-related and other professional customers targeted by our banking subsidiaries. As a percentage of total loans and leases, commercial mortgage loans represent 36.3 percent at December 31, 2007 and December 31, 2006. A large percentage of our commercial mortgage portfolio is secured by owner-occupied facilities, rather than investment property. These loans are underwritten based primarily upon the cash flow from the operation of the business rather than the value of the real estate collateral.

At December 31, 2007, revolving loans secured by real estate totaled $1.49 billion, compared to $1.33 billion at December 31, 2006. The $168.0 million or 12.7 percent increase in revolving mortgage loans in 2007 reflects favorable results from competitive enhancements made to our home equity line of credit product in early 2007 to allow us to attract new, financially-active business and retail customers. At December 31, 2007, revolving mortgage loans represented 13.6 percent of gross loans and leases, compared to 12.9 percent at December 31, 2006.

Commercial and industrial loans equaled $1.71 billion at December 31, 2007, compared to $1.53 billion at December 31, 2006. Commercial and industrial loans realized growth of $180.6 million or 11.8 percent during 2007 following an increase of $320.2 million or 26.5 percent from 2005 to 2006. Growth among these loans in 2007 results from continuing focus on business owners and medical professionals and new opportunities arising from our geographic expansion. Commercial and industrial loans represented 15.6 percent and 14.9 percent of loans and leases, respectively, as of December 31, 2007 and 2006.

Consumer loans not secured by real estate experienced little growth during 2007, totaling $1.37 billion at December 31, 2007, an increase of $7.7 million from the prior year. This compares to an increase during 2006 of $41.6 million or 3.2 percent. At December 31, 2007 and 2006, consumer loans not secured by real estate represented 12.5 percent and 13.2 percent of the total portfolio, respectively.

We anticipate moderate levels of growth in commercial mortgage and commercial and industrial loans in 2008. Our growth and expansion in new markets will favorably influence aggregate loan and lease demand among our business customers. However, projected economic instability will likely curb customer demand for loans and lender support for increased debt levels. All growth projections are therefore subject to change due to further economic deterioration or improvement and other external factors.

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Table 3

LOANS AND LEASES

	December 31				
	2007	2006	2005	2004	2003
	(thousands)				
Real estate:					
Construction and land development	$ 810,818	$ 783,680	$ 766,945	$ 588,092	$ 509,578
Commercial mortgage	3,982,496	3,725,752	3,518,563	3,279,729	2,654,414
Residential mortgage	1,029,030	1,025,235	1,016,677	979,663	929,096
Revolving mortgage	1,494,431	1,326,403	1,368,729	1,714,032	1,598,603
Other mortgage	145,552	165,223	172,712	171,700	173,489
Total real estate loans	7,462,327	7,026,293	6,843,626	6,733,216	5,865,180
Commercial and industrial	1,707,394	1,526,818	1,206,585	980,164	935,514
Consumer	1,368,228	1,360,524	1,318,971	1,397,820	1,303,718
Lease financing	340,601	294,366	233,499	192,164	160,390
Other	85,354	65,042	53,549	61,458	68,271
Total loans and leases	10,963,904	10,273,043	9,656,230	9,364,822	8,333,073
Less allowance for loan and lease losses	136,974	132,004	128,847	123,861	112,304
Net loans and leases	$ 10,826,930	$ 10,141,039	$ 9,527,383	$ 9,240,961	$ 8,220,769

There were no foreign loans or leases in any period.

Investment securities. Investment securities available for sale at December 31, 2007 and 2006 totaled $3.23 billion and $3.00 billion, respectively, a $227.4 million increase. Available-for-sale securities are reported at their aggregate fair value, and unrealized gains and losses on available-for-sale securities are included as a component of other comprehensive income, net of deferred taxes.

Investment securities held to maturity totaled $7.6 million and $219.2 million, respectively, at December 31, 2007 and 2006. The $211.6 million reduction in investment securities held to maturity during 2007 resulted from scheduled maturities and the designation of all newly-purchased securities as available-for-sale. Securities that are classified as held-to-maturity reflect BancShares ability and positive intent to hold those investments until maturity.

Table 4 presents detailed information relating to the investment securities portfolio.

Income on interest-earning assets. Interest income amounted to $904.1 million during 2007, a $73.7 million or 8.9 percent increase from 2006, compared to a $160.8 million or 24.0 percent increase from 2005 to 2006. The increase in interest income during 2007 resulted from higher asset yields and growth in interest-earning assets.

Table 5 analyzes interest-earning assets and interest-bearing liabilities for the five years ending December 31, 2007. To assess the impact of the tax-exempt status of income earned on certain loans, leases and investment securities, Table 5 is prepared on a taxable-equivalent basis. The taxable-equivalent yield on interest-earning assets was 6.38 percent during 2007, a 24 basis point increase from the 6.14 percent reported in 2006. The taxable-equivalent yield on interest-earning assets equaled 5.39 percent in 2005.

The taxable-equivalent yield on the loan and lease portfolio increased marginally from 6.86 percent in 2006 to 6.94 percent in 2007. The combination of the 8 basis point yield increase, and the $523.8 million or 5.2 percent growth in average loans and leases contributed to an increase in loan interest income of $44.2 million or 6.5 percent over 2006. This followed an increase of $109.0 million or 19.0 percent in loan interest income in 2006 over 2005, the combined result of a $614.5 million increase in average loans and leases and a 72 basis point yield increase. The higher yield during 2006 reflects the impact of Federal Reserve actions to increase market interest rates.

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Table 4

INVESTMENT SECURITIES

	December 31							
	2007				2006		2005	
	Cost	Fair Value	Average Maturity (Yrs./Mos.)	Taxable Equivalent Yield	Cost	Fair Value	Cost	Fair Value
	(thousands, except maturity and yield information)							
Investment securities available for sale:								
U. S. Government:								
Within one year	$ 1,667,530	$ 1,675,309	0/6	4.83%	$ 1,514,194	$ 1,503,970	$ 1,159,556	$ 1,140,602
One to five years	1,377,766	1,399,482	1/7	4.55	1,367,029	1,363,571	1,055,472	1,044,913
Five to ten years	6,435	6,419	5/7	4.88	6,337	6,095	115	109
Over ten years	78,012	77,632	26/11	5.47	53,250	52,054	29,721	29,097
Total	3,129,743	3,158,842	1/8	4.72	2,940,810	2,925,690	2,244,864	2,214,721
State, county and municipal:								
Within one year	709	708	0/4	3.86	875	873	954	947
One to five years	2,246	2,236	2/3	4.11	2,734	2,696	3,013	2,977
Five to ten years	356	363	5/3	4.95	470	477	1,115	1,110
Over ten years	66	65	21/0	4.44	211	211	145	145
Total	3,377	3,372	2/6	4.15	4,290	4,257	5,227	5,179
Other:								
Within one year								
One to five years								
Five to ten years								
Over ten years	7,771	9,390	10/4	11.08	10,173	10,240	11,902	11,902
Total	7,771	9,390	10/4	11.08				