TRUSTMARK CORP
Form 10-Q
November 07, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended September 30, 2013

or

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 000-03683

Trustmark Corporation
(Exact name of registrant as specified in its charter)

Mississippi	64-0471500
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
248 East Capitol Street, Jackson, Mississippi	39201
(Address of principal executive offices)	(Zip Code)

(601) 208-5111
(Registrant's telephone number, including area code)

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 þ No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company” in Rule 12b of the Exchange Act.

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

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

As of October 31, 2013, there were 67,186,694 shares outstanding of the registrant’s common stock (no par value).

Forward-Looking Statements

Certain statements contained in this document constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You can identify forward-looking statements by words such as "may," "hope," "will," "should," "expect," "plan," "anticipate," "intend," "believe," "estimate," "predict," "potential," "continue," "could," "fu negative of those terms or other words of similar meaning. You should read statements that contain these words carefully because they discuss our future expectations or state other "forward-looking" information. These forward-looking statements include, but are not limited to, statements relating to anticipated future operating and financial performance measures, including net interest margin, credit quality, business initiatives, growth opportunities and growth rates, among other things, and encompass any estimate, prediction, expectation, projection, opinion, anticipation, outlook or statement of belief included therein as well as the management assumptions underlying these forward-looking statements. You should be aware that the occurrence of the events described under the caption "Risk Factors" in Trustmark's filings with the Securities and Exchange Commission could have an adverse effect on our business, results of operations and financial condition. Should one or more of these risks materialize, or should any such underlying assumptions prove to be significantly different, actual results may vary significantly from those anticipated, estimated, projected or expected.

Risks that could cause actual results to differ materially from current expectations of Management include, but are not limited to, changes in the level of nonperforming assets and charge-offs, local, state and national economic and market conditions, including the extent and duration of the current volatility in the credit and financial markets, a material decline in, or changes in our ability to measure the fair value of assets in our portfolio (including loans and investment securities), material changes in the level and/or volatility of market interest rates, the performance and demand for the products and services we offer, including the level and timing of withdrawals from our deposit accounts, acceleration of significantly extended deterioration in loan performance and default levels, a significant increase in foreclosure activity, the costs and effects of litigation and of unexpected or adverse outcomes in such litigation, our ability to attract noninterest-bearing deposits and other low-cost funds, competition in loan and deposit pricing, as well as the entry of new competitors into our markets through de novo expansion and acquisitions, economic conditions, including the potential impact of the European financial crisis on the U.S. economy and the markets we serve, and monetary and other governmental actions designed to address the level and volatility of interest rates and the volatility of securities, currency and other markets, the enactment of legislation and changes in existing regulations, or enforcement practices, or the adoption of new regulations, changes in accounting standards and practices, including changes in the interpretation of existing standards, that affect our consolidated financial statements, changes in consumer spending, borrowings and savings habits, technological changes, changes in the financial performance or condition of our borrowers, changes in our ability to control expenses, changes in our compensation and benefit plans, greater than expected costs or difficulties related to the integration of acquisitions or new products and lines of business, natural disasters, environmental disasters, acts of war or terrorism, and other risks described in our filings with the Securities and Exchange Commission.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Except as required by law, we undertake no obligation to update or revise any of this information, whether as the result of new information, future events or developments or otherwise.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

Trustmark Corporation and Subsidiaries
Consolidated Balance Sheets
($ in thousands)

	(Unaudited) September 30, 2013	December 31, 2012
Assets		
Cash and due from banks (noninterest-bearing)	$335,695	$231,489
Federal funds sold and securities purchased under reverse repurchase agreements	7,867	7,046
Securities available for sale (at fair value)	3,372,101	2,657,745
Securities held to maturity (fair value: $70,949-2013; $46,888-2012)	69,980	42,188
Loans held for sale (LHFS)	119,986	257,986
Loans held for investment (LHFI)	5,696,641	5,592,754
Less allowance for loan losses, LHFI	68,632	78,738
Net LHFI	5,628,009	5,514,016
Acquired loans:		
Noncovered loans	837,875	81,523
Covered loans	37,250	52,041
Less allowance for loan losses, acquired loans	5,333	6,075
Net acquired loans	869,792	127,489
Net LHFI and acquired loans	6,497,801	5,641,505
Premises and equipment, net	208,837	154,841
Mortgage servicing rights	63,150	47,341
Goodwill	372,463	291,104
Identifiable intangible assets	44,424	17,306
Other real estate, excluding covered other real estate	116,329	78,189
Covered other real estate	5,092	5,741
FDIC indemnification asset	17,085	21,774
Other assets	574,387	374,412
Total Assets	$11,805,197	$9,828,667
Liabilities		
Deposits:		
Noninterest-bearing	$2,643,612	$2,254,211
Interest-bearing	7,143,622	5,642,306
Total deposits	9,787,234	7,896,517
Federal funds purchased and securities sold under repurchase agreements	342,465	288,829
Short-term borrowings	60,698	86,920
Long-term FHLB advances	8,562	-
Subordinated notes	49,896	49,871
Junior subordinated debt securities	61,856	61,856
Other liabilities	164,972	157,305
Total Liabilities	10,475,683	8,541,298
Shareholders' Equity		
Common stock, no par value:		

Authorized: 250,000,000 shares		
Issued and outstanding: 67,181,694 shares - 2013; 64,820,414 shares - 2012	13,998	13,506
Capital surplus	343,759	285,905
Retained earnings	1,023,983	984,563
Accumulated other comprehensive (loss) income, net of tax	(52,226)	3,395
Total Shareholders' Equity	1,329,514	1,287,369
Total Liabilities and Shareholders' Equity	$11,805,197	$9,828,667

See notes to consolidated financial statements.

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Trustmark Corporation and Subsidiaries
Consolidated Statements of Income
($ in thousands except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest Income				
Interest and fees on LHFI & LHFS	$65,403	$69,656	$194,572	$212,783
Interest and fees on acquired loans	19,183	5,229	52,952	13,263
Interest on securities:				
Taxable	18,654	15,909	53,740	51,645
Tax exempt	1,274	1,358	3,869	4,080
Interest on federal funds sold and securities purchased under reverse repurchase agreements	8	6	17	17
Other interest income	372	339	1,099	1,005
Total Interest Income	104,894	92,497	306,249	282,793
Interest Expense				
Interest on deposits	4,970	5,725	14,950	19,543
Interest on federal funds purchased and securities sold under repurchase agreements	106	135	275	448
Other interest expense	1,389	1,358	4,392	4,131
Total Interest Expense	6,465	7,218	19,617	24,122
Net Interest Income	98,429	85,279	286,632	258,671
Provision for loan losses, LHFI	(3,624)	3,358	(11,438)	7,301
Provision for loan losses, acquired loans	3,292	2,105	1,870	3,583
Net Interest Income After Provision for Loan Losses	98,761	79,816	296,200	247,787
Noninterest Income				
Service charges on deposit accounts	13,852	13,135	38,462	37,960
Bank card and other fees	8,929	6,924	26,381	22,467
Mortgage banking, net	8,440	11,150	28,318	29,629
Insurance commissions	8,227	7,533	23,483	21,318
Wealth management	7,520	5,612	21,335	16,875
Other, net	165	512	(3,171)	3,120
Security gains (losses), net	-	(1)	378	1,041
Total Noninterest Income	47,133	44,865	135,186	132,410
Noninterest Expense				
Salaries and employee benefits	56,043	47,404	165,040	140,795
Services and fees	13,580	11,682	39,428	34,179
Net occupancy - premises	6,644	5,352	19,302	15,244
Equipment expense	6,271	5,095	18,138	15,190
ORE/Foreclosure expense	3,079	1,702	12,030	7,992
FDIC assessment expense	2,376	1,826	6,773	5,427
Other expense	13,531	10,399	50,153	38,366
Total Noninterest Expense	101,524	83,460	310,864	257,193
Income Before Income Taxes	44,370	41,221	120,522	123,004

Income taxes	11,336	11,317	31,501	33,431
Net Income	$33,034	$29,904	$89,021	$89,573
Earnings Per Common Share				
Basic	$0.49	$0.46	$1.33	$1.39
Diluted	$0.49	$0.46	$1.33	$1.38
Dividends Per Common Share	$0.23	$0.23	$0.69	$0.69

See notes to consolidated financial statements.

Trustmark Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
($ in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income per consolidated statements of income	$33,034	$29,904	$89,021	$89,573
Other comprehensive (loss) income, net of tax:				
Unrealized (losses) gains on available for sale securities:				
Unrealized holding (losses) gains arising during the period	(17,461)	2,618	(60,596)	1,834
Less: adjustment for net gains realized in net income	-	-	(233)	(643)
Pension and other postretirement benefit plans:				
Change in the net actuarial loss during the period	1,565	976	3,996	2,936
Derivatives:				
Change in the accumulated gain on effective cash flow hedge derivatives	(242)	-	1,212	-
Other comprehensive (loss) income, net of tax	(16,138)	3,594	(55,621)	4,127
Comprehensive income	$16,896	$33,498	$33,400	$93,700

See notes to consolidated financial statements.

Trustmark Corporation and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
($ in thousands)
(Unaudited)

	2013	2012
Balance, January 1,	$1,287,369	$1,215,037
Net income per consolidated statements of income	89,021	89,573
Other comprehensive (loss) income	(55,621)	4,127
Common stock dividends paid	(46,674)	(44,941)
Common stock issued-net, long-term incentive plans:		
Stock options	845	268
Restricted stock	(963)	(1,203)
Excess tax (expense) benefit from stock-based compensation arrangements	(808)	35
Compensation expense, long-term incentive plans	2,850	3,119
Common stock issued, business combinations	53,495	12,000
Balance, September 30,	$1,329,514	$1,278,015

See notes to consolidated financial statements.

Trustmark Corporation and Subsidiaries
Consolidated Statements of Cash Flows
($ in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2013	2012
Operating Activities		
Net income	$89,021	$89,573
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses, net	(9,568)	10,884
Depreciation and amortization	27,800	21,718
Net amortization of securities	5,390	5,499
Securities gains, net	(378)	(1,041)
Gains on sales of loans, net	(24,220)	(21,884)
Bargain purchase gain on acquisition	-	(3,635)
Deferred income tax provision (benefit)	14,145	(13,035)
Proceeds from sales of loans held for sale	1,156,310	1,330,506
Purchases and originations of loans held for sale	(1,021,237)	(1,419,368)
Originations and sales of mortgage servicing rights, net	(15,551)	(17,074)
Net increase in other assets	(74,411)	(46,425)
Net (decrease) increase in other liabilities	(3,431)	48,541
Other operating activities, net	7,390	17,048
Net cash provided by operating activities	151,260	1,307
Investing Activities		
Proceeds from calls and maturities of securities held to maturity	7,269	12,240
Proceeds from calls and maturities of securities available for sale	642,687	692,179
Proceeds from sales of securities available for sale	67,558	34,826
Purchases of securities held to maturity	(35,045)	-
Purchases of securities available for sale	(1,000,015)	(927,652)
Net (increase) decrease in federal funds sold and securities purchased under reverse repurchase agreements	(821)	3,963
Net decrease in loans	59,025	312,194
Purchases of premises and equipment	(12,862)	(12,466)
Proceeds from sales of premises and equipment	3,782	(3)
Proceeds from sales of other real estate	30,389	26,185
Net cash received in business combination	89,037	78,151
Net cash (used in) provided by investing activities	(148,996)	219,617
Financing Activities		
Net increase in deposits	150,463	28,882
Net increase (decrease) in federal funds purchased and securities sold under repurchase agreements	53,636	(195,789)
Net decrease in short-term borrowings	(21,174)	(1,613)
Payments on long-term FHLB advances	(383)	-
Redemption of junior subordinated debt securities	(33,000)	-
Common stock dividends	(46,674)	(44,941)
Common stock issued-net, long-term incentive plans	(118)	(935)
Excess tax (expense) benefit from stock-based compensation arrangements	(808)	35

Net cash provided by (used in) financing activities	101,942	(214,361)
Increase in cash and cash equivalents	104,206	6,563
Cash and cash equivalents at beginning of period	231,489	202,625
Cash and cash equivalents at end of period	$335,695	$209,188

See notes to consolidated financial statements.

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Trustmark Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

Note 1 – Business, Basis of Financial Statement Presentation and Principles of Consolidation

Trustmark Corporation (Trustmark) is a multi-bank holding company headquartered in Jackson, Mississippi. Through its subsidiaries, Trustmark operates as a financial services organization providing banking and financial solutions to corporate institutions and individual customers through 214 offices in Alabama, Florida, Mississippi, Tennessee and Texas.

The consolidated financial statements in this quarterly report on Form 10-Q include the accounts of Trustmark and all other entities in which Trustmark has a controlling financial interest. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements, and notes thereto, included in Trustmark's 2012 annual report on Form 10-K.

Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. In the opinion of Management, all adjustments considered necessary for the fair presentation of these consolidated financial statements have been included. The preparation of financial statements in conformity with these accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and income and expense during the reporting period and the related disclosures. Although Management's estimates contemplate current conditions and how they are expected to change in the future, it is reasonably possible that in 2013 actual conditions could vary from those anticipated, which could affect Trustmark's results of operations and financial condition. The allowance for loan losses, the amount and timing of expected cash flows from acquired loans and the Federal Deposit Insurance Corporation (FDIC) indemnification asset, the valuation of other real estate, the fair value of mortgage servicing rights, the valuation of goodwill and other identifiable intangibles, the status of contingencies and the fair values of financial instruments are particularly subject to change. Actual results could differ from those estimates.

Note 2 – Business Combinations

Oxford, Mississippi Branches

On March 29, 2013, Trustmark National Bank (TNB), a subsidiary of Trustmark, announced the signing of a definitive Branch Purchase and Assumption Agreement (the Agreement) pursuant to which TNB would acquire the two branches of SOUTHBank, F.S.B. (SOUTHBank), serving the Oxford, Mississippi market. TNB completed its purchase of the two branches from SOUTHBank effective as of the close of business on July 26, 2013. Pursuant to the Agreement, TNB assumed deposit accounts of approximately $11.7 million in addition to purchasing the two physical branch offices. The transaction was not material to Trustmark's consolidated financial statements and was not considered a business combination in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805, "Business Combinations."

BancTrust Financial Group, Inc.

On February 15, 2013, Trustmark completed its merger with BancTrust Financial Group, Inc. (BancTrust), a 26-year-old bank holding company headquartered in Mobile, Alabama. In accordance with the terms of the definitive agreement, the holders of BancTrust common stock received 0.125 of a share of Trustmark common stock for each share of BancTrust common stock in a tax-free exchange. Trustmark issued approximately 2.24 million shares of its common stock for all issued and outstanding shares of BancTrust common stock. The total value of the 2.24 million shares of Trustmark common stock issued to the BancTrust shareholders on the acquisition date was approximately $53.5 million, based on a closing stock price of $23.83 per share of Trustmark common stock on February 15, 2013. At closing, Trustmark repurchased the $50.0 million of BancTrust preferred stock and associated warrant issued to the U.S. Department of Treasury under the Capital Purchase Program for approximately $52.6 million.

The acquisition of BancTrust was consistent with Trustmark's strategic plan to selectively expand the Trustmark franchise. The acquisition provided Trustmark entry into more than 15 markets in Alabama and enhanced the Trustmark franchise in the Florida Panhandle.

This acquisition was accounted for under the acquisition method in accordance with FASB ASC Topic 805. Accordingly, the assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition date. The fair values of assets acquired and liabilities assumed are subject to adjustment if additional information becomes available to indicate a more accurate or appropriate value for an asset or liability during the measurement period, which is not to exceed one year from the acquisition date of February 15, 2013. Assets that are particularly susceptible to adjustment include certain loans, other real estate and certain premises and equipment.

During the second and third quarters of 2013, Trustmark recorded fair value adjustments based on the estimated fair value of certain acquired loans and other real estate. These measurement period adjustments resulted in a decrease in acquired noncovered loans of $6.8 million, a decrease in other real estate of $2.6 million, an increase in the deferred tax asset of $3.1 million, and an increase in goodwill of $5.9 million. Trustmark also recorded an adjustment to transfer $1.6 million of acquired property from premises and equipment, net to other real estate. These measurement period adjustments have been presented on a retrospective basis, consistent with applicable accounting guidance. The statement of assets purchased and liabilities assumed in the BancTrust acquisition is presented below at their adjusted estimated fair values, which were considered preliminary at September 30, 2013, as of the acquisition date of February 15, 2013 ($ in thousands):

Assets:	
Cash and due from banks	$141,616
Securities available for sale	528,016
Loans held for sale	1,050
Acquired noncovered loans	944,235
Premises and equipment, net	55,579
Identifiable intangible assets	33,498
Other real estate	40,103
Other assets	101,833
Total Assets	1,845,930
Liabilities:	
Deposits	1,740,254
Other borrowings	64,051
Other liabilities	16,761
Total Liabilities	1,821,066
Net identified assets acquired at fair value	24,864
Goodwill	81,210
Net assets acquired at fair value	$106,074

The excess of the consideration paid over the estimated fair value of the net assets acquired was $81.2 million, which was recorded as goodwill under FASB ASC Topic 805. The identifiable intangible assets acquired represent the core deposit intangible at fair value at the acquisition date. The core deposit intangible is being amortized on an accelerated basis over the estimated useful life, currently expected to be approximately 10 years.

Loans, excluding loans held for sale (LHFS), acquired from BancTrust were evaluated under a fair value process involving various degrees of deterioration in credit quality since origination, and also for those loans for which it was probable at acquisition that Trustmark would not be able to collect all contractually required payments. These loans, with the exception of revolving credit agreements and leases, are referred to as acquired impaired loans and are accounted for in accordance with FASB ASC Topic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality." Refer to Note 5 – Acquired Loans for further information on acquired loans.

The operations of BancTrust are included in Trustmark's operating results from February 15, 2013, and added revenue of $50.5 million and net income, excluding non-routine transaction expenses, of approximately $13.0 million through September 30, 2013. Included in BancTrust's net income through September 30, 2013 are recoveries on pay-offs of acquired loans of $4.2 million (after tax). Included in noninterest expense during the first nine months of 2013 are non-routine BancTrust transaction expenses totaling approximately $9.4 million (change in control and severance expense of $1.4 million included in salaries and benefits; professional fees, contract termination and other expenses of $7.9 million included in other expense). Such operating results are not necessarily indicative of future operating results.

The following table presents the unaudited pro forma financial information as if the acquisition of BancTrust had occurred on January 1, 2012. The unaudited pro forma information for the three and nine months ended September 30, 2013 and 2012, contains certain adjustments, including acquisition accounting fair value adjustments, amortization of the core deposit intangible and related income tax effects. The non-routine transaction expenses related to the BancTrust acquisition incurred during the first three months of 2013 as well as potential cost savings from the acquisition are not reflected in the unaudited pro forma amounts. The unaudited pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the acquisition been effected on the assumed date ($ in thousands except per share data).

	Pro Forma Three Months Ended September 30,		Pro Forma Nine Months Ended September 30,	
	2013	2012	2013	2012
Net Interest Income	$98,429	$103,287	$294,171	$309,481
Total Noninterest Income	47,133	48,110	137,049	142,513
Net Income	33,034	34,818	96,830	104,750
Pro Forma Earnings Per Common Share				
Basic	$0.49	$0.52	$1.40	$1.57
Diluted	$0.49	$0.52	$1.40	$1.56

Bay Bank & Trust Company

On March 16, 2012, Trustmark completed its merger with Bay Bank & Trust Co. (Bay Bank), a 76-year old financial institution headquartered in Panama City, Florida. Trustmark acquired all outstanding common stock of Bay Bank for approximately $22 million in cash and stock, comprised of $10 million in cash and the issuance of approximately 510 thousand shares of Trustmark common stock valued at $12 million. This acquisition was accounted for under the acquisition method in accordance with FASB ASC Topic 805. Accordingly, the assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of the acquisition date. The purchase price allocation was finalized in the second quarter of 2012.

The statement of assets purchased and liabilities assumed in the Bay Bank acquisition is presented below at their estimated fair values as of the acquisition date of March 16, 2012 ($ in thousands):

Assets:	
Cash and due from banks	$88,154
Securities available for sale	26,369
Acquired noncovered loans	97,914
Premises and equipment, net	9,466
Identifiable intangible assets	7,017
Other real estate	2,569
Other assets	3,471
Total Assets	234,960
Liabilities:	
Deposits	208,796
Other liabilities	526
Total Liabilities	209,322
Net assets acquired at fair value	25,638
Consideration paid to Bay Bank	22,003
Bargain purchase gain	3,635
Income taxes	-
Bargain purchase gain, net of taxes	$3,635

The bargain purchase gain represents the excess of the net of the estimated fair value of the assets acquired and liabilities assumed over the consideration paid to Bay Bank. Initially, Trustmark recognized a bargain purchase gain of $2.8 million during the first quarter of 2012 and subsequently increased the bargain purchase gain $881 thousand during the second quarter of 2012 as the fair values associated with the Bay Bank acquisition were finalized. The gain of $3.6 million recognized by Trustmark was considered a gain from a bargain purchase under FASB ASC Topic 805 and was included in other noninterest income for the nine months ended September 30, 2012. Included in noninterest expense during the first quarter of 2012 are non-routine Bay Bank transaction expenses totaling approximately $2.6 million (change in control and severance expense of $672 thousand included in salaries and benefits; contract termination and other expenses of $1.9 million included in other expense).

The identifiable intangible assets represent the core deposit intangible at fair value at the acquisition date. The core deposit intangible is being amortized on an accelerated basis over the estimated useful life, currently expected to be approximately 10 years.

Loans acquired from Bay Bank were evaluated under a fair value process involving various degrees of deterioration in credit quality since origination, and also for those loans for which it was probable at acquisition that Trustmark would not be able to collect all contractually required payments. These loans, with the exception of revolving credit agreements, are referred to as acquired impaired loans and are accounted for in accordance with FASB ASC Topic 310-30. Refer to Note 5 – Acquired Loans for further information on acquired loans.

Fair Value of Acquired Financial Instruments

For financial instruments measured at fair value, Trustmark utilized Level 2 inputs to determine the fair value of securities available for sale, time deposits (included in deposits above) and Federal Home Loan Bank (FHLB) advances (included in other borrowings above). Level 3 inputs were used to determine the fair value of acquired loans, identifiable intangible assets, and other real estate. The methodology and significant assumptions used in estimating the fair values of these financial assets and liabilities are as follows:

Securities Available for Sale

Estimated fair values for securities available for sale are based on quoted market prices where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Acquired Loans

Fair value of acquired loans is determined using a discounted cash flow model based on assumptions regarding the amount and timing of principal and interest payments, estimated prepayments, estimated default rates, estimated loss severity in the event of defaults and current market rates.

Identifiable Intangible Assets

The fair value assigned to the identifiable intangible assets, in this case core deposit intangibles, represent the future economic benefit of the potential cost savings from acquiring core deposits in the acquisition compared to the cost of obtaining alternative funding from market sources.

Other Real Estate

Other real estate was initially recorded at its estimated fair value on the acquisition date based on independent appraisals less estimated selling costs.

Time Deposits

Time deposits were valued by projecting expected cash flows into the future based on each account's contracted rate and then determining the present value of those expected cash flows using current rates for deposits with similar maturities.

FHLB Advances

FHLB advances were valued by projecting expected cash flows into the future based on each advance's contracted rate and then determining the present value of those expected cash flows using current rates for advances with similar maturities.

Please refer to Note 16 – Fair Value for more information on Trustmark's classification of financial instruments based on valuation inputs within the fair value hierarchy.

Note 3 – Securities Available for Sale and Held to Maturity

The following table is a summary of the amortized cost and estimated fair value of securities available for sale and held to maturity ($ in thousands):

	Securities Available for Sale				Securities Held to Maturity			
September 30, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
U.S. Treasury securities	$503	$ -	$ -	$503	$ -	$ -	$ -	$ -
U.S. Government agency obligations								
Issued by U.S. Government agencies	133,258	1,125	(1,370)	133,013	-	-	-	-
Issued by U.S. Government sponsored agencies	138,937	24	(6,536)	132,425	-	-	-	-
Obligations of states and political subdivisions	206,168	7,460	(637)	212,991	30,229	2,974	-	33,203
Mortgage-backed securities								
Residential mortgage pass-through securities								
Guaranteed by GNMA	48,737	596	(1,093)	48,240	2,420	158	-	2,578
Issued by FNMA and FHLMC	211,031	4,427	(663)	214,795	564	35	-	599
Other residential mortgage-backed securities								
Issued or guaranteed by FNMA, FHLMC or GNMA	2,083,906	14,665	(50,296)	2,048,275	-	-	-	-
Commercial mortgage-backed securities								
Issued or guaranteed by FNMA, FHLMC or GNMA	349,679	8,568	(4,116)	354,131	36,767	114	(2,312)	34,569
Asset-backed securities and structured financial products	225,621	2,119	(12)	227,728	-	-	-	-
Total	$3,397,840	$ 38,984	$ (64,723)	$3,372,101	$69,980	$ 3,281	$ (2,312)	$70,949
December 31, 2012								
U.S. Government agency obligations								
Issued by U.S. Government agencies	$10	$-	$-	$10	$-	$-	$-	$-
Issued by U.S. Government sponsored agencies	105,396	339	-	105,735	-	-	-	-
Obligations of states and political subdivisions	202,877	12,900	(16)	215,761	36,206	4,184	-	40,390

Mortgage-backed securities								
Residential mortgage pass-through securities								
Guaranteed by GNMA	18,981	921	-	19,902	3,245	227	-	3,472
Issued by FNMA and FHLMC	201,493	7,071	-	208,564	572	52	-	624
Other residential mortgage-backed securities								
Issued or guaranteed by FNMA, FHLMC or GNMA	1,436,812	29,574	(20)	1,466,366	-	-	-	-
Commercial mortgage-backed securities								
Issued or guaranteed by FNMA, FHLMC or GNMA	380,514	19,420	(154)	399,780	2,165	237	-	2,402
Asset-backed securities and structured financial products	238,893	2,755	(21)	241,627	-	-	-	-
Total	$2,584,976	$72,980	$(211)	$2,657,745	$42,188	$4,700	$-	$46,888

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Temporarily Impaired Securities

The table below includes securities with gross unrealized losses segregated by length of impairment ($ in thousands):

	Less than 12 Months		12 Months or More		Total	
September 30, 2013	Estimated Fair Value	Gross Unrealized (Losses)	Estimated Fair Value	Gross Unrealized (Losses)	Estimated Fair Value	Gross Unrealized (Losses)
U.S. Government agency obligations						
Issued by U.S. Government agencies	$60,939	$(1,370)	$-	$ -	$60,939	$(1,370)
Issued by U.S. Government sponsored agencies	132,140	(6,536)	-	-	132,140	(6,536)
Obligations of states and political subdivisions	27,414	(636)	569	(1)	27,983	(637)
Mortgage-backed securities						
Residential mortgage pass-through securities						
Guaranteed by GNMA	36,322	(1,093)	-	-	36,322	(1,093)
Issued by FNMA and FHLMC	49,792	(663)	-	-	49,792	(663)
Other residential mortgage-backed securities						
Issued or guaranteed by FNMA, FHLMC or GNMA	1,352,905	(50,293)	368	(3)	1,353,273	(50,296)
Commercial mortgage-backed securities						
Issued or guaranteed by FNMA, FHLMC, or GNMA	153,092	(6,428)	-	-	153,092	(6,428)
Asset-backed securities and structured financial products	16,513	(12)	-	-	16,513	(12)
Total	$1,829,117	$(67,031)	$937	$ (4)	$1,830,054	$(67,035)

December 31, 2012						
Obligations of states and political subdivisions	$5,878	$(16)	$-	$-	$5,878	$(16)
Mortgage-backed securities						
Other residential mortgage-backed securities						
Issued or guaranteed by FNMA, FHLMC or GNMA	3,055	(20)	-	-	3,055	(20)
Commercial mortgage-backed securities						
Issued or guaranteed by FNMA, FHLMC or GNMA	-	-	16,339	(154)	16,339	(154)
Asset-backed securities and structured financial products	16,412	(21)	-	-	16,412	(21)
Total	$25,345	$(57)	$16,339	$(154)	$41,684	$(211)

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive loss. In estimating other-than-temporary impairment losses, Management considers, among other things, the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer and the intent and ability of Trustmark to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value. The unrealized losses shown above are primarily due to increases in market rates over the yields available at the time of purchase of the underlying securities and not credit quality. Because Trustmark does not intend to sell these securities and it is more likely than not that Trustmark will not be required to sell the investments before recovery of their amortized cost bases, which may be maturity, Trustmark does not consider these investments to be other-than-temporarily impaired at September 30, 2013. There were no other-than-temporary impairments for the nine months ended September 30, 2013 and 2012.

Security Gains and Losses

Gains and losses as a result of calls and dispositions of securities, as well as any associated proceeds, were as follows ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
Available for Sale	2013	2012	2013	2012
Proceeds from calls and sales of securities	$-	$2,710	$64,778	$37,536
Gross realized gains	-	-	394	1,050
Gross realized (losses)	-	(1)	(16)	(12)
Held to Maturity				
Proceeds from calls of securities	$-	$-	$-	$175
Gross realized gains	-	-	-	3

Realized gains and losses are determined using the specific identification method and are included in noninterest income as security gains (losses), net.

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Contractual Maturities

The amortized cost and estimated fair value of securities available for sale and held to maturity at September 30, 2013, by contractual maturity, are shown below ($ in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$10,080	$10,142	$1,627	$ 1,650
Due after one year through five years	244,598	248,610	13,744	14,789
Due after five years through ten years	271,029	270,117	14,104	15,974
Due after ten years	178,780	177,791	754	790
	704,487	706,660	30,229	33,203
Mortgage-backed securities	2,693,353	2,665,441	39,751	37,746
Total	$3,397,840	$3,372,101	$69,980	$ 70,949

Note 4 – Loans Held for Investment (LHFI) and Allowance for Loan Losses, LHFI

For the periods presented, LHFI consisted of the following ($ in thousands):

	September 30, 2013	December 31, 2012
Loans secured by real estate:		
Construction, land development and other land loans	$572,057	$468,975
Secured by 1-4 family residential properties	1,482,963	1,497,480
Secured by nonfarm, nonresidential properties	1,408,342	1,410,264
Other	196,328	189,949
Commercial and industrial loans	1,132,863	1,169,513
Consumer loans	164,612	171,660
Other loans	739,476	684,913
LHFI	5,696,641	5,592,754
Less allowance for loan losses, LHFI	68,632	78,738
Net LHFI	$5,628,009	$5,514,016

Loan Concentrations

Trustmark does not have any loan concentrations other than those reflected in the preceding table, which exceed 10% of total LHFI. At September 30, 2013, Trustmark's geographic loan distribution was concentrated primarily in its five key market regions: Alabama, Florida, Mississippi, Tennessee and Texas. Accordingly, the ultimate collectability of a substantial portion of these loans and the recovery of a substantial portion of the carrying amount of other real estate are susceptible to changes in market conditions in these areas.

Nonaccrual/Impaired LHFI

At September 30, 2013 and December 31, 2012, the carrying amounts of nonaccrual LHFI, which are individually evaluated for impairment, were $73.4 million and $82.4 million, respectively. Of this total, all commercial nonaccrual LHFI over $500 thousand were specifically evaluated for impairment (specifically evaluated impaired LHFI) using a

fair value approach. The remaining nonaccrual LHFI were not all specifically reviewed and written down to fair value less cost to sell. No material interest income was recognized in the income statement on impaired or nonaccrual LHFI for each of the periods ended September 30, 2013 and 2012.

All of Trustmark's specifically evaluated impaired LHFI are collateral dependent loans. At September 30, 2013 and December 31, 2012, specifically evaluated impaired LHFI totaled $32.2 million and $40.6 million, respectively. In addition, these specifically evaluated impaired LHFI had a related allowance of $2.0 million and $5.9 million at the end of the respective periods. For collateral dependent loans, when a loan is deemed impaired, the full difference between the carrying amount of the loan and the most likely estimate of the asset's fair value less cost to sell is charged off. Charge-offs related to specifically evaluated impaired LHFI totaled $2.1 million and $11.0 million for the first nine months of 2013 and 2012, respectively. Provision recapture on specifically evaluated impaired LHFI totaled $3.5 million for the first nine months of 2013, compared to provision expense of $276 thousand for the same time period in 2012.

Fair value estimates for specifically evaluated impaired LHFI are derived from appraised values based on the current market value/as-is value of the property, normally from recently received and reviewed appraisals. Current appraisals are ordered on an annual basis based on the inspection date. Appraisals are obtained from state-certified appraisers and are based on certain assumptions, which may include construction or development status and the highest and best use of the property. These appraisals are reviewed by Trustmark's Appraisal Review Department to ensure they are acceptable, and values are adjusted down for costs associated with asset disposal. Once this estimated net realizable value has been determined, the value used in the impairment assessment is updated. At the time a specifically evaluated impaired LHFI is deemed to be impaired, the full difference between book value and the most likely estimate of the asset's net realizable value is charged off. As subsequent events dictate and estimated net realizable values decline, required reserves may be established or further adjustments recorded.

At September 30, 2013 and December 31, 2012, nonaccrual LHFI not specifically evaluated for impairment and written down to fair value less cost to sell, totaled $41.2 million and $41.8 million, respectively. In addition, these nonaccrual LHFI had allocated allowance for loan losses of $7.7 million and $4.6 million at the end of the respective periods.

The following table details LHFI individually and collectively evaluated for impairment at September 30, 2013 and December 31, 2012 ($ in thousands):

	September 30, 2013		
	LHFI Evaluated for Impairment		
	Individually	Collectively	Total
Loans secured by real estate:			
Construction, land development and other land loans	$14,454	$557,603	$572,057
Secured by 1-4 family residential properties	23,715	1,459,248	1,482,963
Secured by nonfarm, nonresidential properties	21,290	1,387,052	1,408,342
Other	503	195,825	196,328
Commercial and industrial loans	12,196	1,120,667	1,132,863
Consumer loans	203	164,409	164,612
Other loans	1,020	738,456	739,476
Total	$73,381	$5,623,260	$5,696,641

	December 31, 2012		
	LHFI Evaluated for Impairment		
	Individually	Collectively	Total
Loans secured by real estate:			
Construction, land development and other land loans	$27,105	$441,870	$468,975
Secured by 1-4 family residential properties	27,114	1,470,366	1,497,480
Secured by nonfarm, nonresidential properties	18,289	1,391,975	1,410,264
Other	3,956	185,993	189,949
Commercial and industrial loans	4,741	1,164,772	1,169,513
Consumer loans	360	171,300	171,660
Other loans	798	684,115	684,913
Total	$82,363	$5,510,391	$5,592,754

At September 30, 2013 and December 31, 2012, the carrying amount of LHFI individually evaluated for impairment consisted of the following ($ in thousands):

	September 30, 2013 LHFI					
	Unpaid Principal Balance	With No Related Allowance Recorded	With an Allowance Recorded	Total Carrying Amount	Related Allowance	Average Recorded Investment
Loans secured by real estate:						
Construction, land development and other land loans	$26,139	$ 11,073	$ 3,381	$14,454	$ 957	$ 20,779
Secured by 1-4 family residential properties	28,078	3,206	20,509	23,715	260	25,415
Secured by nonfarm, nonresidential properties	24,270	12,391	8,899	21,290	2,733	19,790
Other	543	-	503	503	37	2,229
Commercial and industrial loans	15,549	1,918	10,278	12,196	5,393	8,468
Consumer loans	392	-	203	203	2	281
Other loans	1,154	49	971	1,020	324	909
Total	$96,125	$ 28,637	$ 44,744	$73,381	$ 9,706	$ 77,871

	December 31, 2012 LHFI					
	Unpaid Principal Balance	With No Related Allowance Recorded	With an Allowance Recorded	Total Carrying Amount	Related Allowance	Average Recorded Investment
Loans secured by real estate:						
Construction, land development and other land loans	$46,558	$ 9,571	$ 17,534	$27,105	$ 4,992	$ 33,759
Secured by 1-4 family residential properties	35,155	2,533	24,581	27,114	1,469	25,731
Secured by nonfarm, nonresidential properties	23,337	8,184	10,105	18,289	2,296	21,135
Other	6,036	566	3,390	3,956	760	4,914
Commercial and industrial loans	7,251	2,336	2,405	4,741	640	9,444
Consumer loans	624	-	360	360	5	592
Other loans	857	-	798	798	342	835
Total	$119,818	$ 23,190	$ 59,173	$82,363	$ 10,504	$ 96,410

A troubled debt restructuring (TDR) occurs when a borrower is experiencing financial difficulties, and for related economic or legal reasons, a concession is granted to the borrower that Trustmark would not otherwise consider. Whatever the form of a concession granted by Trustmark, the objective is to make the best of a difficult situation by obtaining more cash or other value from the borrower or by increasing the probability of receipt by granting the concession than by not granting it. Other concessions may arise from court proceedings or may be imposed by law. In addition, TDRs also include those credits that are extended or renewed to a borrower who is not able to obtain funds from sources other than Trustmark at a market interest rate for new debt with similar risk.

A formal TDR may include, but is not necessarily limited to, one or a combination of the following situations:

- Trustmark accepts a third-party receivable or other asset(s) of the borrower, in lieu of the receivable from the borrower.
- Trustmark accepts an equity interest in the borrower in lieu of the receivable.
- Trustmark accepts modification of the terms of the debt including but not limited to:
  - Reduction of (absolute or contingent) the stated interest rate to below the current market rate.

- Extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk.
- Reduction (absolute or contingent) of the face amount or maturity amount of the debt as stated in the note or other agreement.
- Reduction (absolute or contingent) of accrued interest.

Troubled debt restructurings are addressed in Trustmark's loan policy, and in accordance with that policy, any modifications or concessions that may result in a TDR are subject to a special approval process which allows for control, identification, and monitoring of these arrangements. Prior to granting a concession, a revised borrowing arrangement is proposed which is structured so as to improve collectability of the loan in accordance with a reasonable repayment schedule with any loss promptly identified. It is supported by a thorough evaluation of the borrower's financial condition and prospects for repayment under those revised terms. Other TDRs arising from renewals or extensions of existing debt are routinely identified through the processes utilized in the Problem Loan Committees and in the Credit Quality Review Committee. All TDRs are subsequently reported to the Director Credit Policy Committee on a quarterly basis and are disclosed in Trustmark's consolidated financial statements in accordance with GAAP and regulatory reporting guidance.

All loans whose terms have been modified in a troubled debt restructuring are evaluated for impairment under FASB ASC Topic 310. Accordingly, Trustmark measures any loss on the restructuring in accordance with that guidance. A TDR in which Trustmark receives physical possession of the borrower's assets, regardless of whether formal foreclosure or repossession proceedings take place, is accounted for in accordance with FASB ASC Subtopic 310-40, "Troubled Debt Restructurings by Creditors." Thus, the loan is treated as if assets have been received in satisfaction of the loan and reported as a foreclosed asset.

A TDR may be returned to accrual status if Trustmark is reasonably assured of repayment of principal and interest under the modified terms and the borrower has demonstrated sustained performance under those terms for a period of at least six months. Otherwise, the restructured loan must remain on nonaccrual.

At September 30, 2013 and December 31, 2012, LHFI classified as TDRs totaled $16.8 million and $24.3 million, respectively, and were primarily comprised of credits with interest-only payments for an extended period of time totaling $12.6 million and $21.6 million, respectively. The remaining TDRs at September 30, 2013 and December 31, 2012 resulted from real estate loans discharged through Chapter 7 bankruptcy that were not reaffirmed or from payment or maturity extensions.

For TDRs, Trustmark had a related loan loss allowance of $1.7 million and $4.3 million at the end of each respective period. LHFI classified as TDRs are charged down to the most likely fair value estimate less an estimated cost to sell for collateral dependent loans, which would approximate net realizable value. Specific charge-offs related to TDRs totaled $703 thousand and $5.3 million for the nine months ended September 30, 2013 and 2012, respectively.

The following table illustrates the impact of modifications classified as TDRs for the three and nine months ended September 30, 2013 and 2012 as well as those TDRs modified within the last 12 months for which there was a payment default during the period ($ in thousands):

	Three Months Ended September 30,								
	2013				2012				
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
Secured by 1-4 family residential properties	1	$	32	$ 32	39	$	3,695	$	3,691
Other loans secured by real estate	-		-	-	1		199		199
Total	1	$	32	$ 32	40	$	3,894	$	3,890

	Nine Months Ended September 30,								
	2013				2012				
Troubled Debt Restructurings	Number of Contracts	Pre-Modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment	
Construction, land development and other land loans	-	$	-	$ -	11	$	4,078	$	4,078
Secured by 1-4 family residential properties	6		412	358	44		5,062		5,069
Secured by nonfarm, nonresidential properties	1		952	952	2		1,210		1,210
Other loans secured by real estate	-		-	-	1		199		199
Commercial and industrial	2		944	937	-		-		-
Other loans	1		2,490	2,490	-		-		-
Total	10	$	4,798	$ 4,737	58	$	10,549	$	10,556

	Nine Months Ended September 30,					
	2013			2012		
Troubled Debt Restructurings that Subsequently Defaulted	Number of Contracts	Recorded Investment		Number of Contracts	Recorded Investment	
Construction, land development and other land loans	1	$	9	10	$	3,671
Secured by 1-4 family residential properties	4		389	8		1,781
Secured by nonfarm, nonresidential properties	-		-	1		870
Total	5	$	398	19	$	6,322

Trustmark's TDRs have resulted primarily from allowing the borrower to pay interest only for an extended period of time rather than from forgiveness. Accordingly, as shown above, these TDRs have a similar recorded investment for both the pre-modification and post-modification disclosure. Trustmark has utilized loans 90 days or more past due to define payment default in determining TDRs that have subsequently defaulted.

At September 30, 2013 and December 31, 2012, the following table details LHFI classified as TDRs by loan type ($ in thousands):

	September 30, 2013		
	Accruing	Nonaccrual	Total
Construction, land development and other land loans	$227	$ 7,304	$7,531
Secured by 1-4 family residential properties	1,255	4,965	6,220
Secured by nonfarm, nonresidential properties	-	2,349	2,349
Other loans secured by real estate	-	174	174
Commercial and industrial	-	568	568
Total Troubled Debt Restructurings by Type	$1,482	$ 15,360	$16,842

	December 31, 2012		
	Accruing	Nonaccrual	Total
Construction, land development and other land loans	$233	$ 12,073	$12,306
Secured by 1-4 family residential properties	1,280	5,908	7,188
Secured by nonfarm, nonresidential properties	-	4,582	4,582
Other loans secured by real estate	-	197	197
Total Troubled Debt Restructurings by Type	$1,513	$ 22,760	$24,273

Credit Quality Indicators

Trustmark's loan portfolio credit quality indicators focus on six key quality ratios that are compared against bank tolerances. The loan indicators are total classified outstanding, total criticized outstanding, nonperforming loans, nonperforming assets, delinquencies and net loan losses. Due to the homogenous nature of consumer loans, Trustmark does not assign a formal internal risk rating to each credit and therefore the criticized and classified measures are unique to commercial loans.

In addition to monitoring portfolio credit quality indicators, Trustmark also measures how effectively the lending process is being managed and risks are being identified. As part of an ongoing monitoring process, Trustmark grades the commercial portfolio as it relates to credit file completion and financial statement exceptions, total policy exceptions, collateral exceptions and violations of law as shown below:

- Credit File Completeness and Financial Statement Exceptions – evaluates the quality and condition of credit files in terms of content, completeness and organization and focuses on efforts to obtain and document sufficient information to determine the quality and status of credits. Also included is an evaluation of the systems/procedures used to insure compliance with policy such as financial statements, review memos and loan agreements.
- Underwriting/Policy – evaluates whether credits are adequately analyzed, appropriately structured and properly approved within requirements of bank loan policy. A properly approved credit is approved by adequate authority in a timely manner with all conditions of approval fulfilled. Total policy exceptions measures the level of underwriting and other policy exceptions within a loan portfolio.
- Collateral Documentation – focuses on the adequacy of documentation to support the obligation, perfect Trustmark's collateral position and protect collateral value. There are two parts to this measure:
  - ü Collateral exceptions are where certain collateral documentation is either not present, is not considered current or has expired.
  - ü 90 days and over collateral exceptions are where certain collateral documentation is either not present, is not considered current or has expired and the exception has been identified in excess of 90 days.
- Compliance with Law – focuses on underwriting, documentation, approval and reporting in compliance with banking laws and regulations. Primary emphasis is directed to Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) and Regulation O requirements.

Commercial Credits

Trustmark has established a loan grading system that consists of ten individual credit risk grades (risk ratings) that encompass a range from loans where the expectation of loss is negligible to loans where loss has been established. The model is based on the risk of default for an individual credit and establishes certain criteria to delineate the level of risk across the ten unique credit risk grades. Credit risk grade definitions are as follows:

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- Risk Rate (RR) 1 through RR 6 – Grades one through six represent groups of loans that are not subject to adverse criticism as defined in regulatory guidance. Loans in these groups exhibit characteristics that represent low to moderate risk measured by using a variety of credit risk criteria such as cash flow coverage, debt service coverage, balance sheet leverage, liquidity, management experience, industry position, prevailing economic conditions, support from secondary sources of repayment and other credit factors that may be relevant to a specific loan. In general, these loans are supported by properly margined collateral and guarantees of principal parties.
- Other Assets Especially Mentioned (OAEM) (RR 7) – a loan that has a potential weakness that if not corrected will lead to a more severe rating. This rating is for credits that are currently protected but potentially weak because of an adverse feature or condition that if not corrected will lead to a further downgrade.
- Substandard (RR 8) – a loan that has at least one identified weakness that is well defined. This rating is for credits where the primary sources of repayment are not viable at this time or where either the capital or collateral is not adequate to support the loan and the secondary means of repayment does not provide a sufficient level of support to offset the identified weakness. Loss potential exists in the aggregate amount of substandard loans but does not necessarily exist in individual loans.
- Doubtful (RR 9) – a loan with an identified weakness that does not have a valid secondary source of repayment. Generally these credits have an impaired primary source of repayment and secondary sources are not sufficient to prevent a loss in the credit. The exact amount of the loss has not been determined at this time.
- Loss (RR 10) – a loan or a portion of a loan that is deemed to be uncollectible.

By definition, credit risk grades OAEM (RR 7), substandard (RR 8), doubtful (RR 9) and loss (RR 10) are criticized loans while substandard (RR 8), doubtful (RR 9) and loss (RR 10) are classified loans. These definitions are standardized by all bank regulatory agencies and are generally equally applied to each individual lending institution. The remaining credit risk grades are considered pass credits and are solely defined by Trustmark.

The credit risk grades represent the probability of default (PD) for an individual credit and as such are not a direct indication of loss given default (LGD). The LGD aspect of the subject risk ratings is neither uniform across the nine primary commercial loan groups or constant between the geographic areas. To account for the variance in the LGD aspects of the risk rate system, the loss expectations for each risk rating is integrated into the allowance for loan loss methodology where the calculated LGD is allotted for each individual risk rating with respect to the individual loan group and unique geographic area. The LGD aspect of the reserve methodology is calculated each quarter as a component of the overall reserve factor for each risk grade by loan group and geographic area.

To enhance this process, loans of a certain size that are rated in one of the criticized categories are routinely reviewed to establish an expectation of loss, if any, and if such examination indicates that the level of reserve is not adequate to cover the expectation of loss, a special reserve or impairment is generally applied.

The distribution of the losses is accomplished by means of a loss distribution model that assigns a loss factor to each risk rating (1 to 9) in each commercial loan pool. A factor is not applied to risk rate 10 (Loss) as loans classified as Losses are not carried on Trustmark's books over quarter-end as they are charged off within the period that the loss is determined.

The expected loss distribution is spread across the various risk ratings by the perceived level of risk for loss. The nine grade scale described above ranges from a negligible risk of loss to an identified loss across its breadth. The loss distribution factors are graduated through the scale on a basis proportional to the degree of risk that appears manifest in each individual rating and assumes that migration through the loan grading system will occur.

Each loan officer assesses the appropriateness of the internal risk rating assigned to their credits on an ongoing basis. Trustmark's Asset Review area conducts independent credit quality reviews of the majority of Trustmark's commercial loan portfolio concentrations both on the underlying credit quality of each individual loan portfolio as well as the adherence to bank loan policy and the loan administration process. In general, Asset Review conducts reviews of each lending area within a six to eighteen month window depending on the overall credit quality results of the individual

area.

In addition to the ongoing internal risk rate monitoring described above, Trustmark conducts monthly credit quality reviews (CQR) for the credits described below, as well as semi-annual analysis and stress testing on all residential real estate development credits and non-owner occupied commercial real estate (CRE) credits of $1.0 million or more as described below:

- Trustmark's Credit Quality Review Committee meets monthly and performs the following functions: detailed review and evaluation of all loans of $100 thousand or more that are either delinquent thirty days or more or on nonaccrual, including determination of appropriate risk ratings, accrual status, and appropriate servicing officer; review of risk rate changes for relationships of $100 thousand or more; quarterly review of all nonaccruals less than $100 thousand to determine whether the credit should be charged off, returned to accrual, or remain in nonaccrual status; monthly/quarterly review of continuous action plans for all credits rated seven or worse for relationships of $100 thousand or more; monthly review of all commercial charge-offs of $25 thousand or more for the preceding month.

- Residential real estate developments - a development project analysis is performed on all projects regardless of size. Performance of the development is assessed through an evaluation of the number of lots remaining, the payout ratios, and the loan-to-value ratios. Results are stress tested as to absorption and price of lots. This information is reviewed by each senior credit officer for that market to determine the need for any risk rate or accrual status changes.
- Non-owner occupied commercial real estate – a cash flow analysis is performed on all projects with an outstanding balance of $1.0 million or more. In addition, credits are stress tested for vacancies and rate sensitivity. Confirmation is obtained that guarantor's financial statements are current, taxes have been paid, and that there are no other issues that need to be addressed. This information is reviewed by each senior credit officer for that market to determine the need for any risk rate or accrual status changes.

Consumer Credits

Consumer loans that do not meet a minimum custom credit score are reviewed quarterly by Management. The Retail Credit Review Committee reviews the volume and percentage of approvals that did not meet the minimum passing custom score by region, individual location, and officer. To assure that Trustmark continues to originate quality loans, this process allows Management to make necessary changes such as revisions to underwriting procedures and credit policies, or changes in loan authority to Trustmark personnel.

Trustmark monitors the levels and severity of past due consumer loans on a daily basis through its collection activities. A detailed assessment of consumer loan delinquencies is performed monthly at both a product and market level by delivery channel, which incorporates the perceived level of risk at time of underwriting. Trustmark also monitors its consumer loan delinquency trends by comparing them to quarterly industry averages.

The table below illustrates the carrying amount of LHFI by credit quality indicator at September 30, 2013 and December 31, 2012 ($ in thousands):

	September 30, 2013				
	Commercial LHFI				
	Pass - Categories 1-6	Special Mention - Category 7	Substandard - Category 8	Doubtful - Category 9	Subtotal
Loans secured by real estate:					
Construction, land development and other land loans	$444,526	$24,211	$ 56,419	$ 143	$525,299
Secured by 1-4 family residential properties	120,665	567	8,257	113	129,602
Secured by nonfarm, nonresidential properties	1,304,158	9,854	92,908	556	1,407,476
Other	185,201	2	7,361	-	192,564
Commercial and industrial loans	1,080,726	2,951	41,506	7,618	1,132,801
Consumer loans	494	-	-	-	494
Other loans	730,609	-	1,737	696	733,042
	$3,866,379	$37,585	$ 208,188	$ 9,126	$4,121,278

Consumer LHFI					
Current	Past Due 30-89 Days	Past Due 90 Days or More	Nonaccrual	Subtotal	Total LHFI

Loans secured by real estate:						
Construction, land development and other land loans	$46,473	$71	$-	$ 214	$46,758	$572,057
Secured by 1-4 family residential properties	1,321,599	10,228	1,998	19,536	1,353,361	1,482,963
Secured by nonfarm, nonresidential properties	857	9	-	-	866	1,408,342
Other	3,687	77	-	-	3,764	196,328
Commercial and industrial loans	49	8	1	4	62	1,132,863
Consumer loans	161,592	2,018	306	202	164,118	164,612
Other loans	6,434	-	-	-	6,434	739,476
	$1,540,691	$12,411	$2,305	$ 19,956	$1,575,363	$5,696,641

	December 31, 2012				
	Commercial LHFI				
	Pass - Categories 1-6	Special Mention - Category 7	Substandard - Category 8	Doubtful - Category 9	Subtotal
Loans secured by real estate:					
Construction, land development and other land loans	$335,179	$23,812	$63,832	$143	$422,966
Secured by 1-4 family residential properties	110,333	1,012	13,303	432	125,080
Secured by nonfarm, nonresidential properties	1,298,820	12,156	98,082	-	1,409,058
Other	178,790	444	5,768	-	185,002
Commercial and industrial loans	1,091,356	36,992	39,479	1,334	1,169,161
Consumer loans	404	-	-	-	404
Other loans	676,618	59	1,714	784	679,175
	$3,691,500	$74,475	$222,178	$2,693	$3,990,846

	Consumer LHFI					
	Current	Past Due 30-89 Days	Past Due 90 Days or More	Nonaccrual	Subtotal	Total LHFI
Loans secured by real estate:						
Construction, land development and other land loans	$44,131	$1,109	$-	$769	$46,009	$468,975
Secured by 1-4 family residential properties	1,339,000	10,332	2,630	20,438	1,372,400	1,497,480
Secured by nonfarm, nonresidential properties	1,206	-	-	-	1,206	1,410,264
Other	4,746	150	-	51	4,947	189,949
Commercial and industrial loans	313	29	-	10	352	1,169,513
Consumer loans	167,131	3,481	285	359	171,256	171,660
Other loans	5,738	-	-	-	5,738	684,913
	$1,562,265	$15,101	$2,915	$21,627	$1,601,908	$5,592,754

Past Due LHFI and Loans Held for Sale (LHFS)

LHFI past due 90 days or more totaled $2.3 million and $6.4 million at September 30, 2013 and December 31, 2012, respectively. The following table provides an aging analysis of past due and nonaccrual LHFI by class at September 30, 2013 and December 31, 2012 ($ in thousands):

	September 30, 2013					
	Past Due					
	30-89 Days	90 Days or More (1)	Total	Nonaccrual	Current Loans	Total LHFI
Loans secured by real estate:						

Construction, land development and other land loans	$12,401	$1	$12,402	$ 14,454	$545,201	$572,057
Secured by 1-4 family residential properties	10,925	1,996	12,921	23,715	1,446,327	1,482,963
Secured by nonfarm, nonresidential properties	6,163	-	6,163	21,290	1,380,889	1,408,342
Other	120	-	120	503	195,705	196,328
Commercial and industrial loans	2,665	41	2,706	12,196	1,117,961	1,132,863
Consumer loans	2,018	306	2,324	203	162,085	164,612
Other loans	88	-	88	1,020	738,368	739,476
Total	$34,380	$2,344	$36,724	$ 73,381	$5,586,536	$5,696,641

(1) - Past due 90 days or more but still accruing interest.

	December 31, 2012					
	Past Due					
	30-89 Days	90 Days or More (1)	Total	Nonaccrual	Current Loans	Total LHFI
Loans secured by real estate:						
Construction, land development and other land loans	$4,957	$438	$5,395	$ 27,105	$436,475	$468,975
Secured by 1-4 family residential properties	12,626	3,131	15,757	27,114	1,454,609	1,497,480
Secured by nonfarm, nonresidential properties	9,460	-	9,460	18,289	1,382,515	1,410,264
Other	172	-	172	3,956	185,821	189,949
Commercial and industrial loans	4,317	2,525	6,842	4,741	1,157,930	1,169,513
Consumer loans	3,480	284	3,764	360	167,536	171,660
Other loans	181	-	181	798	683,934	684,913
Total	$35,193	$6,378	$41,571	$ 82,363	$5,468,820	$5,592,754

(1) - Past due 90 days or more but still accruing interest.

LHFS past due 90 days or more totaled $18.4 million and $43.1 million at September 30, 2013 and December 31, 2012, respectively. LHFS past due 90 days or more are serviced loans eligible for repurchase, which are fully guaranteed by the Government National Mortgage Association (GNMA). GNMA optional repurchase programs allow financial institutions to buy back individual delinquent mortgage loans that meet certain criteria from the securitized loan pool for which the institution provides servicing. At the servicer's option and without GNMA's prior authorization, the servicer may repurchase such a delinquent loan for an amount equal to 100 percent of the remaining principal balance of the loan. This buy-back option is considered a conditional option until the delinquency criteria are met, at which time the option becomes unconditional. When Trustmark is deemed to have regained effective control over these loans under the unconditional buy-back option, the loans can no longer be reported as sold and must be brought back onto the balance sheet as loans held for sale, regardless of whether Trustmark intends to exercise the buy-back option. These loans are reported as held for sale with the offsetting liability being reported as short-term borrowings.

During the first quarter of 2013, Trustmark exercised its option to repurchase delinquent loans serviced for GNMA. These loans were subsequently sold to a third party under different repurchase provisions. Trustmark retained the servicing for these loans, which are fully guaranteed by FHA/VA. As a result of this repurchase and sale, the loans are no longer carried as LHFS. The transaction resulted in a gain of $534 thousand, which is included in mortgage banking, net for the first nine months of 2013. Trustmark did not exercise its buy-back option on any delinquent loans serviced for GNMA during the first nine months of 2012.

Allowance for Loan Losses, LHFI

Trustmark’s allowance for loan loss methodology for commercial LHFI is based upon regulatory guidance from its primary regulator and GAAP. The methodology segregates the commercial purpose and commercial construction LHFI portfolios into nine separate loan types (or pools) which have similar characteristics such as repayment, collateral and risk profiles. The nine basic loan pools are further segregated into Trustmark’s five key market regions, Alabama, Florida, Mississippi, Tennessee and Texas, to take into consideration the uniqueness of each market. A 10-point risk rating system is utilized for each separate loan pool to apply a reserve factor consisting of quantitative and qualitative components to determine the needed allowance by each loan type. As a result, there are 450 risk rate factors for commercial loan types. The nine separate pools are segmented below:

Commercial Purpose LHFI
- Real Estate – Owner Occupied
- Real Estate – Non-Owner Occupied
- Working Capital
- Non-Working Capital
- Land
- Lots and Development
- Political Subdivisions

Commercial Construction LHFI
- 1 to 4 Family
- Non-1 to 4 Family

The quantitative factors of the allowance methodology reflect a twelve-quarter rolling average of net charge-offs by loan type within each key market region. This allows for a greater sensitivity to current trends, such as economic changes, as well as current loss profiles and creates a more accurate depiction of historical losses.
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Qualitative factors used in the allowance methodology include the following:

- National and regional economic trends and conditions
- Impact of recent performance trends
- Experience, ability and effectiveness of management
- Adherence to Trustmark's loan policies, procedures and internal controls
- Collateral, financial and underwriting exception trends
- Credit concentrations
- Acquisitions
- Catastrophe

Each qualitative factor is converted to a scale ranging from 0 (No risk) to 100 (High Risk), other than the last two factors, which are applied on a dollar-for-dollar basis to ensure that the combination of such factors is proportional. The resulting ratings from the individual factors are weighted and summed to establish the weighted average qualitative factor of a specific loan portfolio within each key market region. This weighted average qualitative factor is then distributed over the nine primary loan pools within each key market region based on the ranking by risk of each.

During the fourth quarter of 2012, Trustmark revised the quantitative portion of the allowance for loan loss methodology for consumer and residential LHFI. Trustmark converted the historical loss factor from a 20-quarter net charge-off rolling average to a 12-quarter rolling average and developed a separate reserve for junior liens on 1-4 family LHFI. The change in quantitative methodology allows Trustmark to more readily correlate portfolio risk to the current market environment as the impact of more recent experience is emphasized. This change also allows for a greater sensitivity to current trends such as economic and performance changes, which includes current loss profiles, and creates a more accurate depiction of historical losses. Loans and lines of credit secured by junior liens on 1-4 family residential properties are being reserved for separately in light of continued uncertainty in the economy and the housing market in particular. An additional provision of approximately $1.4 million was recorded in the fourth quarter of 2012 as a result of this revision to the quantitative portion of the allowance for loan loss methodology for consumer and residential LHFI.

The allowance for loan loss methodology segregates the consumer LHFI portfolio into homogeneous pools of loans that contain similar structure, repayment, collateral and risk profiles. These homogeneous pools of loans are shown below:

- Residential Mortgage
- Direct Consumer
- Auto Finance
- Junior Lien on 1-4 Family Residential Properties
- Credit Cards
- Overdrafts

The historical loss experience for these pools is determined by calculating a 12-quarter rolling average of net charge-offs, one quarter in arrears, which is applied to each pool to establish the quantitative aspect of the methodology. Where, in Management's estimation, the calculated loss experience does not fully cover the anticipated loss for a pool, an estimate is also applied to each pool to establish the qualitative aspect of the methodology, which represents the perceived risks across the loan portfolio at the current point in time. This qualitative methodology utilizes five separate factors made up of unique components that when weighted and combined produce an estimated level of reserve for each of the loan pools. The five qualitative factors include the following:

- Economic indicators
- Performance trends

- Management experience
- Lending policy measures
- Credit concentrations

The risk measure for each factor is converted to a scale ranging from 0 (No risk) to 100 (High Risk) to ensure that the combination of such factors is proportional. The determination of the risk measurement for each qualitative factor is done for all markets combined. The resulting estimated reserve factor is then applied to each pool.

The resulting ratings from the individual factors are weighted and summed to establish the weighted average qualitative factor of a specific loan portfolio. This weighted average qualitative factor is then applied over the six loan pools.

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Changes in the allowance for loan losses, LHFI were as follows ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Balance at January 1,	$78,738	$89,518
Loans charged-off	(10,173)	(22,547)
Recoveries	11,505	9,254
Net recoveries (charge-offs)	1,332	(13,293)
Provision for loan losses, LHFI	(11,438)	7,301
Balance at September 30,	$68,632	$83,526

The following tables detail the balance in the allowance for loan losses, LHFI by portfolio segment at September 30, 2013 and 2012, respectively ($ in thousands):

	2013				
	Balance January 1,	Charge-offs	Recoveries	Provision for Loan Losses	Balance September 30,
Loans secured by real estate:					
Construction, land development and other land loans	$21,838	$ (1,091)	$ 2,561	$(7,419)	$ 15,889
Secured by 1-4 family residential properties	12,957	(839)	363	(3,723)	8,758
Secured by nonfarm, nonresidential properties	21,096	(572)	64	(1,828)	18,760
Other	2,197	(910)	80	497	1,864
Commercial and industrial loans	14,319	(1,225)	2,190	2,004	17,288
Consumer loans	3,087	(1,789)	3,561	(2,256)	2,603
Other loans	3,244	(3,747)	2,686	1,287	3,470
Total allowance for loan losses, LHFI	$78,738	$ (10,173)	$ 11,505	$(11,438)	$ 68,632

	Disaggregated by Impairment Method		
	Individually	Collectively	Total
Loans secured by real estate:			
Construction, land development and other land loans	$957	$ 14,932	$15,889
Secured by 1-4 family residential properties	260	8,498	8,758
Secured by nonfarm, nonresidential properties	2,733	16,027	18,760
Other	37	1,827	1,864
Commercial and industrial loans	5,393	11,895	17,288
Consumer loans	2	2,601	2,603
Other loans	324	3,146	3,470
Total allowance for loan losses, LHFI	$9,706	$ 58,926	$68,632

	2012				
	Balance January 1,	Charge-offs	Recoveries	Provision for Loan Losses	Balance September 30,
Loans secured by real estate:					
Construction, land development and other land loans	$27,220	$ (2,944)	$ -	$ (1,732)	$ 22,544
Secured by 1-4 family residential properties	12,650	(3,238)	364	2,203	11,979
Secured by nonfarm, nonresidential properties	24,358	(5,409)	-	3,823	22,772
Other	3,079	(1,602)	-	733	2,210
Commercial and industrial loans	15,868	(2,985)	2,123	3,428	18,434
Consumer loans	3,656	(2,360)	4,189	(2,620)	2,865
Other loans	2,687	(4,009)	2,578	1,466	2,722
Total allowance for loan losses, LHFI	$89,518	$ (22,547)	$ 9,254	$ 7,301	$ 83,526

	Disaggregated by Impairment Method		
	Individually	Collectively	Total
Loans secured by real estate:			
Construction, land development and other land loans	$4,829	$ 17,715	$22,544
Secured by 1-4 family residential properties	1,373	10,606	11,979
Secured by nonfarm, nonresidential properties	3,259	19,513	22,772
Other	855	1,355	2,210
Commercial and industrial loans	2,995	15,439	18,434
Consumer loans	4	2,861	2,865
Other loans	336	2,386	2,722
Total allowance for loan losses, LHFI	$13,651	$ 69,875	$83,526

Note 5 – Acquired Loans

For the periods presented, acquired loans consisted of the following ($ in thousands):

	September 30, 2013		December 31, 2012	
	Covered	Noncovered	Covered	Noncovered
Loans secured by real estate:				
Construction, land development and other land loans	$2,585	$ 106,655	$3,924	$ 10,056
Secured by 1-4 family residential properties	17,785	168,573	23,990	19,404
Secured by nonfarm, nonresidential properties	12,120	301,686	18,407	45,649
Other	2,817	35,051	3,567	669
Commercial and industrial loans	478	186,649	747	3,035
Consumer loans	151	22,251	177	2,610
Other loans	1,314	17,010	1,229	100
Acquired loans	37,250	837,875	52,041	81,523
Less allowance for loan losses, acquired loans	2,326	3,007	4,190	1,885
Net acquired loans	$34,924	$ 834,868	$47,851	$ 79,638

Acquired loans are accounted for under the acquisition method of accounting.The acquired loans are recorded at their estimated fair value at the time of acquisition. Fair value of acquired loans is determined using a discounted cash flow model based on assumptions regarding the amount and timing of principal and interest payments, estimated prepayments, estimated default rates, estimated loss severity in the event of defaults and current market rates. Estimated credit losses are included in the determination of fair value; therefore, an allowance for loan losses is not

recorded on the acquisition date.

Loans acquired in an FDIC-assisted transaction and covered under loss-share agreements are referred to as "covered loans" and are reported separately in Trustmark's consolidated financial statements. Covered loans are recorded at their estimated fair value at the time of acquisition exclusive of the expected reimbursement cash flows from the FDIC.

Trustmark accounts for acquired impaired loans under FASB ASC Topic 310-30. An acquired loan is considered impaired when there is evidence of credit deterioration since origination and it is probable at the date of acquisition that Trustmark would be unable to collect all contractually required payments. Revolving credit agreements such as home equity lines and commercial leases are excluded from acquired impaired loan accounting requirements. Trustmark acquired $153.9 million of revolving credit agreements and commercial leases, at fair value, in the BancTrust acquisition and $5.9 million of revolving credit agreements, at fair value, in the Bay Bank acquisition, consisting mainly of home equity loans and commercial asset-based lines of credit, where the borrower had revolving privileges on the acquisition date. As such, Trustmark has accounted for such acquired loans in accordance with accounting requirements for acquired nonimpaired loans.

For acquired impaired loans, Trustmark (a) calculates the contractual amount and timing of undiscounted principal and interest payments (the "undiscounted contractual cash flows") and (b) estimates the amount and timing of undiscounted expected principal and interest payments (the "undiscounted expected cash flows"). Under FASB ASC Topic 310-30, the difference between the undiscounted contractual cash flows and the undiscounted expected cash flows is the nonaccretable difference. The nonaccretable difference represents an estimate of the loss exposure of principal and interest related to the acquired impaired loan portfolio, and such amount is subject to change over time based on the performance of such loans.

The excess of expected cash flows at acquisition over the initial fair value of acquired impaired loans is referred to as the "accretable yield" and is recorded as interest income over the estimated life of the loans using the effective yield method if the timing and amount of the future cash flows is reasonably estimable. Improvements in expected cash flows over those originally estimated increase the accretable yield and are recognized as interest income prospectively. Decreases in the amount and changes in the timing of expected cash flows compared to those originally estimated decrease the accretable yield and result in a provision for loan losses and the establishment of an allowance for loan losses. The carrying value of acquired impaired loans is reduced by payments received, both principal and interest, and increased by the portion of the accretable yield recognized as interest income.

Trustmark aggregates certain acquired loans into pools of loans with common credit risk characteristics such as loan type and risk rating. To establish accounting pools of acquired loans, loans are first categorized by similar purpose, collateral and geographic region. Within each category, loans are further segmented by ranges of risk determinants observed at the time of acquisition. For commercial loans, the primary risk determinant is the risk rating as assigned by Trustmark. For consumer loans, the risk determinants include delinquency, FICO and loan-to-value ratios. Statistical comparison of the pools reflect that each pool is comprised of loans generally of similar characteristics, including loan type, loan risk and weighted average life. Each pool is then reviewed for similarity of the pool constituents, including standard deviation of purchase price, weighted average life and concentration of the largest loans. Loan pools are initially booked at the aggregate fair value of the loan pool constituents, based on the present value of Trustmark's expected cash flows from the loans. An acquired loan is removed from a pool of loans only if the loan is sold, foreclosed, or payment is received in full satisfaction of the loan. The acquired loan is removed from the pool at its carrying value. If an individual acquired loan is removed from a pool of loans, the difference between its relative carrying amount and its cash, fair value of the collateral, or other assets received will be recognized as a gain or loss immediately in interest income on loans and would not affect the effective yield used to recognize the accretable yield on the remaining pool. Certain acquired loans are not pooled and are accounted for individually. Such loans are withheld from pools due to the inherent uncertainty of the timing and amount of their cash flows or because they are not a suitable similar constituent to the established pools.

As required by FASB ASC Topic 310-30, Trustmark periodically re-estimates the expected cash flows to be collected over the life of the acquired impaired loans. If, based on current information and events, it is probable that Trustmark

will be unable to collect all cash flows expected at acquisition plus additional cash flows expected to be collected arising from changes in estimate after acquisition, the acquired loans are considered impaired. The decrease in the expected cash flows reduces the carrying value of the acquired impaired loans as well as the accretable yield and results in a charge to income through the provision for loans losses, acquired loans and the establishment of an allowance for loan losses, acquired loans. If, based on current information and events, it is probable that there is a significant increase in the cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, Trustmark will reduce any remaining allowance for loan losses, acquired loans established on the acquired impaired loans for the increase in the present value of cash flows expected to be collected. The increase in the expected cash flows for the acquired impaired loans over those originally estimated at acquisition increases the carrying value of the acquired impaired loans as well as the accretable yield. The increase in the accretable yield is recognized as interest income over the remaining average life of the acquired impaired loans.

On February 15, 2013, Trustmark completed its merger with BancTrust. Loans acquired in the BancTrust acquisition were evaluated for evidence of credit deterioration since origination and collectability of contractually required payments. Trustmark elected to account for all loans acquired in the BancTrust acquisition as acquired impaired loans under FASB ASC Topic 310-30 except for $153.9 million of acquired loans with revolving privileges and acquired commercial leases, which are outside the scope of the guidance. While not all loans acquired from BancTrust exhibited evidence of significant credit deterioration, accounting for these acquired loans under FASB ASC Topic 310-30 would have materially the same result as the alternative accounting treatment. During the second and third quarters of 2013, Trustmark recorded fair value adjustments based on the estimated fair value of certain acquired loans which resulted in a net decrease in acquired noncovered loans totaling $6.8 million. The purchase price allocation was deemed preliminary as of September 30, 2013 and is subject to refinement as additional information relative to the closing date fair values becomes available through the measurement period.

The following table presents the adjusted fair value of loans acquired as of the date of the BancTrust acquisition ($ in thousands):

At acquisition date:	February 15, 2013
Contractually required principal and interest	$1,256,669
Nonaccretable difference	201,324
Cash flows expected to be collected	1,055,345
Accretable yield	98,394
FASB ASC Topic 310-20 discount	12,716
Fair value of loans at acquisition	$944,235

On March 16, 2012, Trustmark completed its merger with Bay Bank. Loans acquired in the Bay Bank acquisition were evaluated for evidence of credit deterioration since origination and collectability of contractually required payments. Trustmark elected to account for all loans acquired in the Bay Bank acquisition as acquired impaired loans under FASB ASC Topic 310-30 except for $5.9 million of acquired loans with revolving privileges, which are outside the scope of the guidance. While not all loans acquired from Bay Bank exhibited evidence of significant credit deterioration, accounting for these acquired loans under FASB ASC Topic 310-30 would have materially the same result as the alternative accounting treatment. The purchase price allocation was deemed preliminary as of March 31, 2012 and was finalized in the second quarter of 2012.

The following tables present changes in the net carrying value of the acquired loans for the periods presented ($ in thousands):

	Covered		Noncovered	
	Acquired Impaired	Acquired Not ASC 310-30 (1)	Acquired Impaired	Acquired Not ASC 310-30 (1)
Carrying value, net at January 1, 2012	$72,131	$4,171	$4,350	$13
Loans acquired (2)	-	-	91,987	5,927
Accretion to interest income	8,031	367	4,138	161
Payments received, net	(27,496)	(2,107)	(24,330)	868
Other	(3,085)	29	(1,318)	(273)
Less allowance for loan losses, acquired loans	(4,190)	-	(1,885)	-
Carrying value, net at December 31, 2012	45,391	2,460	72,942	6,696
Loans acquired (3)	-	-	790,335	153,900
Accretion to interest income	3,934	157	24,993	2,143
Payments received, net	(16,136)	(743)	(174,776)	(22,804)

Other	(1,866)	(137)	(17,243)	(196)
Less allowance for loan losses, acquired loans	1,864	-	(1,122)	-
Carrying value, net at September 30, 2013	$33,187	$1,737	$695,129	$139,739

(1) Acquired nonimpaired loans consist of revolving credit agreements and commercial leases that are not in scope for FASB ASC Topic 310-30.
(2) Fair value of loans acquired from Bay Bank on March 16, 2012.
(3) Adjusted fair value of loans acquired from BancTrust on February 15, 2013.
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The following table presents changes in the accretable yield ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Accretable yield at January 1,	$(26,383)	$(17,653)
Additions due to acquisition (1)	(98,394)	(15,538)
Accretion to interest income	28,927	9,045
Disposals	11,167	2,687
Reclassification to / (from) nonaccretable difference	(25,772)	(6,429)
Accretable yield at September 30,	$(110,455)	$(27,888)

(1) Accretable yield on loans acquired from BancTrust on February 15, 2013, and Bay Bank on March 16, 2012.

No allowance for loan losses was brought forward on any of the acquired loans as any credit deterioration evident in the loans was included in the determination of the fair value of the loans at the acquisition date. Updates to expected cash flows for acquired impaired loans accounted for under FASB ASC Topic 310-30 may result in a provision for loan losses, acquired loans and the establishment of an allowance for loan losses, acquired loans to the extent the amount and timing of expected cash flows decrease compared to those originally estimated at acquisition.

The following table presents the components of the allowance for loan losses on acquired impaired loans for the nine months ended September 30, 2013 and 2012 ($ in thousands):

	Covered	Noncovered	Total
Balance at January 1, 2013	$4,190	$ 1,885	$6,075
Provision for loan losses, acquired loans	(1,168)	3,038	1,870
Loans charged-off	(663)	(3,028)	(3,691)
Recoveries	(33)	1,112	1,079
Net charge-offs	(696)	(1,916)	(2,612)
Balance at September 30, 2013	$2,326	$ 3,007	$5,333

	Covered	Noncovered	Total
Balance at January 1, 2012	$ 502	$ -	$502
Provision for loan losses, acquired loans	2,655	928	3,583
Loans charged-off	174	(278)	(104)
Recoveries	195	167	362
Net recoveries (charge-offs)	369	(111)	258
Balance at September 30, 2012	$ 3,526	$ 817	$4,343

As discussed in Note 4 - Loans Held for Investment (LHFI) and Allowance for Loan Losses, LHFI, Trustmark has established a loan grading system that consists of ten individual credit risk grades (risk ratings) that encompass a range from loans where the expectation of loss is negligible to loans where loss has been established. The model is based on the risk of default for an individual credit and establishes certain criteria to segregate the level of risk across the ten unique risk ratings. These credit quality measures are unique to commercial loans. Credit quality for consumer loans is based on individual credit scores, aging status of the loan and payment activity.

The tables below illustrate the carrying amount of acquired loans by credit quality indicator at September 30, 2013 and December 31, 2012 ($ in thousands):

	September 30, 2013 Commercial Loans				
	Pass - Categories 1-6	Special Mention - Category 7	Substandard - Category 8	Doubtful - Category 9	Subtotal
Covered Loans: (1)					
Loans secured by real estate:					
Construction, land development and other land loans	$204	$-	$ 1,354	$748	$2,306
Secured by 1-4 family residential properties	1,670	469	1,926	-	4,065
Secured by nonfarm, nonresidential properties	5,309	113	6,031	-	11,453
Other	909	142	737	2	1,790
Commercial and industrial loans	314	29	135	-	478
Consumer loans	-	-	-	-	-
Other loans	289	-	397	628	1,314
Total covered loans	8,695	753	10,580	1,378	21,406
Noncovered loans:					
Loans secured by real estate:					
Construction, land development and other land loans	33,404	11,028	46,329	8,170	98,931
Secured by 1-4 family residential properties	25,708	15,711	16,763	856	59,038
Secured by nonfarm, nonresidential properties	192,453	22,235	80,844	6,154	301,686
Other	23,298	6,469	5,181	-	34,948
Commercial and industrial loans	138,428	13,677	28,927	5,617	186,649
Consumer loans	82	-	-	-	82
Other loans	15,111	1,613	261	-	16,985
Total noncovered loans	428,484	70,733	178,305	20,797	698,319
Total acquired loans	$437,179	$71,486	$ 188,885	$22,175	$719,725

	Consumer Loans					
	Current	Past Due 30-89 Days	Past Due 90 Days or More	Nonaccrual	Subtotal	Total Acquired Loans
Covered Loans: (1)						
Loans secured by real estate:						
Construction, land development and other land loans	$251	$28	$-	$ -	$279	$2,585
Secured by 1-4 family residential properties	11,480	979	1,223	38	13,720	17,785
Secured by nonfarm, nonresidential properties	497	-	170	-	667	12,120
Other	903	124	-	-	1,027	2,817
Commercial and industrial loans	-	-	-	-	-	478
Consumer loans	151	-	-	-	151	151
Other loans	-	-	-	-	-	1,314
Total covered loans	13,282	1,131	1,393	38	15,844	37,250

Noncovered loans:						
Loans secured by real estate:						
Construction, land development and other land loans	6,810	179	735	-	7,724	106,655
Secured by 1-4 family residential properties	101,895	3,585	3,912	143	109,535	168,573
Secured by nonfarm, nonresidential properties	-	-	-	-	-	301,686
Other	103	-	-	-	103	35,051
Commercial and industrial loans	-	-	-	-	-	186,649
Consumer loans	21,566	494	109	-	22,169	22,251
Other loans	25	-	-	-	25	17,010
Total noncovered loans	130,399	4,258	4,756	143	139,556	837,875
Total acquired loans	$143,681	$5,389	$6,149	$ 181	$155,400	$875,125

(1) Total dollar balances are presented in this table; however, these loans are covered by the loss-share agreement with the FDIC.
TNB is at risk for only 20% of the losses incurred on these loans.

	December 31, 2012				
	Commercial Loans				
	Pass - Categories 1-6	Special Mention - Category 7	Substandard - Category 8	Doubtful - Category 9	Subtotal
Covered Loans: (1)					
Loans secured by real estate:					
Construction, land development and other land loans	$1,341	$ 18	$ 1,489	$ 744	$3,592
Secured by 1-4 family residential properties	3,128	810	2,940	85	6,963
Secured by nonfarm, nonresidential properties	5,857	1,052	9,839	798	17,546
Other	443	318	1,231	-	1,992
Commercial and industrial loans	82	458	207	-	747
Consumer loans	-	-	-	-	-
Other loans	245	-	345	535	1,125
Total covered loans	11,096	2,656	16,051	2,162	31,965
Noncovered loans:					
Loans secured by real estate:					
Construction, land development and other land loans	3,259	119	4,915	921	9,214
Secured by 1-4 family residential properties	7,325	-	3,708	23	11,056
Secured by nonfarm, nonresidential properties	22,453	3,596	18,682	831	45,562
Other	236	-	417	-	653
Commercial and industrial loans	2,853	89	93	-	3,035
Consumer loans	-	-	-	-	-
Other loans	86	-	-	-	86
Total noncovered loans	36,212	3,804	27,815	1,775	69,606
Total acquired loans	$47,308	$ 6,460	$ 43,866	$ 3,937	$101,571

	Consumer Loans					
	Current	Past Due 30-89 Days	Past Due 90 Days or More	Nonaccrual	Subtotal	Total Acquired Loans
Covered Loans: (1)						
Loans secured by real estate:						
Construction, land development and other land loans	$306	$26	$-	$ -	$332	$3,924
Secured by 1-4 family residential properties	14,311	1,028	1,650	38	17,027	23,990
Secured by nonfarm, nonresidential properties	692	169	-	-	861	18,407
Other	1,468	48	52	7	1,575	3,567
Commercial and industrial loans	-	-	-	-	-	747
Consumer loans	177	-	-	-	177	177
Other loans	104	-	-	-	104	1,229
Total covered loans	17,058	1,271	1,702	45	20,076	52,041
Noncovered loans:						
Loans secured by real estate:						
Construction, land development and other land loans	802	-	40	-	842	10,056

Secured by 1-4 family residential properties	7,715	357	215	61	8,348	19,404
Secured by nonfarm, nonresidential properties	87	-	-	-	87	45,649
Other	16	-	-	-	16	669
Commercial and industrial loans	-	-	-	-	-	3,035
Consumer loans	2,394	164	52	-	2,610	2,610
Other loans	14	-	-	-	14	100
Total noncovered loans	11,028	521	307	61	11,917	81,523
Total acquired loans	$28,086	$1,792	$2,009	$ 106	$31,993	$133,564

(1) Total dollar balances are presented in this table; however, these loans are covered by the loss-share agreement with the FDIC.
TNB is at risk for only 20% of the losses incurred on these loans.

Under FASB ASC Topic 310-30, acquired impaired loans are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when expected cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans as long as the estimated cash flows are received as expected. If the timing and amount of cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income may be recognized on a cash basis or as a reduction of the principal amount outstanding. At September 30, 2013 and December 31, 2012, there were no acquired impaired loans accounted for under FASB ASC Topic 310-30 classified as nonaccrual loans. At September 30, 2013, approximately $3.0 million of acquired loans not accounted for under FASB ASC Topic 310-30 were classified as nonaccrual loans, compared to approximately $1.1 million of acquired loans at December 31, 2012.

The following table provides an aging analysis of contractually past due and nonaccrual acquired loans, by class at September 30, 2013 and December 31, 2012 ($ in thousands):

	September 30, 2013					
	Past Due					
	30-89 Days	90 Days or More (1)	Total	Nonaccrual (2)	Current Loans	Total Acquired Loans
Covered loans:						
Loans secured by real estate:						
Construction, land development and other land loans	$290	$454	$744	$ 445	$1,396	$2,585
Secured by 1-4 family residential properties	1,338	1,355	2,693	38	15,054	17,785
Secured by nonfarm, nonresidential properties	873	542	1,415	-	10,705	12,120
Other	431	2	433	-	2,384	2,817
Commercial and industrial loans	21	49	70	53	355	478
Consumer loans	-	-	-	-	151	151
Other loans	397	628	1,025	-	289	1,314
Total covered loans	3,350	3,030	6,380	536	30,334	37,250
Noncovered loans:						
Loans secured by real estate:						
Construction, land development and other land loans	4,801	37,844	42,645	71	63,939	106,655
Secured by 1-4 family residential properties	6,273	8,825	15,098	872	152,603	168,573
Secured by nonfarm, nonresidential properties	8,053	14,105	22,158	293	279,235	301,686
Other	344	1,848	2,192	270	32,589	35,051
Commercial and industrial loans	9,531	4,844	14,375	951	171,323	186,649
Consumer loans	508	109	617	-	21,634	22,251
Other loans	91	8	99	-	16,911	17,010
Total noncovered loans	29,601	67,583	97,184	2,457	738,234	837,875
Total acquired loans	$32,951	$70,613	$103,564	$ 2,993	$768,568	$875,125

(1) - Past due 90 days or more but still accruing interest.
(2) - Acquired loans not accounted for under FASB ASC Topic 310-30.

	December 31, 2012					
	Past Due					
	30-89 Days	90 Days or More (1)	Total	Nonaccrual (2)	Current Loans	Total Acquired Loans
Covered loans:						
Loans secured by real estate:						
Construction, land development and other land loans	$240	$246	$486	$ 445	$2,993	$3,924
Secured by 1-4 family residential properties	1,705	1,883	3,588	234	20,168	23,990
Secured by nonfarm, nonresidential properties	3,953	1,539	5,492	-	12,915	18,407
Other	221	52	273	9	3,285	3,567
Commercial and industrial loans	94	4	98	39	610	747

Consumer loans	-	-	-	-	177	177
Other loans	-	-	-	-	1,229	1,229
Total covered loans	6,213	3,724	9,937	727	41,377	52,041
Noncovered loans:						
Loans secured by real estate:						
Construction, land development and other land loans	-	3,622	3,622	-	6,434	10,056
Secured by 1-4 family residential properties	458	1,392	1,850	243	17,311	19,404
Secured by nonfarm, nonresidential properties	3,526	1,217	4,743	133	40,773	45,649
Other	30	44	74	-	595	669
Commercial and industrial loans	217	23	240	-	2,795	3,035
Consumer loans	164	52	216	-	2,394	2,610
Other loans	-	-	-	-	100	100
Total noncovered loans	4,395	6,350	10,745	376	70,402	81,523
Total acquired loans	$10,608	$10,074	$20,682	$ 1,103	$111,779	$133,564

(1) - Past due 90 days or more but still accruing interest.
(2) - Acquired loans not accounted for under FASB ASC Topic 310-30.
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Note 6 – Mortgage Banking

Trustmark recognizes as assets the rights to service mortgage loans based on the estimated fair value of the mortgage servicing rights (MSR) when loans are sold and the associated servicing rights are retained. Trustmark has elected to account for MSR at fair value.

The fair value of MSR is determined using discounted cash flow techniques benchmarked against third-party valuations. Estimates of fair value involve several assumptions, including the key valuation assumptions about market expectations of future prepayment rates, interest rates and discount rates which are provided by a third party firm. Prepayment rates are projected using an industry standard prepayment model. The model considers other key factors, such as a wide range of standard industry assumptions tied to specific portfolio characteristics such as remittance cycles, escrow payment requirements, geographic factors, foreclosure loss exposure, VA no-bid exposure, delinquency rates and cost of servicing, including base cost and cost to service delinquent mortgages. Prevailing market conditions at the time of analysis are factored into the accumulation of assumptions and determination of servicing value. In recent years, there have been significant market-driven fluctuations in loan prepayment speeds and discount rates. These fluctuations can be rapid and may continue to be significant. Therefore, estimating prepayment speed and/or discount rates within ranges that market participants would use in determining the fair value of MSR requires significant management judgment.

Trustmark utilizes a portfolio of exchange-traded derivative instruments, such as Treasury note futures contracts and option contracts, to achieve a fair value return that economically hedges changes in fair value of the MSR attributable to interest rates. These transactions are considered freestanding derivatives that do not otherwise qualify for hedge accounting. These exchange-traded derivative instruments are accounted for at fair value with changes in the fair value recorded in noninterest income in mortgage banking, net and are offset by the changes in the fair value of the MSR. The MSR fair value represents the present value of future cash flows, which among other things includes decay and the effect of changes in interest rates. Ineffectiveness of hedging the MSR fair value is measured by comparing the change in value of hedge instruments to the change in the fair value of the MSR asset attributable to changes in interest rates and other market driven changes in valuation inputs and assumptions. The impact of this strategy resulted in a net positive ineffectiveness of $1.3 million compared to a net negative ineffectiveness of $1.8 million for the three months ended September 30, 2013 and 2012, respectively. For the nine months ended September 30, 2013, the impact was a net positive ineffectiveness of $2.7 million compared to a net negative ineffectiveness of $2.7 million for the nine months ended September 30, 2012.

The activity in MSR is detailed in the table below ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Balance at beginning of period	$47,341	$43,274
Origination of servicing assets	15,551	17,074
Change in fair value:		
Due to market changes	7,881	(8,960)
Due to runoff	(7,623)	(7,177)
Balance at end of period	$63,150	$44,211

Trustmark is subject to losses in its loan servicing portfolio due to loan foreclosures. Trustmark has obligations to either repurchase the outstanding principal balance of a loan or make the purchaser whole for the economic benefits of a loan if it is determined that the loan sold was in violation of representations or warranties made by Trustmark at the time of the sale, herein referred to as mortgage loan servicing putback expenses. Such representations and warranties typically include those made regarding loans that had missing or insufficient file documentation and/or loans obtained

through fraud by borrowers or other third parties. Putback requests may be made until the loan is paid in full. When a putback request is received, Trustmark evaluates the request and takes appropriate actions based on the nature of the request. Effective January 1, 2013, Trustmark was required by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) to provide a response to putback requests within 60 days of the date of receipt. Currently, putback requests primarily relate to 2005 through 2008 vintage mortgage loans and to government sponsored entity-guaranteed mortgage-backed securities.

The total mortgage loan servicing putback expenses, included in other noninterest expense, incurred by Trustmark during the first nine months of 2013 and 2012 were $1.0 million and $7.2 million, respectively. During the second quarter of 2012, Trustmark updated its quarterly analysis of mortgage loan servicing putback exposure. This analysis, along with recent mortgage industry trends, resulted in Trustmark providing an additional reserve of approximately $4.0 million in the second quarter of 2012. At September 30, 2013 and December 31, 2012, the reserve for mortgage loan servicing putback expenses were $5.0 million and $7.8 million, respectively.

There is inherent uncertainty in reasonably estimating the requirement for reserves against future mortgage loan servicing putback expenses. Future putback expenses are dependent on many subjective factors, including the review procedures of the purchasers and the potential refinance activity on loans sold with servicing released and the subsequent consequences under the representations and warranties. Trustmark believes that it has appropriately reserved for potential mortgage loan servicing putback requests.

During October 2013, Trustmark reached an agreement in principle with FNMA to resolve its existing and future repurchase and make whole obligations (collectively "Repurchase Obligations") related to mortgage loans originated between January 1, 2000 and December 31, 2008 and delivered to FNMA. The terms of the agreement are subject to final approval by FNMA. Under the proposed terms of the agreement, Trustmark will pay FNMA approximately $4.4 million with respect to the Repurchase Obligations, subject to reconciliation and adjustment. Trustmark believes that it is in its best interests to execute the agreement in order to bring finality to the loss reimbursement exposure with FNMA for these years and reduce the resources spent on individual file reviews and defending loss reimbursement requests. The Repurchase Obligations are covered by Trustmark's existing reserve for mortgage loan servicing putback expenses.

Note 7 –Other Real Estate and Covered Other Real Estate

Other Real Estate, excluding Covered Other Real Estate

Other real estate, excluding covered other real estate, is recorded at the lower of cost or estimated fair value less the estimated cost of disposition. Fair value is based on independent appraisals and other relevant factors. Valuation adjustments required at foreclosure are charged to the allowance for loan losses. Other real estate is revalued on an annual basis or more often if market conditions necessitate. Subsequent to foreclosure, losses on the periodic revaluation of the property are charged against an other real estate specific reserve or net income in ORE/Foreclosure expense, if a reserve does not exist. At September 30, 2013, Trustmark's geographic other real estate distribution was concentrated primarily in its five key market regions: Alabama, Florida, Mississippi, Tennessee and Texas. The ultimate recovery of a substantial portion of the carrying amount of other real estate, excluding covered other real estate, is susceptible to changes in market conditions in these areas.

For the periods presented, changes and losses, net on other real estate, excluding covered other real estate, were as follows ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Balance at beginning of period	$78,189	$79,053
Additions (1)	73,890	32,428
Disposals	(29,605)	(24,248)
Writedowns	(6,145)	(4,758)
Balance at end of period	$116,329	$82,475
Loss, net on the sale of other real estate included in ORE/Foreclosure expense	$(110)	$(175)

(1) Includes $40.1 million of other real estate acquired from BancTrust at September 30, 2013, and $2.6 million of other real estate acquired from Bay Bank at September 30, 2012.

Other real estate, excluding covered other real estate, by type of property consisted of the following for the periods presented ($ in thousands):

	September 30, 2013	December 31, 2012
Construction, land development and other land properties	$66,200	$46,957
1-4 family residential properties	15,280	8,134
Nonfarm, nonresidential properties	32,249	22,760
Other real estate properties	2,600	338

Total other real estate, excluding covered other real estate	$ 116,329	$ 78,189

Other real estate, excluding covered other real estate, by geographic location consisted of the following for the periods presented ($ in thousands):

	September 30, 2013	December 31, 2012
Alabama	$ 25,308	$ -
Florida	39,198	18,569
Mississippi (1)	25,439	27,771
Tennessee (2)	14,615	17,589
Texas	11,769	14,260
Total other real estate, excluding covered other real estate	$ 116,329	$ 78,189

(1) - Mississippi includes Central and Southern Mississippi Regions
(2) - Tennessee includes Memphis, Tennessee and Northern Mississippi Regions

Covered Other Real Estate

Covered other real estate is initially recorded at its estimated fair value on the acquisition date based on an independent appraisal less estimated selling costs. Any subsequent valuation adjustments due to declines in fair value are charged to noninterest expense, and are mostly offset by noninterest income representing the corresponding increase to the FDIC indemnification asset for the offsetting loss reimbursement amount. Any recoveries of previous valuation adjustments are credited to noninterest expense with a corresponding charge to noninterest income for the portion of the recovery that is due to the FDIC.

For the nine months ended September 30, 2013 and 2012, changes and gains, net on covered other real estate were as follows ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Balance at beginning of period	$ 5,741	$ 6,331
Transfers from covered loans	1,380	1,424
FASB ASC 310-30 adjustment for the residual recorded investment	(541)	(112)
Net transfers from covered loans	839	1,312
Disposals	(848)	(1,673)
Writedowns	(640)	(248)
Balance at end of period	$ 5,092	$ 5,722
Gain, net on the sale of covered other real estate included in ORE/Foreclosure expense	$ 47	$ 440

Covered other real estate by type of property consisted of the following for the periods presented ($ in thousands):

	September 30, 2013	December 31, 2012
Construction, land development and other land properties	$ 733	$ 1,284
1-4 family residential properties	1,777	1,306
Nonfarm, nonresidential properties	2,525	3,151
Other real estate properties	57	-

Total covered other real estate	$ 5,092	$ 5,741

Note 8 – FDIC Indemnification Asset

TNB elected to account for amounts receivable under the loss-share agreement TNB entered into at the time of its acquisition of the Heritage Banking Group (Heritage) as an indemnification asset in accordance with FASB ASC Topic 805. The FDIC indemnification asset was initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreement. The difference between the present value at the acquisition date and the undiscounted cash flows TNB expects to collect from the FDIC is accreted into noninterest income over the life of the FDIC indemnification asset. Pursuant to the provisions of the loss-share agreement, the FDIC indemnification asset is presented net of any true-up provision due to the FDIC at the termination of the loss-share agreement.

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The FDIC indemnification asset is reduced as expected losses on covered loans and covered other real estate decline or as loss-share claims are submitted to the FDIC. The FDIC indemnification asset is revalued concurrent with the loan re-estimation and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of covered loans and covered other real estate. These adjustments are measured on the same basis as the related covered loans and covered other real estate. Increases in cash flow of the covered loans and covered other real estate over those expected reduce the FDIC indemnification asset, and decreases in cash flow of the covered loans and covered other real estate under those expected increase the FDIC indemnification asset. Increases and decreases to the FDIC indemnification asset are recorded as adjustments to noninterest income.

In October 2012, FASB issued Accounting Standard Update (ASU) 2012-06, "Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution (a consensus of the FASB Emerging Issues Task Force)," to address the diversity in practice regarding how to account for the subsequent measurement of an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. ASU 2012-06 requires that the indemnification asset be measured subsequently on the same basis as the indemnified assets and, if the effect of the change in the cash flows expected to be collected on an indemnification asset must be amortized, the amortization period is limited to the lesser of the term of the indemnification agreement or the remaining life of the indemnified asset.

Trustmark has accounted for the FDIC indemnification asset using the "collectibility method," which recognized write-downs of the FDIC indemnification asset resulting from improvements in expected cash flows and covered losses based on the re-estimation of the acquired covered loans, pay-offs of acquired covered loans, sales of covered other real estate, or reductions in FDIC loss claims immediately in noninterest income. Under ASU 2012-06, write-downs of the FDIC indemnification asset resulting from improvements in expected cash flows and covered losses based on the re-estimation of acquired covered loans will be recognized over the lesser of the remaining life or contractual period of the acquired covered loan by a yield adjustment on the accretion of the discount basis of the FDIC indemnification asset. All other valuation changes of the FDIC indemnification asset (i.e., pay-offs of acquired covered loans, sales of covered other real estate, and reductions of FDIC loss claims) will continue to be accounted for under the "collectibility method." The amendments in ASU 2012-06 are effective prospectively for interim and annual periods beginning on or after December 15, 2012, and, therefore, were effective for Trustmark's consolidated financial statements as of January 1, 2013. Management determined that the impact of this change in accounting principle was immaterial to Trustmark's consolidated financial statements for the first nine months of 2013.

Pursuant to the provisions of the loss-share agreement, TNB may be required to make a true-up payment to the FDIC at the termination of the loss-share agreement should actual losses be less than certain thresholds established in the agreement. TNB calculates the projected true-up payable to the FDIC quarterly and records a FDIC true-up provision for the present value of the projected true-up payable to the FDIC at the termination of the loss-share agreement. TNB's FDIC true-up provision totaled $1.3 million and $1.1 million at September 30, 2013 and December 31, 2012, respectively.

Trustmark periodically re-estimates the expected cash flows on the acquired loans as required by FASB ASC Topic 310-30. For the first nine months of 2013, this analysis resulted in improvements in the estimated future cash flows of the acquired covered loans that remain outstanding as well as lower expected remaining losses on those loans, primarily due to pay-offs of acquired covered loans. The pay-offs and improvements in the estimated expected cash flows of the acquired covered loans resulted in a reduction of the expected loss-share receivable from the FDIC. Other income included a write-down of the FDIC indemnification asset of $3.5 million and $3.0 million on covered loans as a result of loan payoffs, improved cash flow projections and lower loss expectations for loan pools for the nine months ended September 30, 2013 and 2012, respectively.

The following table presents changes in the FDIC indemnification asset for the periods presented ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Balance at beginning of period	$21,774	$28,348
Accretion	(141)	187
Transfers to FDIC claims receivable	(1,097)	(1,271)
Change in expected cash flows (1)	(3,251)	(2,925)
Change in FDIC true-up provision	(200)	(360)
Balance at end of period	$17,085	$23,979

(1) The decrease during the first nine months of 2013 was due to loan pay-offs, improved cash flow projections,and lower loss expectations for covered loans.

Note 9 – Deposits

Deposits consisted of the following for the periods presented ($ in thousands):

	September 30, 2013	December 31, 2012
Noninterest-bearing demand deposits	$2,643,612	$2,254,211
Interest-bearing demand	1,826,118	1,481,182
Savings	2,977,391	2,322,280
Time	2,340,113	1,838,844
Total	$9,787,234	$7,896,517

Note 10 – Defined Benefit and Other Postretirement Benefits

Qualified Pension Plans

Trustmark maintains a noncontributory defined benefit pension plan (Trustmark Capital Accumulation Plan), which covers substantially all associates employed prior to 2007. The plan provides retirement benefits that are based on the length of credited service and final average compensation, as defined in the plan and vest upon three years of service. In an effort to control expenses, the Board voted to freeze plan benefits effective during 2009, with the exception of certain associates covered through plans obtained by acquisitions. Associates will not earn additional benefits, except for interest as required by the IRS regulations, after the effective date. Associates will retain their previously earned pension benefits. As a result of the BancTrust acquisition on February 15, 2013, Trustmark acquired a qualified pension plan, which was frozen prior to the acquisition date. The following table presents information regarding Trustmark's net periodic benefit cost for the periods presented and includes amounts related to the acquisition of BancTrust ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net periodic benefit cost:				
Service cost	$148	$134	$446	$413
Interest cost	1,252	947	3,506	2,837

Expected return on plan assets	(2,060)	(1,438)	(5,660)	(4,238)
Recognized net loss due to settlement	838	-	1,363	-
Recognized net actuarial loss	1,374	1,303	4,142	3,922
Net periodic benefit cost	$1,552	$946	$3,797	$2,934

In the table above, recognized net loss due to settlement is related to the lump sum settlement of certain benefits in the Trustmark Capital Accumulation Plan in accordance with FASB ASC Topic 715-30, “Defined Benefit Plans - Pension.” It is expected that additional settlement charges will be recognized during the remainder of the year.

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The acceptable range of contributions to the plan is determined each year by the plan's actuary. Trustmark's policy is to fund amounts allowable for federal income tax purposes. The actual amount of the contribution is determined based on the plan's funded status and return on plan assets as of the measurement date, which is December 31. In July 2012, the Moving Ahead for Progress in the 21st Century Act (“MAP-21”) became effective. Through MAP-21, Congress provides pension sponsors with funding relief by stabilizing interest rates used to determine required funding contributions to defined benefit plans. Under MAP-21, instead of using a two-year average of these rates, plan sponsors determine required pension funding contributions based on a 25-year average of these rates with a cap and a floor. For 2013, the cap is set at 115% and the floor is set at 85% of the 25-year average of these rates as of September 30, 2012, whereas for 2012 the cap was 110% and the floor was 90% of the average of these rates as of September 30, 2011. Trustmark expects its minimum required contribution for 2013 to be approximately $2.1 million. During 2012, Trustmark made a minimum required contribution of $1.5 million for the 2012 plan year. The increase of approximately $600 thousand in 2013 as compared to 2012 is primarily due to the change in MAP-21 interest rates, with the effective interest rate dropping from 6.82% in 2012 to 6.13% in 2013.

Supplemental Retirement Plan

Trustmark maintains a nonqualified supplemental retirement plan covering directors who elected to defer fees, key executive officers and senior officers. The plan provides for defined death benefits and/or retirement benefits based on a participant's covered salary. Trustmark has acquired life insurance contracts on the participants covered under the plan, which may be used to fund future payments under the plan. The measurement date for the plan is December 31. The following table presents information regarding the plan's net periodic benefit cost for the periods presented ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net periodic benefit cost:				
Service cost	$150	$170	$448	$510
Interest cost	484	517	1,452	1,550
Amortization of prior service cost	62	63	188	188
Recognized net actuarial loss	260	215	778	645
Net periodic benefit cost	$956	$965	$2,866	$2,893

Note 11 – Stock and Incentive Compensation Plans

Trustmark has granted, and currently has outstanding, stock and incentive compensation awards subject to the provisions of the 1997 Long Term Incentive Plan (the 1997 Plan) and the 2005 Stock and Incentive Compensation Plan (the 2005 Plan). New awards have not been issued under the 1997 Plan since it was replaced by the 2005 Plan. The 2005 Plan is designed to provide flexibility to Trustmark regarding its ability to motivate, attract and retain the services of key associates and directors. The 2005 Plan allows Trustmark to make grants of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units and performance units to key associates and directors.

Stock Option Grants

Stock option awards under the 2005 Plan were granted with an exercise price equal to the market price of Trustmark’s stock on the date of grant. Stock options granted under the 2005 Plan vested equally over five years and had a contractual term of seven years. Stock option awards, which were granted under the 1997 Plan, had an exercise price

equal to the market price of Trustmark's stock on the date of grant, vested equally over four years with a contractual term of ten years. During 2011, compensation expense related to stock options was fully recognized. Compensation expense for stock options granted under these plans was estimated using the fair value of each option granted using the Black-Scholes option-pricing model and was recognized on the straight-line method over the requisite service period. No stock options have been granted since 2006, when Trustmark began granting restricted stock awards exclusively.

Restricted Stock Grants

Performance Awards

Trustmark's performance awards are granted to Trustmark's executive and senior management team. Performance awards granted vest based on performance goals of return on average tangible equity (ROATE) and total shareholder return (TSR) compared to a defined peer group. Performance awards are valued utilizing a Monte Carlo simulation model to estimate fair value of the awards at the grant date. The restriction period for performance awards covers a three-year vesting period. These awards are recognized using the straight-line method over the requisite service period. These awards provide for excess shares if performance measures exceed 100%. Any excess shares related to the performance awards granted in 2013 vest at the end of the three year performance period. Any excess shares related to the performance awards granted prior to 2013 are restricted for an additional three-year vesting period subsequent to the end of the three-year performance period. The restricted share agreement provides for voting rights and dividend privileges.

Time-Vested Awards

Trustmark's time-vested awards are granted to Trustmark's Board of Directors, executive and senior management team. The restriction period for time-vested awards covers a three-year vesting period. Time-vested awards are valued utilizing the fair value of Trustmark's stock at the grant date. These awards are recognized on the straight-line method over the requisite service period.

The following tables summarize the stock and incentive plan activity for the periods presented:

	Three Months Ended September 30, 2013		
	Stock Options	Performance Awards	Time-Vested Awards
Outstanding/Nonvested shares or units, beginning of period	289,700	160,520	348,251
Granted	-	-	1,800
Granted - excess shares	-	-	-
Exercised or released from restriction	(17,500)	-	(1,044)
Expired	(10,000)	-	-
Forfeited	-	-	(2,181)
Outstanding/Nonvested shares or units, end of period	262,200	160,520	346,826

	Nine Months Ended September 30, 2013		
	Stock Options	Performance Awards	Time-Vested Awards
Outstanding/Nonvested shares or units, beginning of period	699,600	159,583	317,573
Granted	-	62,119	102,155
Granted - excess shares	-	-	10,809
Exercised or released from restriction	(33,300)	(54,784)	(68,960)
Expired	(404,100)	-	-
Forfeited	-	(6,398)	(14,751)
Outstanding/Nonvested shares or units, end of period	262,200	160,520	346,826

The following table presents information regarding compensation expense for stock and incentive plans for the periods presented ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Compensation expense - Stock and Incentive plans:				
Performance awards	$222	$229	$620	$677
Time-vested awards	754	749	2,230	2,442
Total	$976	$978	$2,850	$3,119

Note 12 – Contingencies

Lending Related

Trustmark makes commitments to extend credit and issues standby and commercial letters of credit (letters of credit) in the normal course of business in order to fulfill the financing needs of its customers. The carrying amount of commitments to extend credit and letters of credit approximates the fair value of such financial instruments. These amounts are not material to Trustmark's financial statements.

Commitments to extend credit are agreements to lend money to customers pursuant to certain specified conditions. Commitments generally have fixed expiration dates or other termination clauses. Because many of these commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The exposure to credit loss in the event of nonperformance by the other party to the commitments to extend credit is represented by the contract amount of those instruments. Trustmark applies the same credit policies and standards as it does in the lending process when making these commitments. The collateral obtained is based upon the assessed creditworthiness of the borrower. At September 30, 2013 and 2012, Trustmark had unused commitments to extend credit of $2.064 billion and $1.843 billion, respectively.

Letters of credit are conditional commitments issued by Trustmark to insure the performance of a customer to a third party. A financial standby letter of credit irrevocably obligates Trustmark to pay a third-party beneficiary when a customer fails to repay an outstanding loan or debt instrument. A performance standby letter of credit irrevocably obligates Trustmark to pay a third-party beneficiary when a customer fails to perform some contractual, nonfinancial obligation. When issuing letters of credit, Trustmark uses essentially the same policies regarding credit risk and collateral which are followed in the lending process. At September 30, 2013 and 2012, Trustmark's maximum exposure to credit loss in the event of nonperformance by the other party for letters of credit was $148.5 million and $152.9 million, respectively. These amounts consist primarily of commitments with maturities of less than three years, which have an immaterial carrying value. Trustmark holds collateral to support standby letters of credit when deemed necessary. As of September 30, 2013, the fair value of collateral held was $39.9 million.

Legal Proceedings

Trustmark's wholly-owned subsidiary, TNB, has been named as a defendant in two lawsuits related to the collapse of the Stanford Financial Group. The first is a purported class action complaint that was filed on August 23, 2009 in the District Court of Harris County, Texas, by Peggy Roif Rotstain, Guthrie Abbott, Catherine Burnell, Steven Queyrouze, Jaime Alexis Arroyo Bornstein and Juan C. Olano, on behalf of themselves and all others similarly situated, naming TNB and four other financial institutions unaffiliated with Trustmark as defendants. The complaint seeks to recover (i) alleged fraudulent transfers from each of the defendants in the amount of fees and other monies received by each defendant from entities controlled by R. Allen Stanford (collectively, the "Stanford Financial Group") and (ii) damages allegedly attributable to alleged conspiracies by one or more of the defendants with the Stanford Financial Group to commit fraud and/or aid and abet fraud on the asserted grounds that defendants knew or should have known the Stanford Financial Group was conducting an illegal and fraudulent scheme. Plaintiffs have demanded a jury trial. Plaintiffs did not quantify damages. In November 2009, the lawsuit was removed to federal court by certain defendants and then transferred by the United States Panel on Multidistrict Litigation to federal court in the Northern District of Texas (Dallas) where multiple Stanford related matters are being consolidated for pre-trial proceedings. In May 2010, all defendants (including TNB) filed motions to dismiss the lawsuit, and the motions to dismiss have been fully briefed by all parties. The court has not yet ruled on the defendants' motions to dismiss. In August 2010, the court authorized and approved the formation of an Official Stanford Investors Committee ("OSIC") to represent the interests of Stanford investors and, under certain circumstances, to file legal actions for the benefit of Stanford investors. In December 2011, OSIC filed a motion to intervene in this action. In September 2012, the district court referred the case to a magistrate judge for hearing and determination of certain pretrial issues. In December 2012, the court granted the OSIC's motion to intervene, and the OSIC filed an Intervenor Complaint against one of the other defendant financial institutions. In February 2013, the OSIC filed an additional Intervenor Complaint that asserts claims against TNB and the remaining defendant financial institutions. The OSIC seeks to recover: (i) alleged fraudulent transfers in the amount of the fees each of the defendants allegedly received from Stanford Financial Group, the profits each of the defendants allegedly made from Stanford Financial Group deposits, and other monies each of the defendants allegedly received from Stanford Financial Group; (ii) damages attributable to alleged conspiracies by each of the defendants with the Stanford Financial Group to commit fraud and/or aid and abet fraud and conversion on the asserted grounds that the defendants knew or should have known the Stanford Financial Group was conducting an illegal and fraudulent scheme; and (iii) punitive damages. The OSIC did not quantify damages. In July 2013, all defendants (including TNB) filed motions to dismiss the OSIC's claims. The court has not yet ruled on the defendants' motions to dismiss the OSIC's claims.

The second Stanford-related lawsuit was filed on December 14, 2009 in the District Court of Ascension Parish, Louisiana, individually by Harold Jackson, Paul Blaine, Carolyn Bass Smith, Christine Nichols, and Ronald and Ramona Hebert naming TNB (misnamed as Trust National Bank) and other individuals and entities not affiliated with Trustmark as defendants. The complaint seeks to recover the money lost by these individual plaintiffs as a result of the collapse of the Stanford Financial Group (in addition to other damages) under various theories and causes of action, including negligence, breach of contract, breach of fiduciary duty, negligent misrepresentation, detrimental reliance, conspiracy, and violation of Louisiana's uniform fiduciary, securities, and racketeering laws. The complaint does not quantify the amount of money the plaintiffs seek to recover. In January 2010, the lawsuit was removed to federal court by certain defendants and then transferred by the United States Panel on Multidistrict Litigation to federal court in the Northern District of Texas (Dallas) where multiple Stanford related matters are being consolidated for pre-trial proceedings. On March 29, 2010, the court stayed the case. TNB filed a motion to lift the stay, which was denied on February 28, 2012. In September 2012, the district court referred the case to a magistrate judge for hearing and determination of certain pretrial issues.

TNB's relationship with the Stanford Financial Group began as a result of Trustmark's acquisition of a Houston-based bank in August 2006, and consisted of correspondent banking and other traditional banking services in the ordinary course of business. Both Stanford-related lawsuits are in their preliminary stages and have been previously disclosed by Trustmark.

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TNB is the defendant in two putative class actions challenging TNB's practices regarding "overdraft" or "non-sufficient funds" fees charged by TNB in connection with customer use of debit cards, including TNB's order of processing transactions, notices and calculations of charges, and calculations of fees. Kathy D. White v. TNB was filed in Tennessee state court in Memphis, Tennessee and was removed on June 19, 2012 to the United States District Court for the Western District of Tennessee. (Plaintiff Kathy White had filed an earlier, virtually identical action that was voluntarily dismissed.) Leroy Jenkins v. TNB was filed on June 4, 2012 in the United States District Court for the Southern District of Mississippi. The White and Jenkins pleadings are matters of public record in the files of the courts. In both cases, the plaintiffs purport to represent classes of similarly-situated customers of TNB. The White complaint asserts claims of breach of contract, breach of a duty of good faith and fair dealing, unconscionability, conversion, and unjust enrichment. The Jenkins complaint originally included similar allegations as well as federal-law claims under the Electronic Funds Transfer Act (EFTA) and RICO; however, the RICO claims were voluntarily dismissed from the case on January 9, 2013. Each of these complaints seeks the imposition of a constructive trust and unquantified damages. These complaints were largely patterned after similar lawsuits that have been filed against other banks across the country. On July 19, 2012, the plaintiff in the White case filed an amended complaint to add plaintiffs from Mississippi and also to add federal EFTA claims. Trustmark contends that amended complaint was procedurally improper. On October 4, 2012, the plaintiff in the White case moved for leave to add two Tennessee plaintiffs. Trustmark filed preliminary dismissal and venue transfer motions, and discovery has begun, in the White case; the Jenkins case has also entered the active discovery stage. Trustmark also filed a motion to dismiss all claims except the EFTA claim in the Jenkins case. All of these motions remained pending when the parties began active settlement negotiations under the Mississippi federal court's supervision in June of 2013.

On August 18, 2013, the class action plaintiffs in both cases and Trustmark agreed to a settlement, the terms and conditions of which are set forth in an executed Settlement Agreement and Release (the "Settlement"). The Settlement is a matter of public record in the court file in the Leroy Jenkins case referenced above. The parties reached the Settlement through arm's-length negotiations following two court-ordered settlement conferences with United States Magistrate Judge F. Keith Ball. Under the Settlement, subject to the terms and conditions therein and subject to court approval, and without admission of liability, fault or wrongdoing by Trustmark, plaintiffs and a settlement class consisting of TNB account holders whose accounts met certain criteria with respect to overdraft and non-sufficient funds fees between September 28, 2005 and the date of the court's preliminary approval of the Settlement (the "Settlement Class") would fully, finally, and forever resolve, discharge, and release their claims in exchange for Trustmark's payment of $4.0 million, inclusive of all attorneys' fees and costs, to create a common fund to benefit the Settlement Class. In addition, Trustmark has agreed to adhere to its current method of time-ordered posting for non-recurring point of sale and ATM debit transactions for two years following the effective date of the Settlement, and to pay all fees and costs associated with providing notice to the Settlement Class and for implementation of the Settlement by the Settlement Administrator.

In an order dated October 11, 2013, the United States District Court for the Southern District of Mississippi preliminarily approved the Settlement. The court will hold a hearing in early 2014 to determine whether to issue final approval of the Settlement. As is common in class action settlements, notice will be provided to members of the Settlement Class, who will be given the option of opting out of the Settlement or objecting to the Settlement. Pursuant to court approval, a professional settlement administrator has been engaged to provide notices to class members and to facilitate apportionment of the Settlement funds among class members.

The Settlement of $4.0 million, or $2.5 million net of taxes, was included in other noninterest expense for the quarter ended June 30, 2013. Trustmark deposited the $4.0 million into the Settlement Administrator's escrow account on October 25, 2013.

Trustmark and its subsidiaries are also parties to other lawsuits and other claims that arise in the ordinary course of business. Some of the lawsuits assert claims related to the lending, collection, servicing, investment, trust and other business activities, and some of the lawsuits allege substantial claims for damages.

All pending legal proceedings described above are being vigorously contested. In the regular course of business, Management evaluates estimated losses or costs related to litigation, and provision is made for anticipated losses whenever Management believes that such losses are probable and can be reasonably estimated. At the present time, Management believes, based on the advice of legal counsel and Management's evaluation, that (i) the final resolution of pending legal proceedings described above will not, individually or in the aggregate, have a material impact on Trustmark's consolidated financial position or results of operations and (ii) a loss in any such case is not probable at this time, and thus no accrual is required under FASB ASC Topic 450-20, "Loss Contingencies." In addition, given the preliminary nature of these matters and the lack of any quantification by plaintiffs of the relief being sought, to the extent that a loss in any such matter may be viewed as reasonably possible under FASB ASC Topic 450-20, it is not possible at this time to provide an estimate of any such possible loss (or range of possible loss) for any such matter.

Note 13 – Earnings Per Share

Basic earnings per share (EPS) is computed by dividing net income by the weighted-average shares of common stock outstanding. Diluted EPS is computed by dividing net income by the weighted-average shares of common stock outstanding, adjusted for the effect of potentially dilutive stock awards outstanding during the period. The following table reflects weighted-average shares used to calculate basic and diluted EPS for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Basic shares	67,177	64,778	66,779	64,616
Dilutive shares	205	215	184	189
Diluted shares	67,382	64,993	66,963	64,805

Weighted-average antidilutive stock awards were excluded in determining diluted earnings per share. The following table reflects weighted-average antidilutive shares for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Weighted-average antidilutive shares	270	501	379	705

Note 14 – Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks. The following table reflects specific transaction amounts for the periods presented ($ in thousands):

	Nine Months Ended September 30,	
	2013	2012
Income taxes paid	$14,220	$37,551
Interest expense paid on deposits and borrowings	18,656	24,197
Noncash transfers from loans to foreclosed properties (1)	34,226	33,740
Assets acquired in business combinations	1,845,930	234,960
Liabilities assumed in business combinations	1,821,066	209,322

(1) Includes transfers from covered loans to foreclosed properties

Note 15 – Shareholders' Equity

Trustmark and TNB are subject to minimum capital requirements, which are administered by the federal bank regulatory agencies. These capital requirements, as defined by federal regulations, involve quantitative and qualitative measures of assets, liabilities and certain off-balance sheet instruments. Failure to meet minimum capital requirements can result in certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements of Trustmark and TNB. As of September 30, 2013, Trustmark and TNB have exceeded all of the minimum capital standards for the parent company and its

primary banking subsidiary as established by regulatory requirements. In addition, TNB has met applicable regulatory guidelines to be considered well-capitalized at September 30, 2013. To be categorized in this manner, TNB must maintain minimum total risk-based capital, Tier 1 risk-based capital and Tier 1 leverage ratios as set forth in the accompanying table. There are no significant conditions or events that have occurred since September 30, 2013, which Management believes have affected Trustmark’s and TNB's present classification.

Trustmark's and TNB's actual regulatory capital amounts and ratios are presented in the table below ($ in thousands):

	Actual Regulatory Capital		Minimum Regulatory Capital Required		Minimum Regulatory Provision to be Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2013:						
Total Capital (to Risk Weighted Assets)						
Trustmark Corporation	$1,097,058	14.02%	$626,067	8.00%	n/a	n/a
Trustmark National Bank	1,055,807	13.63%	619,558	8.00%	$774,448	10.00%
Tier 1 Capital (to Risk Weighted Assets)						
Trustmark Corporation	$993,155	12.69%	$313,034	4.00%	n/a	n/a
Trustmark National Bank	954,563	12.33%	309,779	4.00%	$464,669	6.00%
Tier 1 Capital (to Average Assets)						
Trustmark Corporation	$993,155	8.78%	$339,316	3.00%	n/a	n/a
Trustmark National Bank	954,563	8.53%	335,621	3.00%	$559,369	5.00%
At December 31, 2012:						
Total Capital (to Risk Weighted Assets)						
Trustmark Corporation	$1,157,838	17.22%	$537,861	8.00%	n/a	n/a
Trustmark National Bank	1,119,438	16.85%	531,577	8.00%	$664,472	10.00%
Tier 1 Capital (to Risk Weighted Assets)						
Trustmark Corporation	$1,043,865	15.53%	$268,930	4.00%	n/a	n/a
Trustmark National Bank	1,007,775	15.17%	265,789	4.00%	$398,683	6.00%
Tier 1 Capital (to Average Assets)						
Trustmark Corporation	$1,043,865	10.97%	$285,556	3.00%	n/a	n/a
Trustmark National Bank	1,007,775	10.72%	281,984	3.00%	$469,974	5.00%

Accumulated Other Comprehensive Income

The following table presents the components of accumulated other comprehensive (loss) income and the related tax effects allocated to each component for the periods ended September 30, 2013 and 2012 ($ in thousands):

	Before-Tax Amount	Tax Effect	Accumulated Other Comprehensive (Loss) Income
Balance, January 1, 2013	$ 5,533	$(2,138)	$ 3,395
Unrealized holding losses on AFS arising during period	(98,130)	37,534	(60,596)
Adjustment for net gains realized in net income	(378)	145	(233)
Pension and other postretirement benefit plans	6,471	(2,475)	3,996
Change in accumulated gain on effective cash flow hedge derivatives	1,963	(751)	1,212
Balance, September 30, 2013	$ (84,541)	$32,315	$ (52,226)
Balance, January 1, 2012	$ 5,089	$(1,968)	$ 3,121

Unrealized holding gains on AFS arising during period	2,970	(1,136)	1,834
Adjustment for net gains realized in net income	(1,041)	398	(643)
Pension and other postretirement benefit plans	4,755	(1,819)	2,936
Balance, September 30, 2012	$ 11,773	$(4,525)	$ 7,248

The following table presents the amounts affecting accumulated other comprehensive (loss) income that are included in their entirety in net income for the periods presented ($ in thousands). Reclassification adjustments related to securities available for sale are included in securities gains, net in the accompanying consolidated statements of income. The amortization of prior service cost and recognized net actuarial loss on pension and other postretirement benefit plans are included in the computation of net periodic benefit cost (see Note 10 – Defined Benefit and Other Postretirement Benefits for additional details).

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	Pre-Tax Income (Expense)	Tax (Expense) Benefit	After Tax Income (Expense)
Nine Months Ended September 30, 2013:			
Securities available for sale:			
Reclassification adjustment for net gains realized in net income	$ 378	$ (145)	$ 233
Pension and other postretirement benefit plans:			
Amortization of prior service cost	$ (188)	$ 72	$ (116)
Recognized net loss due to settlement	(1,363)	521	(842)
Recognized net actuarial loss	(4,920)	1,882	(3,038)
Total pension and other postretirement benefit plans	$ (6,471)	$ 2,475	$ (3,996)
Nine Months Ended September 30, 2012:			
Securities available for sale:			
Reclassification adjustment for net gains realized in net income	$ 1,041	$ (398)	$ 643
Pension and other postretirement benefit plans:			
Amortization of prior service cost	$ (188)	$ 72	$ (116)
Recognized net actuarial loss	(4,567)	1,747	(2,820)
Total pension and other postretirement benefit plans	$ (4,755)	$ 1,819	$ (2,936)

Note 16 – Fair Value

Fair Value Measurements

FASB ASC Topic 820, "Fair Value Measurements and Disclosures," defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. Depending on the nature of the asset or liability, Trustmark uses various valuation techniques and assumptions when estimating fair value. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. FASB ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 Inputs – Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that Trustmark has the ability to access at the measurement date.

Level 2 Inputs – Valuation is based upon quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability such as interest rates, yield curves, volatilities and default rates and inputs that are derived principally from or corroborated by observable market data.

Level 3 Inputs – Unobservable inputs reflecting the reporting entity's own determination about the assumptions that market participants would use in pricing the asset or liability based on the best information available.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the fair value measurement in its entirety is classified is based on the lowest level input that is significant to the fair value measurement in its entirety. Trustmark's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and

considers factors specific to the asset or liability.

Financial Instruments Measured at Fair Value

The methodologies Trustmark uses in determining the fair values are based primarily on the use of independent, market-based data to reflect a value that would be reasonably expected upon exchange of the position in an orderly transaction between market participants at the measurement date. The large majority of assets that are stated at fair value are of a nature that can be valued using prices or inputs that are readily observable through a variety of independent data providers. The providers selected by Trustmark for fair valuation data are widely recognized and accepted vendors whose evaluations support the pricing functions of financial institutions, investment and mutual funds, and portfolio managers. Trustmark has documented and evaluated the pricing methodologies used by the vendors and maintains internal processes that regularly test valuations for anomalies.

Trustmark utilizes an independent pricing service to advise it on the carrying value of the securities available for sale portfolio. As part of Trustmark's procedures, the price provided from the service is evaluated for reasonableness given market changes. When a questionable price exists, Trustmark investigates further to determine if the price is valid. If needed, other market participants may be utilized to determine the correct fair value. Trustmark has also reviewed and confirmed its determinations in thorough discussions with the pricing source regarding their methods of price discovery.

Mortgage loan commitments are valued based on the securities prices of similar collateral, term, rate and delivery for which the loan is eligible to deliver in place of the particular security. Trustmark acquires a broad array of mortgage security prices that are supplied by a market data vendor, which in turn accumulates prices from a broad list of securities dealers. Prices are processed through a mortgage pipeline management system that accumulates and segregates all loan commitment and forward-sale transactions according to the similarity of various characteristics (maturity, term, rate, and collateral). Prices are matched to those positions that are deemed to be an eligible substitute or offset (i.e., "deliverable") for a corresponding security observed in the market place.

Trustmark estimates fair value of MSR through the use of prevailing market participant assumptions and market participant valuation processes. This valuation is periodically tested and validated against other third-party firm valuations.

Trustmark obtains the fair value of interest rate swaps from a third-party pricing service that uses an industry standard discounted cash flow methodology. In addition, credit valuation adjustments are incorporated in the fair values to account for potential nonperformance risk. In adjusting the fair value of its interest rate swap contracts for the effect of nonperformance risk, Trustmark has considered any applicable credit enhancements such as collateral postings, thresholds, mutual puts, and guarantees. In conjunction with the FASB's fair value measurement guidance, Trustmark made an accounting policy election to measure the credit risk of these derivative financial instruments, which are subject to master netting agreements, on a net basis by counterparty portfolio.

Trustmark has determined that the majority of the inputs used to value its interest rate swaps offered to qualified commercial borrowers fall within Level 2 of the fair value hierarchy, while the credit valuation adjustments associated with these derivatives utilize Level 3 inputs, such as estimates of current credit spreads. Trustmark has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its interest rate swaps and has determined that the credit valuation adjustment is not significant to the overall valuation of these derivatives. As a result, Trustmark classifies its interest rate swap valuations in Level 2 of the fair value hierarchy.

Trustmark also utilizes exchange-traded derivative instruments such as Treasury note futures contracts and option contracts to achieve a fair value return that offsets the changes in fair value of MSR attributable to interest rates. Fair values of these derivative instruments are determined from quoted prices in active markets for identical assets therefore allowing them to be classified within Level 1 of the fair value hierarchy. In addition, Trustmark utilizes derivative instruments such as interest rate lock commitments in its mortgage banking area which lack observable inputs for valuation purposes resulting in their inclusion in Level 3 of the fair value hierarchy.

At this time, Trustmark presents no fair values that are derived through internal modeling. Should positions requiring fair valuation arise that are not relevant to existing methodologies, Trustmark will make every reasonable effort to obtain market participant assumptions, or independent evaluation.

Financial Assets and Liabilities

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012, segregated by the level of valuation inputs within the fair value hierarchy utilized to measure fair value ($ in thousands). There were no transfers between fair value levels for the nine months ended September 30, 2013 and the year ended December 31, 2012.

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	September 30, 2013			
	Total	Level 1	Level 2	Level 3
U.S. Treasury securities	$503	$-	$503	$-
U.S. Government agency obligations	265,438	-	265,438	-
Obligations of states and political subdivisions	212,991	-	212,991	-
Mortgage-backed securities	2,665,441	-	2,665,441	-
Asset-backed securities	227,728	-	227,728	-
Securities available for sale	3,372,101	-	3,372,101	-
Loans held for sale	119,986	-	119,986	-
Mortgage servicing rights	63,150	-	-	63,150
Other assets - derivatives	10,841	2,633	6,161	2,047
Other liabilities - derivatives	7,305	480	6,825	-

	December 31, 2012			
	Total	Level 1	Level 2	Level 3
U.S. Government agency obligations	$105,745	$-	$105,745	$-
Obligations of states and political subdivisions	215,761	-	215,761	-
Mortgage-backed securities	2,094,612	-	2,094,612	-
Asset-backed securities	241,627	-	241,627	-
Securities available for sale	2,657,745	-	2,657,745	-
Loans held for sale	257,986	-	257,986	-
Mortgage servicing rights	47,341	-	-	47,341
Other assets - derivatives	7,107	(440)	5,263	2,284
Other liabilities - derivatives	6,612	545	6,067	-

The changes in Level 3 assets measured at fair value on a recurring basis for the periods ended September 30, 2013 and 2012 are summarized as follows ($ in thousands):

	MSR	Other Assets - Derivatives
Balance, January 1, 2013	$47,341	$ 2,284
Total net gains included in net income (1)	258	7,558
Additions	15,551	-
Sales	-	(7,795)
Balance, September 30, 2013	$63,150	$ 2,047
The amount of total gains for the period included in earnings that are attributable to the change in unrealized gains or losses still held at September 30, 2013	$7,881	$ 954
Balance, January 1, 2012	$43,274	$ 702
Total net (losses) gains included in net income (1)	(16,137)	10,261
Additions	17,074	-
Sales	-	(6,658)
Balance, September 30, 2012	$44,211	$ 4,305
The amount of total (losses) gains for the period included in	$(8,960)	$ 2,320

earnings that are attributable to the change in unrealized
gains or losses still held at September 30, 2012

(1) Total net gains (losses) included in net income relating to MSR includes changes in fair value due to market changes and due to runoff.

Trustmark may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. Assets at September 30, 2013, which have been measured at fair value on a nonrecurring basis, include impaired LHFI. Loans for which it is probable Trustmark will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement are considered impaired. Impaired LHFI have been determined to be collateral dependent and assessed using a fair value approach. Specific allowances for impaired LHFI are based on comparisons of the recorded carrying values of the loans to the present value of the estimated cash flows of these loans at each loan's original effective interest rate, the fair value of the collateral or the observable market prices of the loans. Fair value estimates begin with appraised values based on the current market value/as-is value of the property being appraised, normally from recently received and reviewed appraisals. Appraisals are obtained from state-certified appraisers and are based on certain assumptions, which may include construction or development status and the highest and best use of the property. These appraisals are reviewed by Trustmark's Appraisal Review Department to ensure they are acceptable. Appraised values are adjusted down for costs associated with asset disposal. At September 30, 2013, Trustmark had outstanding balances of $32.2 million in impaired LHFI that were specifically identified for evaluation and written down to fair value of the underlying collateral less cost to sell based on the fair value of the collateral or other unobservable input compared to $40.6 million at December 31, 2012. These specifically evaluated impaired LHFI are classified as Level 3 in the fair value hierarchy. Impaired LHFI are periodically reviewed and evaluated for additional impairment and adjusted accordingly based on the same factors identified above.

Please refer to Note 2 – Business Combinations, for financial assets and liabilities acquired, which were measured at fair value on a nonrecurring basis in accordance with GAAP.

Nonfinancial Assets and Liabilities

Certain nonfinancial assets measured at fair value on a nonrecurring basis include foreclosed assets (upon initial recognition or subsequent impairment), nonfinancial assets and nonfinancial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other nonfinancial long-lived assets measured at fair value for impairment assessment.

Other real estate, excluding covered other real estate, includes assets that have been acquired in satisfaction of debt through foreclosure and is recorded at the lower of cost or estimated fair value less the estimated cost of disposition. Fair value is based on independent appraisals and other relevant factors. In the determination of fair value subsequent to foreclosure, Management also considers other factors or recent developments, such as changes in market conditions from the time of valuation and anticipated sales values considering plans for disposition, which could result in an adjustment to lower the collateral value estimates indicated in the appraisals. At September 30, 2013, Trustmark's geographic other real estate distribution was concentrated primarily in its five key market regions: Alabama, Florida, Mississippi, Tennessee and Texas. The ultimate recovery of a substantial portion of the carrying amount of other real estate, excluding covered other real estate, is susceptible to changes in market conditions in these areas. Periodic revaluations are classified as Level 3 in the fair value hierarchy since assumptions are used that may not be observable in the market.

Certain foreclosed assets, upon initial recognition, are remeasured and reported at fair value through a charge-off to the allowance for loan losses based upon the fair value of the foreclosed asset. The fair value of a foreclosed asset, upon initial recognition, is estimated using Level 3 inputs based on adjusted observable market data. Foreclosed assets measured at fair value upon initial recognition totaled $73.9 million (utilizing Level 3 valuation inputs) during the nine months ended September 30, 2013 compared with $32.4 million for the same period in 2012. Foreclosed assets measured at fair value upon initial recognition for the nine months ended September 30, 2013 and 2012, included $40.1 million of other real estate acquired from BancTrust and $2.6 million of other real estate acquired from Bay Bank, respectively. In connection with the measurement and initial recognition of the foregoing foreclosed assets, Trustmark recognized charge-offs of the allowance for loan losses totaling $9.2 million and $8.5 million for the first nine months of 2013 and 2012, respectively. Other than foreclosed assets measured at fair value upon initial

recognition, $35.0 million of foreclosed assets were remeasured during the first nine months of 2013, requiring write-downs of $5.5 million to reach their current fair values compared to $29.7 million of foreclosed assets that were remeasured during the first nine months of 2012, requiring write-downs of $4.8 million.

Fair Value of Financial Instruments

FASB ASC Topic 825, “Financial Instruments,” requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. A detailed description of the valuation methodologies used in estimating the fair value of financial instruments can be found in Note 19 – Fair Value included in Item 8 of Trustmark’s Form 10-K Annual Report for the year ended December 31, 2012.

The carrying amounts and estimated fair values of financial instruments at September 30, 2013 and December 31, 2012, are as follows ($ in thousands):

	September 30, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial Assets:				
Level 2 Inputs:				
Cash and short-term investments	$343,562	$343,562	$238,535	$238,535
Securities held to maturity	69,980	70,949	42,188	46,888
Level 3 Inputs:				
Net LHFI	5,628,009	5,701,646	5,514,016	5,619,933
Net acquired loans	869,792	869,792	127,489	127,489
FDIC indemnification asset	17,085	17,085	21,774	21,774
Financial Liabilities:				
Level 2 Inputs:				
Deposits	9,787,234	9,792,076	7,896,517	7,904,179
Short-term liabilities	403,163	403,163	375,749	375,749
Long-term FHLB advances	8,562	8,562	-	-
Subordinated notes	49,896	53,605	49,871	53,980
Junior subordinated debt securities	61,856	40,206	61,856	40,206

In cases where quoted market prices are not available, fair values are generally based on estimates using present value techniques. Trustmark’s premise in present value techniques is to represent the fair values on a basis of replacement value of the existing instrument given observed market rates on the measurement date. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates for those assets or liabilities cannot be necessarily substantiated by comparison to independent markets and, in many cases, may not be realizable in immediate settlement of the instruments. The estimated fair value of financial instruments with immediate and shorter-term maturities (generally 90 days or less) is assumed to be the same as the recorded book value. All nonfinancial instruments, by definition, have been excluded from these disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of Trustmark.

The fair values of net LHFI are estimated for portfolios of loans with similar financial characteristics. For variable rate LHFI that reprice frequently with no significant change in credit risk, fair values are based on carrying values. The fair values of certain mortgage LHFI, such as 1-4 family residential properties, are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. The fair values of other types of LHFI are estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The processes for estimating the fair value of net LHFI described above does not represent an exit price under FASB ASC Topic 820 and such an exit price could potentially produce a different fair value estimate at September 30, 2013 and December 31, 2012.

Note 17 – Derivative Financial Instruments

Trustmark maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. Trustmark’s interest rate risk management strategy involves modifying the repricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Under the guidelines of FASB ASC Topic 815, “Derivatives and Hedging,” all derivative instruments are

required to be recognized as either assets or liabilities and be carried at fair value on the balance sheet. The fair value of derivative positions outstanding is included in other assets and/or other liabilities in the accompanying consolidated balance sheets and in the net change in these financial statement line items in the accompanying consolidated statements of cash flows as well as included in noninterest income in the accompanying consolidated statements of income.

Derivatives Designated as Hedging Instruments

As part of Trustmark's risk management strategy in the mortgage banking area, derivative instruments such as forward sales contracts are utilized. Trustmark's obligations under forward contracts consist of commitments to deliver mortgage loans, originated and/or purchased, in the secondary market at a future date. These derivative instruments are designated as fair value hedges under FASB ASC Topic 815. The ineffective portion of changes in the fair value of the forward contracts and changes in the fair value of the loans designated as loans held for sale are recorded in noninterest income in mortgage banking, net. Trustmark's off-balance sheet obligations under these derivative instruments totaled $149.5 million at September 30, 2013, with a negative valuation adjustment of $2.9 million, compared to $310.3 million, with a negative valuation adjustment of $738 thousand as of December 31, 2012.

On April 4, 2013, Trustmark entered into an interest rate swap contract on junior subordinated debentures with a total notional amount of $60.0 million. The interest rate swap contract was designated as a derivative instrument in a cash flow hedge under FASB ASC Topic 815, with the objective of protecting the quarterly interest payments on Trustmark's $60.0 million of junior subordinated debentures issued to Trustmark Preferred Capital Trust I throughout the five-year period beginning December 31, 2014 and ending December 31, 2019 from the risk of variability of those payments resulting from changes in the three-month LIBOR interest rate. Under the swap, Trustmark will pay a fixed interest rate of 1.66% and receive a variable interest rate based on three-month LIBOR on a total notional amount of $60.0 million, with quarterly settlements.

No ineffectiveness related to the interest rate derivative designated as a cash flow hedge was recognized in the consolidated statements of income during the three or nine months ended September 30, 2013. The accumulated net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive loss totaled $1.2 million at September 30, 2013. Trustmark does not expect to reclassify any amounts from accumulated other comprehensive loss to interest expense during the next 12 months since Trustmark's derivative relating to its junior subordinated debentures does not become effective until December 31, 2014.

Derivatives not Designated as Hedging Instruments

Trustmark utilizes a portfolio of exchange-traded derivative instruments, such as Treasury note futures contracts and option contracts, to achieve a fair value return that economically hedges changes in fair value of MSR attributable to interest rates. These transactions are considered freestanding derivatives that do not otherwise qualify for hedge accounting. These exchange-traded derivative instruments are accounted for at fair value with changes in the fair value recorded in noninterest income in mortgage banking, net and are offset by changes in the fair value of MSR. The MSR fair value represents the present value of future cash flows, which among other things includes decay and the effect of changes in interest rates. Ineffectiveness of hedging the MSR fair value is measured by comparing the change in value of hedge instruments to the change in the fair value of the MSR asset attributable to changes in interest rates and other market driven changes in valuation inputs and assumptions. The impact of this strategy resulted in a net positive ineffectiveness of $1.3 million compared to a net negative ineffectiveness of $1.8 million for the three months ended September 30, 2013 and 2012, respectively. For the nine months ended September 30, 2013, the impact was a net positive ineffectiveness of $2.7 million compared to a net negative ineffectiveness of $2.7 million for the nine months ended September 30, 2012.

Trustmark also utilizes derivative instruments such as interest rate lock commitments in its mortgage banking area. Rate lock commitments are residential mortgage loan commitments with customers, which guarantee a specified interest rate for a specified time period. Changes in the fair value of these derivative instruments are recorded in noninterest income in mortgage banking, net and are offset by the changes in the fair value of forward sales contracts. Trustmark's off-balance sheet obligations under these derivative instruments totaled $111.5 million at September 30, 2013, with a positive valuation adjustment of $2.0 million, compared to $186.9 million, with a positive valuation adjustment of $2.3 million as of December 31, 2012.

Trustmark offers certain derivatives products directly to qualified commercial borrowers seeking to manage their interest rate risk. Trustmark economically hedges interest rate swap transactions executed with commercial borrowers by entering into offsetting interest rate swap transactions with third parties. Derivative transactions executed as part of this program are not designated as qualifying hedging relationships and are, therefore, carried at fair value with the change in fair value recorded in noninterest income in bank card and other fees. Because these derivatives have mirror-image contractual terms, in addition to collateral provisions which mitigate the impact of non-performance risk, the changes in fair value substantially offset. As of September 30, 2013, Trustmark had interest rate swaps with an aggregate notional amount of $365.7 million related to this program, compared to $321.3 million as of December 31, 2012.

Trustmark has agreements with its financial institution counterparties that contain provisions where if Trustmark defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then Trustmark could also be declared in default on its derivative obligations.

As of September 30, 2013, the termination value of interest rate swaps in a liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $908 thousand compared to $5.4 million as of December 31, 2012. As of September 30, 2013, Trustmark had posted collateral with a market value of $1.2 million against its obligations because of negotiated thresholds and minimum transfer amounts under these agreements. If Trustmark had breached any of these triggering provisions at September 30, 2013, it could have been required to settle its obligations under the agreements at the termination value.

Credit risk participation agreements arise when Trustmark contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps. These agreements provide for reimbursement of losses resulting from a third party default on the underlying swap. As of September 30, 2013, Trustmark had entered into three risk participation agreements as a beneficiary with an aggregate notional amount of $19.8 million, compared to two risk participation agreements with an aggregate notional amount of $10.1 million at December 31, 2012. The fair values of these risk participation agreements were immaterial at September 30, 2013.

Tabular Disclosures

The following tables disclose the fair value of derivative instruments in Trustmark's balance sheets as well as the effect of these derivative instruments on Trustmark's results of operations for the periods presented ($ in thousands):

	September 30, 2013	December 31, 2012
Derivatives in hedging relationships		
Interest rate contracts:		
Interest rate swaps included in other assets	$ 1,963	$ -
Forward contracts included in other liabilities	2,878	738
Derivatives not designated as hedging instruments		
Interest rate contracts:		
Futures contracts included in other assets	$ 2,228	$ (482)
Exchange traded purchased options included in other assets	405	42
OTC written options (rate locks) included in other assets	2,047	2,284
Interest rate swaps included in other assets	4,174	5,241
Credit risk participation agreements included in other assets	24	22
Exchange traded written options included in other liabilities	480	545
Interest rate swaps included in other liabilities	3,947	5,329

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Derivatives in hedging relationships				
Amount of loss recognized in mortgage banking, net	$(13,008)	$(4,212)	$(2,141)	$(5,279)
Derivatives not designated as hedging instruments				
Amount of gain (loss) recognized in mortgage banking, net	$2,728	$2,883	$(5,421)	$9,913
Amount of (loss) gain recognized in bankcard and other fees	(203)	(85)	192	(246)

The following table discloses the amount included in other comprehensive (loss) income for derivative instruments designated as cash flow hedges for the periods presented ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Derivatives in cash flow hedging relationship				

Amount of (loss) gain recognized in other comprehensive (loss) income	$ (242)	$ -	$ 1,212	$ -

Certain financial instruments, including resell and repurchase agreements, securities lending arrangements and derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements or similar agreements. Information about financial instruments that are eligible for offset in the consolidated balance sheets as of September 30, 2013 and December 31, 2012 is presented in the following tables ($ in thousands):

Offsetting of Derivative Assets
As of September 30, 2013

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral Received	
Derivatives	$ 6,137	$ -	$ 6,137	$(1,253)	$ (1,500)	$ 3,384

Offsetting of Derivative Liabilities
As of September 30, 2013

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral Posted	
Derivatives	$ 3,947	$ -	$ 3,947	$(1,253)	$ -	$ 2,694

Offsetting of Derivative Assets
As of December 31, 2012

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the	Net Amounts of Assets presented	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
				Financial Instruments	Cash Collateral Received	

		Statement of Financial Position	in the Statement of Financial Position			
Derivatives	$ 5,241	$ -	$ 5,241	$ -	$ -	$ 5,241

Offsetting of Derivative Liabilities
As of December 31, 2012

				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Posted	Net Amount
Derivatives	$ 5,329	$ -	$ 5,329	$ -	$ (594)	$ 4,735

Note 18 – Segment Information

Trustmark’s management reporting structure includes three segments: General Banking, Wealth Management and Insurance. General Banking is primarily responsible for all traditional banking products and services, including loans and deposits. General Banking also consists of internal operations such as Human Resources, Executive Administration, Treasury, Funds Management, Public Affairs and Corporate Finance. Wealth Management provides customized solutions for affluent customers by integrating financial services with traditional banking products and services such as private banking, money management, full-service brokerage, financial planning, personal and institutional trust and retirement services. Through Fisher Brown Bottrell Insurance, Inc. (FBBI), a wholly owned subsidiary of TNB, Trustmark’s Insurance Division provides a full range of retail insurance products including commercial risk management products, bonding, group benefits and personal lines coverage.

The accounting policies of each reportable segment are the same as those of Trustmark except for its internal allocations. Noninterest expenses for back-office operations support are allocated to segments based on estimated uses of those services. Trustmark measures the net interest income of its business segments with a process that assigns cost of funds or earnings credit on a matched-term basis. This process, called "funds transfer pricing", charges an appropriate cost of funds to assets held by a business unit, or credits the business unit for potential earnings for carrying liabilities. The net of these charges and credits flows through to the General Banking segment, which contains the management team responsible for determining Trustmark’s funding and interest rate risk strategies.

The following table discloses financial information by reportable segment for the periods presented ($ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
General Banking				
Net interest income	$97,210	$84,125	$283,134	$255,184
Provision for loan losses, net	(375)	5,448	(9,606)	10,849
Noninterest income	31,367	30,433	90,250	92,772
Noninterest expense	88,615	72,029	272,951	224,256
Income before income taxes	40,337	37,081	110,039	112,851
Income taxes	9,916	9,817	27,803	29,834
General banking net income	$30,421	$27,264	$82,236	$83,017
Selected Financial Information				
Average assets	$11,621,803	$9,664,428	$11,312,070	$9,653,259
Depreciation and amortization	$9,182	$7,514	$26,897	$20,649
Wealth Management				
Net interest income	$1,117	$1,065	$3,261	$3,254
Provision for loan losses, net	43	15	38	35
Noninterest income	7,535	6,895	21,440	18,327
Noninterest expense	6,877	5,957	19,824	16,894
Income before income taxes	1,732	1,988	4,839	4,652
Income taxes	570	701	1,591	1,549
Wealth management net income	$1,162	$1,287	$3,248	$3,103
Selected Financial Information				
Average assets	$66,760	$77,999	$71,417	$78,684
Depreciation and amortization	$43	$42	$126	$132
Insurance				
Net interest income	$102	$89	$237	$233
Provision for loan losses, net	-	-	-	-
Noninterest income	8,231	7,537	23,496	21,311
Noninterest expense	6,032	5,474	18,089	16,043
Income before income taxes	2,301	2,152	5,644	5,501
Income taxes	850	799	2,107	2,048
Insurance net income	$1,451	$		