FIRST CITIZENS BANCSHARES INC /DE/
Form 10-Q
May 03, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2018
or

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-16715

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

Delaware	56-1528994
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
4300 Six Forks Road, Raleigh, North Carolina	27609
(Address of principle executive offices)	(Zip code)

(919) 716-7000
(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 twelve months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past ninety days. Yes x No ¨

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

Class A Common Stock—$1 Par Value—11,005,220 shares
Class B Common Stock—$1 Par Value—1,005,185 shares

(Number of shares outstanding, by class, as of May 2, 2018)

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PART I

Item 1. Financial Statements

First Citizens BancShares, Inc. and Subsidiaries
Consolidated Balance Sheets

(Dollars in thousands, unaudited)	March 31, 2018	December 31, 2017
Assets		
Cash and due from banks	$248,139	$336,150
Overnight investments	1,946,882	1,387,927
Investment in marketable equity securities	110,107	—
Investment securities available for sale	6,857,740	7,180,180
Investment securities held to maturity	74	76
Loans held for sale	46,660	51,179
Loans and leases	23,611,977	23,596,825
Allowance for loan and lease losses	(223,116)	(221,893)
Net loans and leases	23,388,861	23,374,932
Premises and equipment	1,140,820	1,138,431
Other real estate owned	48,089	51,097
Income earned not collected	96,607	95,249
FDIC shared-loss receivable	3,636	2,223
Goodwill	150,601	150,601
Other intangible assets	68,668	73,096
Other assets	329,553	686,371
Total assets	$34,436,437	$34,527,512
Liabilities		
Deposits:		
Noninterest-bearing	$12,000,741	$11,237,375
Interest-bearing	17,968,504	18,028,900
Total deposits	29,969,245	29,266,275
Short-term borrowings	554,758	693,807
Long-term obligations	194,413	870,240
FDIC shared-loss payable	102,466	101,342
Other liabilities	243,441	261,784
Total liabilities	31,064,323	31,193,448
Shareholders’ equity		
Common stock:		
Class A - $1 par value (16,000,000 shares authorized; 11,005,220 shares issued and outstanding at March 31, 2018 and December 31, 2017)	11,005	11,005
Class B - $1 par value (2,000,000 shares authorized; 1,005,185 shares issued and outstanding at March 31, 2018 and December 31, 2017)	1,005	1,005
Preferred stock - $0.01 par value (10,000,000 shares authorized; no shares issued and outstanding at March 31, 2018 and December 31, 2017)	—	—
Surplus	658,918	658,918
Retained earnings	2,931,509	2,785,430
Accumulated other comprehensive loss	(230,323)	(122,294)

Total shareholders’ equity	3,372,114	3,334,064
Total liabilities and shareholders’ equity	$34,436,437	$34,527,512

See accompanying Notes to Consolidated Financial Statements.

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First Citizens BancShares, Inc. and Subsidiaries
Consolidated Statements of Income

	Three months ended March 31	
(Dollars in thousands, except per share data, unaudited)	2018	2017
Interest income		
Loans and leases	$251,982	$226,630
Investment securities and dividend income	35,020	29,751
Overnight investments	5,599	4,476
Total interest income	292,601	260,857
Interest expense		
Deposits	3,756	4,436
Short-term borrowings	1,434	580
Long-term obligations	2,974	5,498
Total interest expense	8,164	10,514
Net interest income	284,437	250,343
Provision for loan and lease losses	7,605	8,231
Net interest income after provision for loan and lease losses	276,832	242,112
Noninterest income		
Gain on acquisitions	—	12,017
Cardholder services	14,782	11,907
Merchant services	6,177	6,693
Service charges on deposit accounts	26,543	22,142
Wealth management services	23,569	20,962
Securities losses, net	—	(24)
Marketable equity securities gains, net	971	—
Other service charges and fees	7,480	7,601
Mortgage income	4,237	7,576
Insurance commissions	3,776	3,558
ATM income	2,171	1,773
Adjustments to FDIC shared-loss receivable	(1,478)	(1,628)
Net impact from FDIC shared-loss agreement termination	—	(45)
Gain on extinguishment of debt	25,814	—
Other	8,642	7,115
Total noninterest income	122,684	99,647
Noninterest expense		
Salaries and wages	129,203	116,362
Employee benefits	32,091	27,178
Occupancy expense	27,954	24,762
Equipment expense	24,974	24,588
FDIC insurance expense	5,733	5,593
Collection and foreclosure-related expenses	4,146	3,763
Merger-related expenses	598	833
Other	43,364	33,621
Total noninterest expense	268,063	236,700
Income before income taxes	131,453	105,059
Income taxes	31,222	37,438
Net income	$100,231	$67,621

Average shares outstanding	12,010,405	12,010,405
Net income per share	$ 8.35	$ 5.63

See accompanying Notes to Consolidated Financial Statements.

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

	Three months ended March 31	
(Dollars in thousands, unaudited)	2018	2017
Net income	$100,231	$67,621
Other comprehensive (loss) income:		
Unrealized (losses) gains on securities available for sale:		
Change in unrealized securities available for sale (losses) gains arising during period	(78,634)	36,096
Tax effect	18,088	(13,419)
Reclassification adjustment for losses included in income before income taxes	—	24
Tax effect	—	(9)
Total change in unrealized (losses) gains on securities available for sale, net of tax	(60,546)	22,692
Change in pension obligation:		
Amortization of actuarial losses and prior service cost	3,337	2,500
Tax effect	(768)	(941)
Total change in pension obligation, net of tax	2,569	1,559
Other comprehensive (loss) income	(57,977)	24,251
Total comprehensive income	$42,254	$91,872

See accompanying Notes to Consolidated Financial Statements.

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

(Dollars in thousands, unaudited)	Class A Common Stock	Class B Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total Shareholders' Equity
Balance at December 31, 2016	$ 11,005	$ 1,005	$658,918	$2,476,691	$ (135,192)	$3,012,427
Net income	—	—	—	67,621	—	67,621
Other comprehensive income, net of tax	—	—	—	—	24,251	24,251
Cash dividends ($0.30 per share)	—	—	—	(3,603)	—	(3,603)
Balance at March 31, 2017	$ 11,005	$ 1,005	$658,918	$2,540,709	$ (110,941)	$3,100,696
Balance at December 31, 2017	$ 11,005	$ 1,005	$658,918	$2,785,430	$ (122,294)	$3,334,064
Cumulative effect of adoption of ASU 2016-01	—	—	—	18,716	(18,716)	—
Cumulative effect of adoption of ASU 2018-02	—	—	—	31,336	(31,336)	—
Net income	—	—	—	100,231	—	100,231
Other comprehensive loss, net of tax	—	—	—	—	(57,977)	(57,977)
Cash dividends ($0.35 per share)	—	—	—	(4,204)	—	(4,204)
Balance at March 31, 2018	$ 11,005	$ 1,005	$658,918	$2,931,509	$ (230,323)	$3,372,114

See accompanying Notes to Consolidated Financial Statements.

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

(Dollars in thousands, unaudited)	Three months ended March 31 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$100,231	$67,621
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan and lease losses	7,605	8,231
Deferred tax (benefit) expense	(5,573)	6,693
Net change in current taxes	33,128	27,462
Depreciation	23,179	22,616
Net increase (decrease) in accrued interest payable	(2,454)	150
Net increase in income earned not collected	(1,358)	(617)
Gain on acquisitions	—	(12,017)
Securities losses	—	24
Marketable equity securities gains, net	(971)	—
Gain on extinguishment of debt	(25,814)	—
Loss on termination of FDIC shared-loss agreements	—	45
Origination of loans held for sale	(131,353)	(134,932)
Proceeds from sale of loans held for sale	138,538	162,837
Gain on sale of loans held for sale	(2,666)	(3,456)
Gain on sale of portfolio loans	—	(164)
Net write-downs/losses on other real estate	1,210	1,717
Gain on sales of premises and equipment	—	(156)
Net accretion of premiums and discounts	(10,323)	(10,985)
Amortization of intangible assets	6,049	5,271
Net change in FDIC receivable for shared-loss agreements	(1,834)	2,591
Net change in FDIC payable for shared-loss agreements	1,124	1,005
Net change in other assets	342,312	(15,078)
Net change in other liabilities	(12,642)	8,741
Net cash provided by operating activities	458,388	137,599
CASH FLOWS FROM INVESTING ACTIVITIES		
Net increase in loans outstanding	(7,283)	(105,100)
Purchases of investment securities available for sale	(374,850)	(871,698)
Purchases of marketable equity securities	(2,272)	—
Proceeds from maturities/calls of investment securities held to maturity	2	15
Proceeds from maturities/calls of investment securities available for sale	503,717	787,182
Proceeds from sales of investment securities available for sale	—	14,162
Proceeds from sales of marketable equity securities	664	—
Net increase in overnight investments	(558,955)	(856,442)
Proceeds from sales of portfolio loans	—	32,294
Cash paid to the FDIC for shared-loss agreements	—	(2,760)
Net cash paid to the FDIC for termination of shared-loss agreements	—	(285)
Proceeds from sales of other real estate	8,380	8,845
Proceeds from sales of premises and equipment	13	2,205
Purchases of premises and equipment	(24,081)	(15,459)
Net cash acquired in business acquisitions	—	25,646
Net cash used in investing activities	(454,665)	(981,395)

CASH FLOWS FROM FINANCING ACTIVITIES		
Net decrease in time deposits	(92,064)	(107,339)
Net increase in demand and other interest-bearing deposits	795,034	827,009
Net (decrease) increase in short-term borrowings	(139,049)	87,100
Repayment of long-term obligations	(651,451)	(442)
Cash dividends paid	(4,204)	—
Net cash (used in) provided by financing activities	(91,734)	806,328
Change in cash and due from banks	(88,011)	(37,468)
Cash and due from banks at beginning of period	336,150	539,741
Cash and due from banks at end of period	$248,139	$502,273
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfers of loans to other real estate	$6,582	$5,822
Dividends declared but not paid	4,204	3,603
Reclassification of portfolio loans to loans held for sale	—	32,130

See accompanying Notes to Consolidated Financial Statements.

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

NOTE A - ACCOUNTING POLICIES AND BASIS OF PRESENTATION

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

General
These consolidated financial statements and notes thereto are presented in accordance with instructions for Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all information and notes necessary for a complete presentation of financial position, results of operations and cash flow activity required in accordance with accounting principles generally accepted in the United States of America (GAAP). In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the consolidated financial position and consolidated results of operations have been made. The unaudited interim consolidated financial statements included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes to consolidated financial statements included in BancShares' Annual Report on Form 10-K for the year ended December 31, 2017.

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

Use of Estimates in the Preparation of Financial Statements
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported. Actual results could differ from those estimates, and different assumptions in the application of these policies could result in material changes in BancShares' consolidated financial position, the consolidated results of its operations or related disclosures. Material estimates that are particularly susceptible to significant change include:
- Allowance for loan and lease losses;
- Fair value of financial instruments, including acquired assets and assumed liabilities;
- Pension plan assumptions;
- Cash flow estimates on purchased credit-impaired loans;
- Goodwill and other intangible assets;
- Federal Deposit Insurance Corporation (FDIC) shared-loss payable; and
- Income tax assets, liabilities and expense

Recently Adopted Accounting Pronouncements
FASB ASU 2018-03, Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10)
The amendments in this ASU provide clarification on certain aspects related to the guidance issued in ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The areas for correction or improvement include (1) equity securities without a readily determinable fair value - discontinuation; (2) equity securities without a readily determinable fair value - adjustments; (3) forward contracts and purchased options; (4) presentation requirements for certain fair value option liabilities; (5) fair value option liabilities denominated in a foreign currency; and (6) transition guidance for equity securities without a readily determinable fair value.
This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. We adopted the guidance effective in the first quarter of 2018. The adoption did not have a material impact on our consolidated financial

position or consolidated results of operations.

FASB ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

This ASU requires a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017 (Tax Act), which

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was enacted on December 22, 2017. The Tax Act included a reduction to the corporate income tax rate from 35 percent to 21 percent effective January 1, 2018. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate.

The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We adopted the guidance effective in the first quarter of 2018. The change in accounting principle was accounted for as a cumulative-effect adjustment to the balance sheet resulting in a $31.3 million increase to retained earnings and a corresponding decrease to AOCI on January 1, 2018.

FASB ASU 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

This ASU requires employers to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Employers will present the other components separately from the line item that includes the service cost. In addition, only the service cost component of net benefit cost is eligible for capitalization.

The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We adopted the guidance effective in the first quarter of 2018. The adoption did not have a material impact on our consolidated financial position or consolidated results of operations.

FASB ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments

This ASU addresses the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments in this ASU provide guidance on (1) debt prepayment or debt extinguishment costs; (2) settlement of zero-coupon debt instruments; (3) contingent consideration payments made after a business combination; (4) proceeds from the settlement of insurance claims; (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (6) distributions received from equity method investees; (7) beneficial interests in securitization transactions; and (8) separately identifiable cash flows and application of the predominance principle.

The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The guidance requires application using a retrospective transition method. We adopted the guidance effective in the first quarter of 2018. The adoption did not have any impact on our Consolidated Statements of Cash Flows.

FASB ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities

This ASU addresses certain aspects of recognition, measurement, presentation and disclosure of certain financial instruments. The amendments in this ASU (1) require most equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplify the impairment assessment of equity investments without a readily determinable fair value; (3) eliminate the requirement to disclose the method(s) and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (4) require public business entities to use exit price notion, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (5) require separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (6) require separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) state that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets.

The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We adopted the guidance effective in the first quarter of 2018. The change in accounting principle was accounted for as a cumulative-effect adjustment to the balance sheet resulting in an $18.7 million increase to retained earnings and a decrease to AOCI on January 1, 2018. With the adoption of this ASU equity securities can no longer be classified as available for sale, as such marketable equity securities will be disclosed as a separate line item on the balance sheet with changes in the fair value of equity securities reflected in net income.

For equity investments without a readily determinable fair value, BancShares has elected to measure the equity investments using the measurement alternative which requires BancShares to make a qualitative assessment of whether the investment is impaired at each reporting period. Under the measurement alternative these investments will be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. If a qualitative assessment indicates that the investment is impaired, BancShares will estimate the investment's fair value in accordance with ASC 820 and, if the fair value is less than the investment's carrying value, recognize an impairment loss in net income equal to the difference between carrying value and fair value. Equity investments without a readily determinable fair value are recorded within other assets in the consolidated balance sheets.

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

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

Per ASU 2015-14, Deferral of the Effective Date, this guidance was deferred and is effective for fiscal periods beginning after December 15, 2017, including interim reporting periods within that reporting period. We adopted the guidance effective in the first quarter of 2018. Our revenue is comprised primarily of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The contracts that are in scope of the guidance are primarily related to cardholder and merchant services income, service charges on deposit accounts, wealth management services income, other service charges and fees, insurance commissions, ATM income, sales of other real estate and other. Based on our overall assessment of revenue streams and review of related contracts affected by the ASU, the adoption of this guidance did not change the method in which we currently recognize revenue.

We also completed an evaluation of the costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on this evaluation, we determined that the classification of cardholder and merchant processing costs as well as expenses for cardholder reward programs should be netted against cardholder and merchant services income. We used the full retrospective method of adoption and restated the prior financial statements to net the cardholder and merchant processing costs against the related cardholder and merchant services income. These classification changes resulted in changes to both noninterest income and noninterest expense, however, there was no change to previously reported net income. Merchant processing expenses of $18.3 million have been reclassified and reported as a component of merchant services income for the three months ended March 31, 2017. Cardholder processing expenses of $6.8 million and cardholder reward programs expense of $2.5 million have been reclassified and reported as a component of cardholder services income for the three months ended March 31, 2017.

Recently Issued Accounting Pronouncements

FASB ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment

This ASU eliminates Step 2 from the goodwill impairment test. Under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. This ASU eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative test.

This ASU will be effective for BancShares' annual or interim goodwill impairment tests for fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We expect to adopt the guidance for our annual impairment test in fiscal year 2020. BancShares does not anticipate any impact to our consolidated financial position or consolidated results of operations as a result of the adoption.

FASB ASU 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

This ASU eliminates the delayed recognition of the full amount of credit losses until the loss was probable of occurring and instead will reflect an entity's current estimate of all expected credit losses. The amendments in this ASU broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The

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ASU does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations of the credit loss estimate based on the entity's size, complexity and risk profile. In addition, the disclosures of credit quality indicators in relation to the amortized cost of financing receivables, a current disclosure requirement, are further disaggregated by year of origination.

The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018. We will adopt the guidance by the first quarter of 2020 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. For BancShares, the standard will apply to loans, unfunded loan commitments and debt securities. We have formed a cross-functional team co-led by Corporate Finance and Risk Management with executive sponsorship and engaged a third party to assist with the adoption. The implementation team has developed a detailed project plan and is staying informed about the broader industry's perspective and insights, and identifying and researching key decision points. We have completed the readiness assessment and gap analysis related to data, modeling IT, accounting policy, controls and reporting which has enabled us to determine the areas of focus and estimate total body of work. Our current critical activities include model design, accounting policy development, data feasibility analysis, evaluation of reporting and disclosure solutions and completion of specific work stream project plans. We will continue to evaluate the impact the new standard will have on our consolidated financial statements as the final impact will be dependent, among other items, upon the loan portfolio composition and credit quality at the adoption date, as well as economic conditions, financial models used and forecasts at that time.

FASB ASU 2016-02, Leases (Topic 842)

This ASU increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The key difference between existing standards and this ASU is the requirement for lessees to recognize all lease contracts on their balance sheet. This ASU requires lessees to classify leases as either operating or finance leases, which are substantially similar to the current operating and capital leases classifications. The distinction between these two classifications under the new standard does not relate to balance sheet treatment, but relates to treatment in the statements of income and cash flows. Lessor guidance remains largely unchanged with the exception of how a lessor determines the appropriate lease classification for each lease to better align the lessor guidance with revised lessee classification guidance.

The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. We will adopt during the first quarter of 2019. We expect an increase to the Consolidated Balance Sheets for right-of-use assets and associated lease liabilities, as well as resulting depreciation expense of the right-of-use assets and interest expense of the lease liabilities in the Consolidated Statements of Income, for arrangements previously accounted for as operating leases. Additionally, adding these assets to our balance sheet will impact our total risk-weighted assets used to determine our regulatory capital levels. Our impact analysis on this change in accounting principle estimates an increase to the Consolidated Balance Sheets for total lease liability ranging between $65.0 million and $85.0 million, as the initial gross up of both assets and liabilities. Capital is expected to be impacted by an estimated four to six basis points. These are preliminary estimates subject to change and will continue to be refined closer to adoption.

Revenue Recognition

The principles based standard requires disclosure of qualitative and quantitative information surrounding the amount, nature, timing and uncertainty of revenues and cash flows arising from contracts with customers. The core principle of the new standard is that revenue should be recognized when a company transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

Descriptions of our noninterest revenue-generating activities that are within the scope of the new revenue ASU is broadly segregated as follows:

Cardholder and Merchant Services - These represent interchange fees from customer debit and credit card transactions that are earned at the time a cardholder engages in a transaction with a merchant as well as fees charged to merchants for providing them the ability to accept and process the debit and credit card transaction. Revenue is recognized when the performance obligation has been met as it is satisfied upon the completion of the card transaction. Additionally, ASU 2014-09 requires us to report costs associated with cardholder and merchant services transactions to be netted against the fees from such transactions.

Service Charges on Deposit Accounts - These deposit account-related fees represent monthly account maintenance and transaction-based service fees such as overdraft fees, stop payment fees and charges for issuing cashier's checks and money orders. For account maintenance services, revenue is recognized at the end of the statement period when our performance obligation has been satisfied. All other revenues from transaction-based services are recognized at a point in time when the performance obligation has been completed.

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Wealth Management Services - These primarily represent annuity fees, sales commissions, management fees, insurance sales, and trust and asset management fees. The performance obligation for wealth management services is the provision of services to place annuity products issued by the counterparty to investors, and the provision of services to manage the client's assets, including brokerage custodial and other management services. Revenue is recognized over the period in which services are performed, are based on a percentage of the value of the assets under management/administration, and are fixed or variable based on account type, or are transaction-based.

Other Service Charges and Fees - These include, but are not limited to, check cashing fees, international banking fees, internet banking fees, wire transfer fees and safe deposit fees. These fees are charged, and revenue is recognized, at the point in time the service being requested by the customer is provided thus satisfying our performance obligation.

Insurance Commissions - These represent commissions earned on the issuance of insurance products and services. The performance obligation is generally satisfied upon the issuance of the insurance policy and revenue is recognized when the commission payment is remitted by the insurance carrier or policy holder depending on if the billing is performed by FCB or the carrier.

ATM Income - These represent fees imposed on customers and non-customers for engaging in an ATM transaction. Revenue is recognized at the time of the transaction as the performance obligation of rendering the ATM service has been met.

Sales of Other Real Estate - ORE property consists of foreclosed real estate used as collateral for loans, closed branches, land acquired and no longer intended for future use by FCB, and other real estate purchased for resale as ORE. Revenue is generally recognized on the date of sale where the performance obligation of providing access and transferring control of the specified ORE property to the buyer in good faith and good title is satisfied. This is recorded as a component of other noninterest income.

Other - This consists of several forms of recurring revenue such as external rental income, parking income, FHLB dividends, and income earned on changes in the cash surrender value of bank-owned life insurance, all of which are outside the scope of ASU 2014-09. The remaining miscellaneous income is the result of immaterial transactions where revenue is recognized when, or as, the performance obligation is satisfied.

NOTE B - BUSINESS COMBINATIONS

HomeBancorp, Inc.

On May 1, 2018, FCB completed the merger of Tampa, Florida-based HomeBancorp, Inc. (HomeBancorp) and its subsidiary, HomeBanc, into FCB. Under the terms of the merger agreement, cash consideration of $15.03 was paid to the shareholders of HomeBancorp for each share of HomeBancorp's common stock, with total consideration paid of $113.7 million. The merger will allow FCB to expand its footprint in Florida by entering into two new markets in Tampa and Orlando. As of March 31, 2018, HomeBancorp had $912.6 million in consolidated assets, $597.7 million in loans and $647.1 million in deposits. Due to the close proximity of the acquisition date and the date that BancShares' financial statements were issued, preliminary fair value estimates are not available.

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NOTE C - INVESTMENTS

The amortized cost and fair value of investment securities classified as available for sale and held to maturity at March 31, 2018 and December 31, 2017, are as follows:

	March 31, 2018			
(Dollars in thousands)	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Investment securities available for sale				
U.S. Treasury	$1,557,991	$—	$4,098	$1,553,893
Government agency	32,006	12	109	31,909
Mortgage-backed securities	5,360,251	1,001	154,585	5,206,667
Corporate bonds	59,414	319	80	59,653
Other	5,538	80	—	5,618
Total investment securities available for sale	$7,015,200	$1,412	$158,872	$6,857,740

	December 31, 2017			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Investment securities available for sale				
U.S. Treasury	$1,658,410	$—	$546	$1,657,864
Government agency	8,695	15	40	8,670
Mortgage-backed securities	5,419,379	1,529	80,152	5,340,756
Equity securities	75,471	29,737	—	105,208
Corporate bonds	59,414	557	8	59,963
Other	7,645	256	182	7,719
Total investment securities available for sale	$7,229,014	$32,094	$80,928	$7,180,180

	March 31, 2018			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Investment securities held to maturity				
Mortgage-backed securities	$74	$5	$—	$79

	December 31, 2017			
	Cost	Gross unrealized gains	Gross unrealized losses	Fair value
Investment securities held to maturity				
Mortgage-backed securities	$76	$5	$—	$81

As a result of adopting ASU 2016-01 in the first quarter of 2018, investments in marketable equity securities are no longer classified as investments available for sale. At March 31, 2018 and December 31, 2017, we had $110.1 million and $105.2 million, respectively, in marketable equity securities recorded at fair value. Prior to January 1, 2018 equity securities were classified as available for sale and stated at fair value with unrealized gains and losses reported in accumulated other comprehensive income. A cumulative-effect adjustment of $18.7 million was recorded on January 1, 2018 to reclassify the net unrealized gains from accumulated other comprehensive income to retained earnings with subsequent changes in fair value recognized in the Consolidated Statements of Income.

Investments in mortgage-backed securities primarily represent securities issued by the Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation. Investments in corporate bonds and marketable equity securities represent positions in securities of other financial institutions. Other investments include trust preferred securities of financial institutions. The following table provides the amortized cost and fair value by contractual maturity. Expected maturities will differ from contractual maturities on certain securities because borrowers and issuers may have the right to call or prepay obligations with or without prepayment penalties. Repayments of mortgage-backed securities are dependent on the repayments of the underlying loan balances.

(Dollars in thousands)	March 31, 2018 Cost	March 31, 2018 Fair value	December 31, 2017 Cost	December 31, 2017 Fair value
Investment securities available for sale				
Non-amortizing securities maturing in:				
One year or less	$1,105,460	$1,103,291	$808,768	$808,301
One through five years	453,082	451,152	850,532	850,450
Five through 10 years	60,303	60,546	60,332	60,886
Over 10 years	36,104	36,084	14,532	14,579
Mortgage-backed securities	5,360,251	5,206,667	5,419,379	5,340,756
Equity securities	—	—	75,471	105,208
Total investment securities available for sale	$7,015,200	$6,857,740	$7,229,014	$7,180,180
Investment securities held to maturity				
Mortgage-backed securities held to maturity	$74	$79	$76	$81

There were no sales of investment securities available for sale for the three months ended March 31, 2018. Gross gains and gross losses on sales of investment securities available for sale were $3 thousand and $27 thousand, respectively for the three months ended March 31, 2017.

The following table provides the realized and unrealized gains or losses on marketable equity securities for the three months ended March 31, 2018.

(Dollars in thousands)	Three months ended March 31, 2018
Marketable equity securities gains, net	$ 971
Less net gains recognized on marketable equity securities sold	96
Unrealized gains recognized on marketable equity securities held	$ 875

The following table provides information regarding securities available for sale with unrealized losses as of March 31, 2018 and December 31, 2017.

	March 31, 2018					
	Less than 12 months		12 months or more		Total	
(Dollars in thousands)	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Investment securities available for sale:						
U.S. Treasury	$1,453,968	$ 4,049	$99,925	$ 49	$1,553,893	$4,098
Government agency	12,059	81	2,159	28	14,218	109
Mortgage-backed securities	2,404,338	58,606	2,535,662	95,979	4,940,000	154,585
Corporate bonds	9,950	80	—	—	9,950	80
Total	$3,880,315	$ 62,816	$2,637,746	$ 96,056	$6,518,061	$158,872

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Investment securities available for sale:						
U.S. Treasury	$1,408,166	$ 345	$249,698	$ 201	$1,657,864	$546

Government agency	848	12	2,527	28	3,375	40
Mortgage-backed securities	2,333,254	20,911	2,723,406	59,241	5,056,660	80,152
Corporate bonds	5,025	8	—	—	5,025	8
Other	5,349	182	—	—	5,349	182
Total	$3,752,642	$ 21,458	$2,975,631	$ 59,470	$6,728,273	$ 80,928

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Investment securities available for sale with an aggregate fair value of $2.64 billion and $2.98 billion had continuous unrealized losses for more than 12 months with a corresponding aggregate unrealized loss of $96.1 million and $59.5 million as of March 31, 2018 and December 31, 2017, respectively. As of March 31, 2018, 224 of these are government sponsored enterprise-issued mortgage-backed securities or government agency securities and 1 is a U.S. Treasury security.

None of the unrealized losses identified as of March 31, 2018 or December 31, 2017 relate to the marketability of the securities or the issuers' ability to honor redemption obligations. Rather, the unrealized losses relate to changes in interest rates relative to when the debt securities were purchased. For all periods presented, BancShares had the ability and intent to retain these securities for a period of time sufficient to recover all unrealized losses. Therefore, none of the securities were deemed to be other than temporarily impaired.

Debt securities having an aggregate carrying value of $3.83 billion at March 31, 2018 and $4.59 billion at December 31, 2017 were pledged as collateral to secure public funds on deposit and certain short-term borrowings, and for other purposes as required by law.

On May 1, 2018, mortgage-backed securities with an amortized cost of $2.49 billion were transferred from investments available for sale to the held to maturity portfolio. At the time of transfer, the mortgage-backed securities had a fair value of $2.38 billion and a weighted average maturity of 13 years. FCB has the intent and ability to retain these securities until maturity.

NOTE D - LOANS AND LEASES

BancShares' accounting methods for loans and leases differ depending on whether they are purchased credit-impaired (PCI) or non-PCI. Non-PCI loans and leases include originated commercial and noncommercial, purchased non-impaired loans, purchased leases and certain purchased revolving credit. For purchased non-impaired loans to be included as non-PCI, it must be determined that the loans do not have any credit deterioration at the time of acquisition. Conversely, loans for which it is probable at acquisition that all required payments will not be collected in accordance with contractual terms are considered impaired and, therefore, classified as PCI loans. PCI loans are accounted for under the guidance in ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality. PCI loans are recorded at fair value at the date of acquisition. No allowance for loan and lease losses is recorded on the acquisition date as the fair value of the acquired assets incorporates assumptions regarding credit risk over the life of the loans. An allowance is recorded if there is additional credit deterioration after the acquisition date.

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

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

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

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

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

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

Lease financing – Lease financing consists solely of lease financing agreements for business equipment, vehicles and other assets.

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

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

Residential mortgage – Residential real estate consists of loans to purchase, construct or refinance the borrower's primary dwelling, second residence or vacation home.
Revolving mortgage – Revolving mortgage consists of home equity lines of credit that are secured by first or second liens on the borrower's primary residence.
Construction and land development – Construction and land development consists of loans to construct the borrower's primary or secondary residence or vacant land upon which the owner intends to construct a dwelling at a future date.
Consumer – Consumer loans consist of installment loans to finance purchases of vehicles, unsecured home improvements, student loans and revolving lines of credit that can be secured or unsecured, including personal credit cards.

Loans and leases outstanding included the following at March 31, 2018 and December 31, 2017:

(Dollars in thousands)	March 31, 2018	December 31, 2017
Non-PCI loans and leases:		
Commercial:		
Construction and land development	$738,413	$669,215
Commercial mortgage	9,859,136	9,729,022
Other commercial real estate	386,734	473,433
Commercial and industrial	2,695,205	2,730,407
Lease financing	910,589	894,801
Other	281,485	302,176
Total commercial loans	14,871,562	14,799,054
Noncommercial:		
Residential mortgage	3,587,791	3,523,786
Revolving mortgage	2,651,648	2,701,525
Construction and land development	243,114	248,289
Consumer	1,554,025	1,561,173
Total noncommercial loans	8,036,578	8,034,773
Total non-PCI loans and leases	22,908,140	22,833,827
PCI loans:		
Commercial:		
Construction and land development	9,316	10,135
Commercial mortgage	325,073	358,103
Other commercial real estate	16,179	17,124
Commercial and industrial	3,732	6,374
Other	1,628	1,683
Total commercial loans	355,928	393,419
Noncommercial:		
Residential mortgage	282,338	299,318
Revolving mortgage	60,388	63,908
Construction and land development	3,006	4,163
Consumer	2,177	2,190
Total noncommercial loans	347,909	369,579
Total PCI loans	703,837	762,998
Total loans and leases	$23,611,977	$23,596,825

At March 31, 2018, $65.5 million of total residential loans and leases were covered under shared-loss agreements with the FDIC, compared to $67.8 million at December 31, 2017. The shared-loss agreements, for their terms, protect BancShares from a substantial portion of the credit and asset quality risk that would otherwise be incurred.

At March 31, 2018, $9.11 billion in noncovered loans with a lendable collateral value of $6.26 billion were used to secure $85.2 million in Federal Home Loan Bank (FHLB) of Atlanta advances, resulting in additional borrowing capacity of $6.17 billion. At December 31, 2017, $8.75 billion in noncovered loans with a lendable collateral value of $6.08 billion were used to secure $835.2 million in FHLB of Atlanta advances, resulting in additional borrowing capacity of $5.24 billion. At March 31, 2018, $2.86 billion in noncovered loans with a lendable collateral value of $2.16 billion were used to secure additional borrowing capacity at the

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Federal Reserve Bank (FRB). At December 31, 2017, $2.77 billion in noncovered loans with a lendable collateral value of $2.08 billion were used to secure additional borrowing capacity at the FRB.
Certain residential real estate loans are originated to be sold to investors and are recorded in loans held for sale at fair value. Loans held for sale totaled $46.7 million and $51.2 million at March 31, 2018 and December 31, 2017, respectively. In addition, we may change our strategy for certain portfolio loans and sell them in the secondary market. At that time, portfolio loans are transferred to loans held for sale at the lower of amortized cost or market. During the first quarter of 2018, total proceeds from sales of loans held for sale were $138.5 million and there were no transfers to loans held for sale from the residential mortgage portfolio. During the first quarter of 2017, total proceeds from sales of loans held for sale were $195.1 million of which $32.3 million in sales were transferred to loans held for sale from the residential mortgage portfolio, resulting in a gain of $164 thousand.
Net deferred fees on originated non-PCI loans and leases, including unearned income as well as unamortized costs and fees, were $1.5 million and $1.7 million at March 31, 2018 and December 31, 2017, respectively. The unamortized discount related to purchased non-PCI loans and leases in the Guaranty Bank (Guaranty), Cordia Bancorp Inc. (Cordia) and First Citizens Bancorporation, Inc. (Bancorporation) acquisitions was $13.3 million, $2.5 million and $16.4 million, respectively, at March 31, 2018. At December 31, 2017, the unamortized discount related to purchased non-PCI loans and leases from the Guaranty, Cordia and Bancorporation acquisitions was $14.2 million, $2.7 million and $18.1 million, respectively. During the three months ended March 31, 2018 and March 31, 2017, accretion income on purchased non-PCI loans and leases was $2.9 million and $3.2 million, respectively.

Credit quality indicators

Loans and leases are monitored for credit quality on a recurring basis. The credit quality indicators used are dependent on the portfolio segment to which the loan relates. Commercial and noncommercial loans and leases have different credit quality indicators as a result of the unique characteristics of the loan segment being evaluated. The credit quality indicators for non-PCI and PCI commercial loans and leases are developed through a review of individual borrowers on an ongoing basis. Commercial loans are evaluated periodically with more frequent evaluations done on more severely criticized loans or leases. The credit quality indicators for non-PCI and PCI noncommercial loans are based on the delinquency status of the borrower. As the borrower becomes more delinquent, the likelihood of loss increases. The indicators represent the rating for loans or leases as of the date presented based on the most recent assessment performed. These credit quality indicators are defined as follows:

Pass – A pass rated asset is not adversely classified because it does not display any of the characteristics for adverse classification.

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

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

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

Loss – Assets classified as loss are considered uncollectible and of such little value that it is inappropriate to be carried as an asset. This classification is not necessarily equivalent to any potential for recovery or salvage value, but rather that it is not appropriate to defer a full charge-off even though partial recovery may be affected in the future.

Ungraded – Ungraded loans represent loans that are not included in the individual credit grading process due to their relatively small balances or borrower type. The majority of ungraded loans at March 31, 2018 and December 31, 2017 relate to business credit cards. Business credit card loans are subject to automatic charge-off when they become 120 days past due in the same manner as unsecured consumer lines of credit. The remaining balance is comprised of a small amount of commercial mortgage, lease financing and other commercial real estate loans.

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Non-PCI loans and leases outstanding at March 31, 2018 and December 31, 2017 by credit quality indicator are provided below:

	March 31, 2018						
(Dollars in thousands)	Non-PCI commercial loans and leases						
Grade:	Construction and land development	Commercial mortgage	Other commercial real estate	Commercial and industrial	Lease financing	Other	Total non-PCI commercial loans and leases
Pass	$733,253	$9,661,079	$ 382,679	$2,476,337	$ 900,464	$278,367	$14,432,179
Special mention	483	81,680	1,187	37,571	3,347	1,107	125,375
Substandard	4,639	115,039	2,868				