

FIRST CITIZENS BANCSHARES INC /DE/

Form 10-K

February 28, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended December 31, 2007

Commission File Number 0-16471

**FIRST CITIZENS BANCSHARES, INC.**

(Exact name of Registrant as specified in the charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**56-1528994**  
(I.R.S. Employer  
Identification Number)

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**4300 Six Forks Road**

**Raleigh, North Carolina 27609**

(Address of Principal Executive Offices, Zip Code)

**(919) 716-7000**

(Registrant's Telephone Number, including Area Code)

Securities registered pursuant to:

Section 12(b) of the Act:

Section 12(g) of the Act:

**Class A Common Stock, Par Value \$1**

**Class B Common Stock, Par Value \$1**

(Title of Class)

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

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

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

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

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(1) Financial Statements (see Item 8 for reference)	
(2) All Financial Statement Schedules normally required on Form 10-K are omitted since they are not applicable, except as referred to in Item 8.	
(3) The Exhibits listed on the Exhibit Index contained in this Form 10-K are filed with or furnished to the Commission or incorporated by reference into this report and are available upon written request.	

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

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

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

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

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

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**Business**

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

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

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

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

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

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

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

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

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

There are many statutes and regulations that apply to and restrict the activities of the banking subsidiaries, including limitations on the ability to pay dividends, capital requirements, reserve requirements, deposit insurance requirements

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and restrictions on transactions with related parties. The impact of these statutes and regulations is discussed below and in the accompanying audited consolidated financial statements.

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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**Risk Factors**

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

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

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

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

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

**Properties**

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

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

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

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

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

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

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

**Controls and Procedures**

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

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

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

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### **Available Information**

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

### **Management's Discussion and Analysis of Financial Condition and Results of Operations**

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

## **OVERVIEW**

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

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

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

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

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



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

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

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

## **PERFORMANCE SUMMARY**

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

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

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

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

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

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

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

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

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LIQUIDITY AND CAPITAL RATIOS

(averages)

Loans and leases to deposits	83.05%	80.22%	80.03%	81.21%	75.65%
Shareholders' equity to total assets	8.61	8.14	8.13	8.20	8.14
Time certificates of \$100,000 or more to total deposits	17.33	15.34	12.57	11.05	10.33

PER SHARE OF STOCK

Net income	\$ 10.41	\$ 12.12	\$ 10.82	\$ 7.17	\$ 7.19
Cash dividends	1.10	1.10	1.10	1.10	1.10
Market price at December 31 (Class A)	145.85	202.64	174.42	148.25	120.50
Book value at December 31	138.12	125.62	113.19	104.11	98.63
Tangible book value at December 31	127.72	115.02	102.35	93.12	87.56

**Table of Contents****Table 2****BUSINESS COMBINATIONS**

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

**CRITICAL ACCOUNTING POLICIES**

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

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

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

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

*Pension plan assumptions.* BancShares offers a defined benefit pension plan to qualifying employees. The calculation of the obligation, future plan asset value, funded status and related pension expense under the pension plan requires the use of actuarial valuation methods and assumptions. The valuations and assumptions used to determine the future value of pension plan assets and liabilities are subject to management

judgment and may differ significantly depending upon the assumption used. The discount rate used to estimate the present value of the benefits to be paid under the pension plan reflects the interest rate that could be obtained for a suitable investment used to fund the obligations. The assumed discount rate equaled 6.25 percent at December 31, 2007, compared to 5.75 percent at December 31, 2006 due to changes in market interest rates. Assuming other variables remain unchanged, an increase in the assumed discount rate would reduce the calculated benefit obligations, which would result in reduced expense. Conversely, a reduction in the assumed discount rate would cause an increase in obligations, thereby resulting in higher employee benefits expense.

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

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

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

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

## **INTEREST-EARNING ASSETS**

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

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

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

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

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

Loans secured by real estate totaled \$7.46 billion at December 31, 2007, compared to \$7.03 billion at December 31, 2006. Loans secured by commercial mortgages totaled \$3.98 billion at December 31, 2007, a \$256.7 million or 6.9 percent increase from December 31, 2006. Although we continued to see adequate growth in commercial mortgage lending during 2007, competition for high quality commercial mortgage loans remains strong. In 2006 commercial mortgage loans increased 5.9 percent over 2005. The sustained growth reflects our continued focus on small business customers, particularly among medical-related and other professional customers targeted by our banking subsidiaries. As a



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percentage of total loans and leases, commercial mortgage loans represent 36.3 percent at December 31, 2007 and December 31, 2006. A large percentage of our commercial mortgage portfolio is secured by owner-occupied facilities, rather than investment property. These loans are underwritten based primarily upon the cash flow from the operation of the business rather than the value of the real estate collateral.

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

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

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

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

**Table of Contents****Table 3****LOANS AND LEASES**

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

There were no foreign loans or leases in any period.

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

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

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

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

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

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

**Table of Contents****Table 4****INVESTMENT SECURITIES**

	December 31							
	2007		Average Maturity (Yrs./Mos.)	Taxable Equivalent Yield	2006		2005	
Cost	Fair Value	Cost			Fair Value	Cost	Fair Value	Cost
Investment securities available for sale:								
U. S. Government:								
Within one year	\$ 1,667,530	\$ 1,675,309	0/6	4.83%	\$ 1,514,194	\$ 1,503,970	\$ 1,159,556	\$ 1,140,602
One to five years	1,377,766	1,399,482	1/7	4.55	1,367,029	1,363,571	1,055,472	1,044,913
Five to ten years	6,435	6,419	5/7	4.88	6,337	6,095	115	109
Over ten years	78,012	77,632	26/11	5.47	53,250	52,054	29,721	29,097
<b>Total</b>	<b>3,129,743</b>	<b>3,158,842</b>	<b>1/8</b>	<b>4.72</b>	<b>2,940,810</b>	<b>2,925,690</b>	<b>2,244,864</b>	<b>2,214,721</b>
State, county and municipal:								
Within one year	709	708	0/4	3.86	875	873	954	947
One to five years	2,246	2,236	2/3	4.11	2,734	2,696	3,013	2,977
Five to ten years	356	363	5/3	4.95	470	477	1,115	1,110
Over ten years	66	65	21/0	4.44	211	211	145	145
<b>Total</b>	<b>3,377</b>	<b>3,372</b>	<b>2/6</b>	<b>4.15</b>	<b>4,290</b>	<b>4,257</b>	<b>5,227</b>	<b>5,179</b>
Other:								
Within one year								
One to five years								
Five to ten years								
Over ten years	7,771	9,390	10/4	11.08	10,173	10,240	11,902	11,902
<b>Total</b>	<b>7,771</b>	<b>9,390</b>	<b>10/4</b>	<b>11.08</b>	<b>10,173</b>	<b>10,240</b>	<b>11,902</b>	<b>11,902</b>
Equity securities	33,614	57,637			35,171	61,703	34,409	61,218
<b>Total investment securities available for sale</b>	<b>3,174,505</b>	<b>3,229,241</b>			<b>2,990,444</b>	<b>3,001,890</b>	<b>2,296,402</b>	<b>2,293,020</b>
Investment securities held to maturity:								
U. S. Government:								
Within one year					210,232	209,296	416,172	413,289
One to five years					3	3	209,207	207,234
Five to ten years	5,563	5,612	9/3	5.53	46	46		
Over ten years	197	231	19/6	6.30	7,049	7,031	9,294	9,385
<b>Total</b>	<b>5,760</b>	<b>5,843</b>	<b>9/8</b>	<b>5.56</b>	<b>217,330</b>	<b>216,376</b>	<b>634,673</b>	<b>629,908</b>
State, county and municipal:								
Within one year								
One to five years	149	153	1/4	5.88	148	154	147	155
Five to ten years								
Over ten years	1,435	1,530	10/4	6.02	1,430	1,553	1,426	1,563

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Total	1,584	1,683	9/6	6.01	1,578	1,707	1,573	1,718
<b>Other:</b>								
Within one year	250	250	0/7	3.25				
One to five years					250	250	250	250
Five to ten years								
<b>Total</b>	<b>250</b>	<b>250</b>	<b>0/7</b>		<b>250</b>	<b>250</b>	<b>250</b>	<b>250</b>
Total investment securities held to maturity	7,594	7,776	9/4	5.58	219,158	218,333	636,496	631,876
<b>Total investment securities</b>	<b>\$ 3,182,099</b>	<b>\$ 3,237,017</b>			<b>\$ 3,209,602</b>	<b>\$ 3,220,223</b>	<b>\$ 2,932,898</b>	<b>\$ 2,924,896</b>

The average maturity assumes callable securities mature on their earliest call date; yields are based on amortized cost; yields related to securities that are exempt from federal and/or state income taxes are stated on a taxable-equivalent basis assuming statutory rates of 35% for federal income taxes and 6.90% for state income taxes for all periods.

**Table of Contents****Table 5****AVERAGE BALANCE SHEETS**

	Average Balance	2007 Interest Income/Expense	Yield/ Rate	Average Balance	2006 Interest Income/Expense	Yield/ Rate
(dollars in thousands, taxable equivalent)						
<b>Assets</b>						
Loans and leases	\$ 10,513,599	\$ 729,635	6.94%	\$ 9,989,757	\$ 685,114	6.86%
<b>Investment securities:</b>						
U.S. Government	3,068,477	146,483	4.77	2,949,201	116,969	3.97
State, county and municipal	5,321	346	6.50	6,174	374	6.06
Other	70,254	3,100	4.41	73,009	3,304	4.53
Total investment securities	3,144,052	149,929	4.77	3,028,384	120,647	3.98
Overnight investments	634,671	32,169	5.07	619,247	30,903	4.99
Total interest-earning assets	14,292,322	\$ 911,733	6.38%	13,637,388	\$ 836,664	6.14%
Cash and due from banks	705,864			757,428		
Premises and equipment	735,465			669,748		
Allowance for loan and lease losses	(132,530)			(131,077)		
Other assets	318,101			306,840		
Total assets	\$ 15,919,222			\$ 15,240,327		
<b>Liabilities and shareholders equity</b>						
<b>Interest-bearing deposits:</b>						
Checking With Interest	\$ 1,431,085	\$ 1,971	0.14%	\$ 1,522,439	\$ 1,875	0.12%
Savings	573,286	1,235	0.22	649,619	1,382	0.21
Money market accounts	2,835,255	94,541	3.33	2,691,292	79,522	2.95
Time deposits	5,283,782	243,489	4.61	4,967,591	197,399	3.97
Total interest-bearing deposits	10,123,408	341,236	3.37	9,830,941	280,178	2.85
Short-term borrowings	1,354,255	55,126	4.07	981,210	41,431	4.22
Long-term obligations	405,758	27,352	6.74	450,272	32,128	7.14
Total interest-bearing liabilities	11,883,421	\$ 423,714	3.57%	11,262,423	\$ 353,737	3.14%
Demand deposits	2,535,828			2,622,014		
Other liabilities	129,356			114,636		
Shareholders equity	1,370,617			1,241,254		
Total liabilities and shareholders equity	\$ 15,919,222			\$ 15,240,327		
<b>Interest rate spread</b>			2.81%	<b>3.00%</b>		
Net interest income and net yield on interest-earning assets		\$ 488,019	3.41%		\$ 482,927	3.54%

Loans and leases include nonaccrual loans. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only, are stated on a taxable-equivalent basis assuming a statutory federal income tax rate of 35.0% and a state income tax rate of 6.9% for all periods. Loan fees, which are not material for any period shown, are included in the yield calculation.

Interest income earned on the investment securities portfolio amounted to \$144.3 million and \$116.0 million during 2007 and 2006. The taxable-equivalent yield on the investment securities portfolio was 4.77 percent and 3.98 percent, respectively, for 2007 and 2006. The \$28.3 million increase in investment interest income during 2007 reflected the 79 basis points increase in the taxable-equivalent yield and a \$115.7 million increase in average investment securities. The \$40.1 million increase in interest income earned on investment securities during 2006 resulted from an 87 basis point increase in the taxable-equivalent yield and a \$495.2 million increase in average investment securities.

**Table of Contents****Table 5****AVERAGE BALANCE SHEETS (continued)**

Average Balance	2005 Interest Income/Expense	Yield/ Rate	Average Balance	2004 Interest Income/Expense	Yield/ Rate	Average Balance	2003 Interest Income/Expense	Yield/ Rate
(dollars in thousands, taxable equivalent)								
\$ 9,375,249	\$ 575,735	6.14%	\$ 8,901,628	\$ 470,325	5.28%	\$ 7,893,621	\$ 448,019	5.68%
2,463,545	76,267	3.10	2,096,869	48,304	2.30	2,525,007	60,318	2.39
7,238	404	5.58	8,667	424	4.89	5,151	277	5.38
62,378	2,224	3.57	51,831	1,137	2.19	55,218	1,345	2.44
2,533,161	78,895	3.11	2,157,367	49,865	2.31	2,585,376	61,940	2.40
595,467	19,208	3.23	434,010	5,878	1.35	460,529	4,959	1.08
12,503,877	\$ 673,838	5.39%	11,493,005	\$ 526,068	4.58%	10,939,526	\$ 514,918	4.71%
654,821			679,955			667,979		
608,668			554,480			522,548		
(127,968)			(124,834)			(115,737)		
265,862			253,496			231,524		
\$ 13,905,260			\$ 12,856,102			\$ 12,245,840		
\$ 1,570,010	\$ 1,923	0.12%	\$ 1,500,638	\$ 1,796	0.12%	\$ 1,379,479	\$ 1,923	0.14%
737,830	1,521	0.21	743,629	1,492	0.20	690,705	2,151	0.31
2,643,330	50,171	1.90	2,571,468	21,594	0.84	2,563,589	22,208	0.87
4,209,996	123,016	2.92	3,778,048	83,557	2.21	3,811,476	98,507	2.58
9,161,166	176,631	1.93	8,593,783	108,439	1.26	8,445,249	124,789	1.48
598,948	14,966	2.50	446,320	3,611	0.81	463,332	2,795	0.60
353,885	26,554	7.50	287,333	21,776	7.58	255,379	20,953	8.21
10,113,999	\$ 218,151	2.16%	9,327,436	\$ 133,826	1.43%	9,163,960	\$ 148,537	1.62%
2,553,403			2,367,597			1,988,532		
106,792			107,209			96,770		
1,131,066			1,053,860			996,578		
\$ 13,905,260			\$ 12,856,102			\$ 12,245,840		
		3.23%			3.15%			3.09%
	\$ 455,687	3.64%		\$ 392,242	3.41%		\$ 366,381	3.35%

Interest earned on overnight investments was \$32.2 million during 2007, compared to \$30.9 million during 2006. The \$1.3 million increase during 2007 resulted from an 8 basis point yield increase and a \$15.4 million increase in average overnight investments. During 2006, interest income earned from overnight investments increased \$11.7 million over 2005, the combined result of a 176 basis point yield increase and a \$23.8 million increase in average overnight investments.



Interest rate reductions initiated by the Federal Reserve in late 2007 and early 2008 will cause asset yields to decline during 2008, and we believe interest rates will likely decrease further until economic conditions improve.

**Table of Contents****INTEREST-BEARING LIABILITIES**

Interest-bearing liabilities include interest-bearing deposits as well as short-term borrowings and long-term obligations. Deposits are our primary funding source, although we also utilize non-deposit borrowings to stabilize our liquidity base and to fulfill commercial customer demand for cash management services. Certain of our long-term borrowings also currently qualify as capital under guidelines established by the Federal Reserve and other banking regulators.

At December 31, 2007 and 2006, interest-bearing liabilities totaled \$12.12 billion and \$11.61 billion, respectively, an increase of \$506.6 million or 4.4 percent. The higher balances during 2007 result from increased levels of interest-bearing deposits and short-term borrowings.

*Deposits.* At December 31, 2007, deposits totaled \$12.93 billion, an increase of \$185.2 million or 1.5 percent from the \$12.74 billion in deposits recorded as of December 31, 2006. Interest-bearing deposits averaged \$10.12 billion during 2007, an increase of \$292.5 million or 3.0 percent. Average interest-bearing deposits equaled \$9.83 billion during 2006, an increase of \$669.8 million or 7.3 percent over 2005. In 2007, the increase in average deposits resulted from growth in average time deposits, which increased \$316.2 million or 6.4 percent and average money market accounts, which increased \$144.0 million or 5.3 percent. During 2006, average time deposits increased \$757.6 million or 18.0 percent.

Competition for deposit business in our primary market areas is extremely intense. While we have access to non-deposit borrowing sources, we prefer to fund loan and lease demand with traditional core bank deposits. Therefore, generating adequate deposit growth is a critical challenge for us, particularly during periods when we experience strong loan demand.

**Table 6****MATURITIES OF TIME DEPOSITS OF \$100,000 OR MORE**

	<b>December 31, 2007 (thousands)</b>
Less than three months	\$ 906,056
Three to six months	758,998
Six to 12 months	339,643
More than 12 months	319,071
<b>Total</b>	<b>\$ 2,323,768</b>

*Short-Term Borrowings.* At December 31, 2007, short-term borrowings totaled \$1.31 billion, compared to \$1.15 billion one year earlier, a 13.4 percent increase. For the year ended December 31, 2007, short-term borrowings averaged \$1.35 billion, compared to \$981.2 billion during 2006. The \$373.0 million or 38.0 percent increase in short-term borrowings during 2007 was the result of significant growth in our commercial master note and repurchase agreement products. Customer interest in these commercial cash management products improved significantly due to relatively attractive rates as compared to other short-term bank deposit products.

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We continue to have access to various short-term borrowings, including the purchase of federal funds, overnight repurchase obligations and credit lines with various correspondent banks. At December 31, 2007, we had immediate access of up to \$525.0 million on an unsecured basis and additional amounts under secured borrowing agreements with the Federal Home Loan Bank of Atlanta. Table 7 provides additional information regarding short-term borrowed funds.

**Table of Contents****Table 7****SHORT-TERM BORROWINGS**

	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
(dollars in thousands)						
<b>Master notes</b>						
At December 31	\$ 923,424	3.02%	\$ 741,029	4.18%	\$ 520,585	3.19%
Average during year	910,389	4.19	643,926	4.28	353,871	2.61
Maximum month-end balance during year	1,035,278		776,734		520,585	
<b>Repurchase agreements</b>						
At December 31	286,090	2.27	251,135	3.68	150,054	2.69
Average during year	303,862	3.38	213,730	3.47	143,813	1.71
Maximum month-end balance during year	325,790		272,807		165,758	
<b>Federal funds purchased</b>						
At December 31	23,893	3.60	66,066	5.04	36,620	3.80
Average during year	59,050	5.07	47,662	4.84	45,595	3.10
Maximum month-end balance during year	101,753		68,620		59,139	
<b>Other</b>						
At December 31	71,880	4.54	92,617	4.56	71,769	3.43
Average during year	80,954	4.57	75,892	5.45	55,669	3.32
Maximum month-end balance during year	96,785		169,305		72,351	

*Long-Term Obligations.* At December 31, 2007 and 2006, long-term obligations totaled \$404.4 million and \$401.2 million, respectively, an increase of \$3.2 million or 0.8 percent. For 2007 and 2006, long-term obligations includes \$273.2 million in junior subordinated debentures representing obligations to two special purpose entities, FCB/NC Capital Trust I and FCB/NC Capital Trust III (the Capital Trusts). The Capital Trusts are the grantor trusts for \$265.0 million of trust preferred capital securities outstanding as of December 31, 2007. The proceeds from the trust preferred capital securities were used to purchase the junior subordinated debentures issued by BancShares. Under current regulatory standards, these trust preferred capital securities qualify as capital for BancShares. The \$150.0 million in trust preferred capital securities issued by FCB/NC Capital Trust I mature in 2028 and may be redeemed in whole or in part on or after March 1, 2008 at a premium that declines until 2018, when the redemption price equals the par value of the securities. The \$115.0 million in trust preferred capital securities issued by FCB/NC Capital Trust III mature in 2036 and may be redeemed at par in whole or in part on or after June 30, 2011. BancShares has guaranteed all obligations of the Capital Trusts.

*Expense of Interest-Bearing Liabilities.* Interest expense amounted to \$423.7 million in 2007, a \$70.0 million or 19.8 percent increase from 2006. This followed a \$135.6 million or 62.2 percent increase in interest expense during 2006 compared to 2005. For both 2007 and 2006, the increase in interest expense was the result of higher interest rates and increased levels of interest-bearing liabilities. The blended rate on total interest-bearing liabilities equaled 3.57 percent during 2007, compared to 3.14 percent in 2006. Interest-bearing liabilities averaged \$11.88 billion during 2007, an increase of \$621.0 million or 5.5 percent over 2006 levels. During 2006, interest-bearing liabilities averaged \$11.26 billion, an increase of \$1.15 billion or 11.4 percent over 2005.

**Table of Contents****Table 8****CHANGES IN CONSOLIDATED TAXABLE EQUIVALENT NET INTEREST INCOME**

	2007			2006		
	Change from previous year due to: Volume	Yield/ Rate	Total Change	Change from previous year due to: Volume	Yield/ Rate	Total Change
(thousands)						
<b>Assets</b>						
Loans and leases	\$ 36,232	\$ 8,289	\$ 44,521	\$ 39,803	\$ 69,576	\$ 109,379
<b>Investment securities:</b>						
U. S. Government	5,327	24,187	29,514	17,162	23,540	40,702
State, county and municipal	(54)	26	(28)	(63)	33	(30)
Other	(121)	(83)	(204)	430	650	1,080
<b>Total investment securities</b>	<b>5,152</b>	<b>24,130</b>	<b>29,282</b>	<b>17,529</b>	<b>24,223</b>	<b>41,752</b>
Overnight investments	770	496	1,266	991	10,704	11,695
<b>Total interest-earning assets</b>	<b>\$ 42,154</b>	<b>\$ 32,915</b>	<b>\$ 75,069</b>	<b>\$ 58,323</b>	<b>\$ 104,503</b>	<b>\$ 162,826</b>
<b>Liabilities</b>						
<b>Interest-bearing deposits:</b>						
Checking With Interest	\$ (120)	\$ 216	\$ 96	\$ (53)	\$ 5	\$ (48)
Savings	(164)	17	(147)	(163)	24	(139)
Money market accounts	4,527	10,492	15,019	1,253	28,098	29,351
Time deposits	13,567	32,523	46,090	26,149	48,234	74,383
<b>Total interest-bearing deposits</b>	<b>17,810</b>	<b>43,248</b>	<b>61,058</b>	<b>27,186</b>	<b>76,361</b>	<b>103,547</b>
Short-term borrowings	15,468	(1,773)	13,695	12,859	13,606	26,465
Long-term obligations	(3,077)	(1,699)	(4,776)	7,038	(1,464)	5,574
<b>Total interest-bearing liabilities</b>	<b>\$ 30,201</b>	<b>\$ 39,776</b>	<b>\$ 69,977</b>	<b>\$ 47,083</b>	<b>\$ 88,503</b>	<b>\$ 135,586</b>
<b>Net interest income</b>	<b>\$ 11,953</b>	<b>\$ (6,861)</b>	<b>\$ 5,092</b>	<b>\$ 11,240</b>	<b>\$ 16,000</b>	<b>\$ 27,240</b>

Changes in income relating to certain loans, leases and investment securities are stated on a fully tax-equivalent basis at a rate that approximates BancShares marginal tax rate. The taxable equivalent adjustment was \$7,677, \$6,349 and \$4,298 for the years 2007, 2006 and 2005 respectively. Table 5 provides detailed information on average balances, income/expense, yield/rate by category and the relevant income tax rates. The rate/volume variance is allocated equally between the changes in volume and rate.

The aggregate rate on interest-bearing deposits was 3.37 percent during 2007, compared to 2.85 percent during 2006. Coupled with the impact of growth in interest-bearing deposits, the higher rates caused interest expense on interest-bearing deposits to reach \$341.2 million during 2007, a 21.8 percent increase from the \$280.2 million recorded during 2006. During both 2007 and 2006, increased rates and higher balances of time deposits and money market deposits caused the growth in interest expense on interest-bearing deposits. The rate increases during 2007 and 2006 were the result of higher market interest rates due to intense competition among banks for interest-bearing deposits combined with adjustments to index rates established by the Federal Reserve.

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Interest expense on short-term borrowings increased \$13.7 million or 33.1 percent during 2007, the result of growth among master note and repurchase obligations. Partially offsetting this growth, the rate on average short-term borrowings declined 15 basis points to 4.07 percent due to reductions in the federal funds rate during late 2007. During 2006, interest expense increased \$26.5 million over 2005, the result of higher interest rates and substantial growth in average short-term borrowings.

Interest expense on long-term obligations decreased \$4.8 million during 2007 due to the net impact of the issuance and redemption of junior subordinated debentures during 2006.

### **NET INTEREST INCOME**

Net interest income amounted to \$480.3 million during 2007, a \$3.8 million or 0.8 percent increase over 2006. The marginal increase from 2006 resulted from balance sheet growth, the favorable impact of which offset the unfavorable influence of a lower net yield on interest-earning assets. The taxable-equivalent net yield on interest-earning assets

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declined 13 basis points from 3.54 percent during 2006 to 3.41 percent during 2007. This reduction resulted from the impact of the flat yield curve and extremely competitive pricing for both loan and deposit products.

During 2006, net interest income equaled \$476.6 million, a \$25.2 million or 5.6 percent increase over 2005. Higher interest rates favorably impacted net interest income during 2006, as the rate-influenced growth in interest income exceeded the growth in interest expense. Strong growth in 2006 among deposits and short-term borrowings resulted in a reduction in our net short-term asset sensitivity which caused the net yield on interest-earning assets to decline by 10 basis points.

Theoretically, a net short-term liability-sensitive balance sheet would result in improvements in net interest income following the reductions in interest rates triggered by Federal Reserve actions in late 2007 and early 2008. However, intense competition for deposits has caused interest rates on these products to remain artificially high. Table 8 isolates the changes in net interest income due to changes in volume and interest rates. Like Table 5, this table is presented on a taxable-equivalent basis to adjust for the tax-exempt status of income earned on certain loans, leases and investment securities.

**Table 9****NONINTEREST INCOME**

	Year ended December 31				
	2007	2006	2005	2004	2003
			(thousands)		
Cardholder and merchant services	\$ 97,070	\$ 86,103	\$ 75,298	\$ 65,903	\$ 56,432
Service charges on deposit accounts	77,827	72,561	77,376	81,478	78,273
Wealth management services					
Trust and asset management fees	25,262	21,586	18,588	16,913	15,005
Broker-dealer activities	24,043	20,627	16,138	15,541	15,387
Total wealth advisory services	49,305	42,213	34,726	32,454	30,392
Fees from processing services	32,531	29,631	25,598	23,888	20,590
Insurance commissions	7,735	6,942	6,390	6,186	6,180
Mortgage income	6,305	5,494	5,361	5,861	11,398
ATM income	6,515	6,803	7,843	8,416	7,894
Other service charges and fees	15,318	15,996	16,902	13,926	14,463
Securities gains (losses)	1,376	(659)	(492)	1,852	309
Gain on sale of branches		826		426	5,710
Other	1,488	5,457	8,664	5,494	6,084
Total	\$ 295,470	\$ 271,367	\$ 257,666	\$ 245,884	\$ 237,725

**NONINTEREST INCOME**

The growth of noninterest income is essential to our ability to sustain adequate levels of profitability. The primary sources of noninterest income are cardholder and merchant services income, service charges on deposit accounts, wealth advisory services and fees from processing services. Noninterest income totaled \$295.5 million during 2007, an increase of \$24.1 million or 8.9 percent. Noninterest income during 2006 equaled

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\$271.4 million, a \$13.7 million or 5.3 percent increase from 2005. Table 9 presents the major components of noninterest income for the past five years.

The increase in noninterest income during 2007 can be primarily attributed to healthy increases in cardholder and merchant services income, fees from wealth advisory services and service charges on deposit accounts. Cardholder and merchant services income amounted to \$97.1 million in 2007 up \$11.0 million or 12.7 percent from 2006, the result of higher merchant discount and interchange fees for debit and credit card transactions. We continue to view this source of noninterest income as a key growth area.



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Fees from wealth management services increased \$7.1 million to \$49.3 million in 2007 from \$42.2 million in 2006. The 16.8 percent increase in 2007 resulted from growth in broker-dealer activity and increases in trust and asset management fees. Service charges on deposit accounts equaled \$77.8 million during 2007, compared to \$72.6 million in 2006. The \$5.3 million or 7.3 percent increase in service charge income during 2007 reflects the result of higher commercial service charges and bad check income when compared to 2006. Commercial service charge income during 2007 benefited from lower interest rates, which generated reduced earnings credit for commercial customers.

During 2007, fees from processing services totaled \$32.5 million, an increase of \$2.9 million or 9.8 percent over 2006. During 2006, BancShares recognized \$29.6 million in fees from processing services, an increase of \$4.0 million or 15.8 percent over the \$25.6 million recognized during 2005. Growth in the number of transactions and the addition of new clients and services led to the favorable trend.

**Table 10****NONINTEREST EXPENSE**

	Year ended December 31				
	2007	2006	2005	2004	2003
	(thousands)				
Salaries and wages	\$ 243,871	\$ 228,472	\$ 212,997	\$ 204,597	\$ 195,632
Employee benefits	52,733	50,445	51,517	48,624	45,958
Equipment	56,404	52,490	50,291	50,125	50,436
Occupancy	56,922	52,153	46,912	43,997	42,430
Cardholder and merchant services:					
Cardholder and merchant processing	41,882	37,286	32,067	28,290	24,119
Cardholder reward programs	12,529	9,228	5,878	5,763	5,458
Telecommunications	10,501	9,844	9,873	10,461	11,455
Postage	9,614	8,926	8,045	8,639	8,826
Processing fees paid to third parties	7,004	5,845	4,332	3,826	2,295
Advertising	7,499	7,212	7,206	7,981	7,566
Legal	6,410	5,244	4,124	5,978	5,851
Consultant	3,324	2,254	3,362	2,980	3,747
Amortization of intangibles	2,142	2,318	2,453	2,360	2,583
Other	63,829	59,360	57,814	53,565	54,471
Total	\$ 574,664	\$ 531,077	\$ 496,871	\$ 477,186	\$ 460,827

**NONINTEREST EXPENSE**

The primary components of noninterest expense are salaries and related employee benefits, occupancy costs for branch offices and support facilities and equipment and software costs related to branch offices and technology. Noninterest expense for 2007 amounted to \$574.7 million, a \$43.6 million or 8.2 percent increase over 2006. Noninterest expense in 2006 was \$531.1 million, a \$34.2 million or 6.9 percent increase over 2005. Table 10 presents the major components of noninterest expense for the past five years. For 2007 and 2006, \$8.4 million and \$6.4 million of the respective increases in total noninterest expense are attributable to the continued growth and expansion of ISB.

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Salary expense totaled \$243.9 million during 2007, compared to \$228.5 million during 2006, an increase of \$15.4 million or 6.7 percent, following a \$15.5 million or 7.3 percent increase in 2006 over 2005. The increase in 2007 is attributable to incremental staff costs for new branch offices and merit increases.

Employee benefits expense equaled \$52.7 million during 2007, an increase of \$2.3 million or 4.5 percent from 2006 due to higher health insurance costs and employer-paid payroll taxes. Partially offsetting these higher costs, pension expense decreased \$1.4 million or 11.9 percent due to the favorable impact of employer contributions to the plan, partially offset by a curtailment charge. During the first quarter of 2008, as a result of the retirement of an executive officer, we recognized employee benefit expense totaling \$3.0 million, representing the present value of benefits granted at the time of his retirement.

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As a result of the earnings and funding volatility associated with providing a defined benefit plan, BancShares discontinued offering traditional pension benefits to newly-hired employees during 2007. Instead, employees hired after March 31, 2007 may elect to participate in an enhanced 401(k) benefit plan. Employees hired on or before March 31, 2007 were allowed the option of continued participation in the defined benefit plan and the existing 401(k) plan or enrollment in an enhanced 401(k) benefit plan. Employees who elected to enroll in the enhanced 401(k) benefit plan discontinued the accrual of future years of service benefit under the defined benefit plan. Based on the elections made by participants, a curtailment charge of \$763,000 is included in employee benefit expense during 2007.

BancShares recorded occupancy expense of \$56.9 million during 2007, an increase of \$4.8 million or 9.1 percent during 2007. Occupancy expense during 2006 equaled \$52.2 million, an increase of \$5.2 million or 11.2 percent over 2005. The increase in occupancy expense in each period resulted from higher depreciation and rent expense attributable to newly constructed branches as well as costs attributable to our corporate headquarters building. ISB's occupancy expense increased \$2.9 million or 22.5 percent during 2007 due to newly-opened locations.

Equipment expense was \$56.4 million for 2007 and \$52.5 million in 2006. The \$3.9 million increase during 2007 resulted primarily from increased technology costs and additional depreciation expense from the corporate headquarters building and new branch offices.

Other expense totaled \$164.7 million for 2007, an increase of \$17.2 million or 11.7 percent over 2006. Expenses related to cardholder and merchant activities amounted to \$54.4 million in 2007 and \$46.5 million in 2006. This increase of \$7.9 million or 17.0 percent is due to growth in credit and debit card transactions, higher levels of merchant volume and higher costs associated with cardholder reward programs. During 2007, BancShares recognized \$3.3 million of expense for litigation matters resulting from Visa International (Visa) member bank status. The exposure estimates result from two separate claims against Visa, which, under the terms of governing agreements, will be shared by member banks. Visa previously announced plans to complete an initial public offering, an event that could result in a gain for current Visa member banks. Although the date for Visa's initial public offering is uncertain any, gain recognized in future periods would offset some or all of the expenses recognized during 2007.

Losses sustained on fixed assets write-offs increased \$1.6 million during 2007 due to the write-off of the unamortized cost of closed branches, abandonment of future development plans for the headquarters site and losses resulting from changes to the scope of a technology project. Legal costs increased \$1.2 million during 2007 due to defense costs related to various litigation and collection matters, while consultant expenses increased \$1.1 million primarily related to various technology projects.

## **INCOME TAXES**

During 2007, BancShares recorded income tax expense of \$58.9 million, compared to \$69.5 million during 2006 and \$65.8 million in 2005. BancShares' effective tax rate was 35.2 percent in 2007, 35.4 percent in 2006 and 36.8 in 2005. The lower effective tax rates during 2007 and 2006 resulted from the benefit of credits earned for low-income housing investments and changes to the deferred tax asset valuation allowance and blended state tax rates when compared to 2005.

## **SHAREHOLDERS' EQUITY**

We continually monitor the capital levels and ratios for BancShares and the subsidiary banks to ensure that they comfortably exceed the minimum requirements imposed by their respective regulatory authorities and to ensure that the subsidiary banks' capital is appropriate given

each bank's growth projections and risk profile. Failure to meet certain capital requirements may result in actions by regulatory agencies that could have a material effect on the financial statements. Table 11 provides information on capital adequacy for BancShares, FCB and ISB as of December 31, 2007, 2006 and 2005.

**Table of Contents****Table 11****ANALYSIS OF CAPITAL ADEQUACY**

	2007	December 31 2006 (dollars in thousands)	2005	Regulatory Minimum
<i>First Citizens BancShares, Inc.</i>				
Tier 1 capital	\$ 1,557,190	\$ 1,456,947	\$ 1,320,152	
Tier 2 capital	279,573	275,079	267,989	
Total capital	\$ 1,836,763	\$ 1,732,026	\$ 1,588,141	
Risk-adjusted assets	\$ 11,961,124	\$ 11,266,342	\$ 10,510,254	
Average total assets	16,168,165	15,518,209	14,403,567	
Risk-based capital ratios				
Tier 1 capital	13.02%	12.93%	12.56%	4.00%
Total capital	15.36%	15.37%	15.11%	8.00%
Tier 1 leverage ratio	9.63%	9.39%	9.17%	3.00%
<i>First-Citizens Bank &amp; Trust Company</i>				
Tier 1 capital	\$ 1,188,599	\$ 1,104,132	\$ 998,152	
Tier 2 capital	244,470	240,070	234,311	
Total capital	\$ 1,433,069	\$ 1,344,202	\$ 1,232,463	
Risk-adjusted assets	\$ 9,716,423	\$ 9,238,512	\$ 8,739,531	
Average total assets	13,497,638	13,250,610	12,523,144	
Risk-based capital ratios				
Tier 1 capital	12.23%	11.95%	11.42%	4.00%
Total capital	14.75%	14.55%	14.10%	8.00%
Tier 1 leverage ratio	8.81%	8.33%	7.97%	3.00%
<i>IronStone Bank</i>				
Tier 1 capital	\$ 261,500	\$ 245,402	\$ 215,263	
Tier 2 capital	24,801	23,576	21,101	
Total capital	\$ 286,301	\$ 268,978	\$ 236,364	
Risk-adjusted assets	\$ 2,190,348	\$ 1,953,178	\$ 1,821,048	
Adjusted total assets	2,333,717	2,130,770	1,849,828	
Risk-based capital ratios				
Tier 1 capital	11.94%	12.56%	11.82%	4.00%
Total capital	13.07%	13.77%	12.98%	8.00%
Tangible equity ratio	11.21%	11.52%	11.64%	3.00%

BancShares continues to exceed minimum capital standards and the banking subsidiaries remain well-capitalized. The sustained growth of ISB has required BancShares to infuse significant amounts of capital into ISB to support its rapidly expanding balance sheet. Infusions totaled \$24.0 million in 2007, \$30.0 million in 2006 and \$20.0 million in 2005. Since ISB was formed in 1997, BancShares has provided \$304.0 million in capital. BancShares' prospective capacity to provide capital to support the future growth and expansion of ISB is highly dependent upon FCB's ability to return capital through dividends to BancShares.

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Dividends from FCB to BancShares provide the sole source for capital infusions into ISB to fund its growth and expansion. These dividends also fund BancShares' payment of shareholder dividends and interest payments on a portion of its long-term obligations. During 2007, FCB declared dividends to BancShares in the amount of \$44.0 million, compared to \$40.0 million in 2006 and \$32.2 million in 2005. At December 31, 2007, based on limitations imposed by North Carolina General Statutes, FCB had the ability to declare dividends totaling \$956.0 million. However, any dividends declared in excess of \$461.4 million would have caused FCB to lose its well-capitalized designation.

**Table of Contents****RISK MANAGEMENT**

In the normal course of business, BancShares is exposed to various risks. To manage the major risks that are inherent in the operation of a financial holding company and to provide reasonable assurance that our long-term business objectives will be attained, various policies and risk management processes identify, monitor and manage risk within acceptable tolerances. Management continually refines and enhances its risk management policies and procedures to maintain effective risk management.

Our most prominent risk exposures are credit, interest rate and liquidity risk. Credit risk is the risk of not collecting the amount of a loan or investment when it is contractually due. Interest rate risk is the potential reduction of net interest income as a result of changes in market interest rates. Liquidity risk is the possible inability to fund obligations to depositors, creditors, investors or borrowers.

**Table 12****NONPERFORMING ASSETS**

	2007	2006	December 31, 2005	2004	2003
	(thousands, except ratios)				
Nonaccrual loans and leases	\$ 13,021	\$ 14,882	\$ 18,969	\$ 14,266	\$ 18,190
Other real estate	6,893	6,028	6,753	9,020	5,949
<b>Total nonperforming assets</b>	<b>\$ 19,914</b>	<b>\$ 20,910</b>	<b>\$ 25,722</b>	<b>\$ 23,286</b>	<b>\$ 24,139</b>
Accruing loans and leases 90 days or more past due	\$ 7,124	\$ 5,185	\$ 9,180	\$ 12,192	\$ 11,492
Loans and leases at December 31	\$ 10,963,904	\$ 10,273,043	\$ 9,656,230	\$ 9,364,822	\$ 8,333,073
Ratio of nonperforming assets to total loans and leases plus other real estate	0.18%	0.20%	0.27%	0.25%	0.29%
Interest income that would have been earned on nonperforming loans and leases had they been performing	\$ 1,200	\$ 1,271	\$ 551	\$ 773	\$ 1,182
Interest income earned on nonperforming loans and leases	465	226	821	281	356

There were no foreign loans or leases outstanding in any period.

*Credit Risk.* BancShares manages and monitors extensions of credit and the quality of the loan and lease portfolio through rigorous initial underwriting processes and periodic ongoing reviews. Underwriting standards reflect credit policies and procedures, and our credit decision process is highly centralized. We maintain a credit review function that conducts independent risk reviews and analyses for the purpose of ensuring compliance with credit policies and to monitor asset quality trends. The independent risk reviews include portfolio analysis by geographic location and horizontal reviews across industry and collateral sectors within the banking subsidiaries. BancShares strives to identify potential credit problems as early as possible, to take charge-offs or write-downs as appropriate and to maintain adequate allowances for credit losses that are inherent in the loan and lease portfolio. The maintenance of excellent asset quality is one of our key performance measures.

We maintain a well-diversified loan and lease portfolio, and seek to avoid the risk associated with large concentrations within specific geographic areas or industries. The ongoing expansion of our branch network has allowed us to mitigate our historic exposure to geographic risk concentration in North Carolina and Virginia.

We have historically carried a significant concentration of real estate-secured loans, although our underwriting policies principally rely on borrower cash flow ability rather than underlying collateral values. When we do rely on underlying real property values, we favor financing secured by owner-occupied real property. At December 31, 2007, loans secured by real estate totaled \$7.46 billion or 68.1 percent of total loans compared to \$7.03 billion or 68.4 percent at December 31, 2006.



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In recent years, we have sought opportunities to provide financial services to businesses associated with and professionals within the medical community. Due to strong loan growth within this industry, our loans to borrowers in medical, dental or related fields totaled \$2.26 billion as of December 31, 2007, which represents 20.6 percent of total loans and leases outstanding, compared to \$1.92 billion or 18.7 percent of loans and leases at December 31, 2006. Except for this single concentration, no other industry represented more than 10 percent of total loans and leases outstanding at December 31, 2007.

In addition to geographic and industry concentrations, we monitor our loan and lease portfolio for other risk characteristics. Among the key indicators of credit risk are loan-to-value ratios, which measure a lender's exposure as compared to the value of the underlying collateral. Regulatory agencies have established guidelines that define high loan-to-value loans as those real estate loans that exceed 65 percent to 85 percent of the collateral value depending upon the type of collateral. At December 31, 2007, we had \$969.1 million or 8.8 percent of loans and leases that exceeded the loan-to-value ratios recommended by the guidelines compared to \$1.08 billion or 10.6 percent at December 31, 2006. While we continuously strive to limit our high loan-to-value loans, we believe that the inherent risk within these loans is lessened by mitigating factors, such as our strict underwriting criteria and the high rate of owner-occupied properties.

Nonperforming assets include nonaccrual loans and leases and other real estate. With the exception of certain residential mortgage loans, the accrual of interest on loans and leases is discontinued when we deem that collection of additional principal or interest is doubtful. Loans and leases are returned to an accrual status when both principal and interest are current and the asset is determined to be performing in accordance with the terms of the loan instrument. The accrual of interest on certain residential mortgage loans is discontinued when a loan is more than three monthly payments past due, and the accrual of interest resumes when the loan is less than three monthly payments past due. Other real estate includes foreclosed property, branch facilities that we have closed but not sold and land that we have elected to sell that was originally acquired for future branches. Nonperforming asset balances for the past five years are presented in Table 12.

BancShares' nonperforming assets at December 31, 2007 totaled \$19.9 million, compared to \$20.9 million at December 31, 2006 and \$25.7 million at December 31, 2005. A portion of the reduction experienced during 2006 related to write downs taken on a single relationship that was classified as non-accrual as of December 31, 2005. As a percentage of total loans, leases and other real estate, nonperforming assets represented 0.18 percent, 0.20 percent, and 0.27 percent as of December 31, 2007, 2006 and 2005. During early 2008, due to deteriorating borrower cash flow and recognition of reductions in collateral value, we identified \$23.1 million in residential construction loans where collection of additional interest is doubtful. These loans were placed on nonaccrual status during the first quarter of 2008. We continue to closely monitor past due accounts to identify any loans and leases that should be classified as impaired or non-accrual.

The allowance for credit losses reflects the estimated losses resulting from the inability of our customers to make required payments. In calculating the allowance, we employ a variety of modeling and estimation tools for measuring credit risk. Generally, loans and leases to commercial customers are evaluated individually and assigned a credit grade based upon factors such as the borrower's cash flow, the value of any underlying collateral and the strength of any guarantee. Relying on data detailing historical credit grade losses and migration patterns among credit grades, we calculate a loss estimate for each credit grade. During 2007, after monitoring the migration of commercial mortgage and commercial and industrial loans between loan grades over a period of several years, we incorporated applicable data into our formula used to calculate the allowance. Relying on that information, the allowance declined \$4.1 million.

Groups of consumer loans are aggregated over their remaining estimated behavioral lives and probable loss projections for each period become the basis for the allowance amount. The loss projections are based on historical losses, delinquency patterns and various other credit risk indicators. During the second quarter of 2007, after accumulating sufficient data related to the actual repayment history of an isolated pool of revolving mortgage loans that are representative of the entire portfolio, we determined that an adjustment to the formula used to calculate the allowance was appropriate. As a result, the allowance required for this portfolio of loans declined by \$4.5 million.

When needed, we also establish specific allowances for impaired loans. Commercial purpose loans are considered to be impaired if they are classified as nonaccrual and have a balance in excess of \$1.0 million. The allowance for each impaired loan is the difference between its carrying value and the estimated collateral value or the present value of anticipated cash flows.

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The allowance for credit losses also includes an amount that is not specifically allocated to individual loan types. This unallocated allowance is based upon factors such as changes in business and economic conditions, recent loss, delinquency and asset quality issues both within BancShares and the banking industry, exposures resulting from loan concentrations or specific industry risks and other judgmental factors. Due to recent economic deterioration, unfavorable industry-wide asset quality trends, and the increased likelihood of unanticipated adverse changes in the quality of the loan and lease portfolio, the unallocated portion of the allowance increased to 8.0 percent of the total allowance for credit losses as of December 31, 2007, up from 3.7 percent as of December 31, 2006.

**Table 13****ALLOWANCE FOR CREDIT LOSSES**

	2007	2006	2005	2004	2003
	(thousands, except ratios)				
Allowance for credit losses at beginning of period	\$ 138,646	\$ 135,770	\$ 130,832	\$ 119,357	\$ 112,533
Adjustment for sale of loans			(1,585)		
Acquired allowance for credit loss					409
Provision for credit losses	33,594	20,922	33,514	34,690	24,617
Charge-offs:					
Real estate:					
Construction and land development	(631)		(1)	(13)	(16)
Commercial mortgage	(49)	(124)	(551)	(804)	(318)
Residential mortgage	(1,246)	(1,717)	(1,912)	(2,351)	(1,594)
Revolving mortgage	(1,363)	(1,475)	(951)	(1,384)	(1,392)
Other mortgage loans					
Total real estate loans	(3,289)	(3,316)	(3,415)	(4,552)	(3,320)
Commercial and industrial	(13,106)	(10,378)	(18,724)	(9,800)	(7,531)
Consumer	(13,203)	(9,171)	(10,425)	(12,238)	(10,481)
Lease financing	(3,092)	(1,488)	(347)	(173)	(756)
Total charge-offs	(32,690)	(24,353)	(32,911)	(26,763)	(22,088)
Recoveries:					
Real estate:					
Construction and land development	21			34	10
Commercial mortgage	8	182	409	236	164
Residential mortgage	261	290	432	244	631
Revolving mortgage	96	182	155	103	63
Other mortgage loans					
Total real estate loans	386	654	996	617	868
Commercial and industrial	1,282	1,358	2,164	1,084	1,428
Consumer	2,883	4,140	2,672	1,761	1,590
Lease financing	170	155	88	86	
Total recoveries	4,721	6,307	5,920	3,548	3,886
Net charge-offs	(27,969)	(18,046)	(26,991)	(23,215)	(18,202)
Allowance for credit losses at end of period	\$ 144,271	\$ 138,646	\$ 135,770	\$ 130,832	\$ 119,357

Allowance for credit losses includes:

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Allowance for loan and lease losses	\$ 136,974	\$ 132,004	\$ 128,847	\$ 123,861	\$ 112,304
Reserve for unfunded commitments	7,297	6,642	6,923	6,971	7,053
Allowance for credit losses at end of period	\$ 144,271	\$ 138,646	\$ 135,770	\$ 130,832	\$ 119,357
Average loans and leases	\$ 10,513,599	\$ 9,989,757	\$ 9,375,249	\$ 8,901,628	\$ 7,893,621
Loans and leases at year-end	10,963,904	10,273,043	9,656,230	9,364,822	8,333,073
Ratios					
Net charge-offs to average loans and leases	0.27%	0.18%	0.29%	0.26%	0.23%
Percent of total loans and leases at period-end:					
Allowance for loan and lease losses	1.25	1.28	1.33	1.32	1.35
Reserve for unfunded commitments	0.07	0.06	0.07	0.07	0.08
Allowance for credit losses	1.32	1.35	1.41	1.40	1.43

All information presented in this table relates to domestic loans and leases as BancShares makes no foreign loans and leases.

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At December 31, 2007, BancShares' allowance for credit losses totaled \$144.3 million or 1.32 percent of loans and leases outstanding. This compares to \$138.6 million or 1.35 percent at December 31, 2006, and \$135.8 million or 1.41 percent at December 31, 2005.

The provision for credit losses equaled \$33.6 million during 2007 compared to \$20.9 million during 2006 and \$33.5 million during 2005. The \$12.7 million or 60.6 percent increase in provision for credit losses from 2006 to 2007 resulted primarily from \$8.3 million of losses related to working capital finance and increased provision for loan growth during 2007.

Net charge-offs for 2007 totaled \$28.0 million, compared to \$18.0 million during 2006, and \$27.0 million during 2005. The ratio of net charge-offs to average loans and leases outstanding equaled 0.27 percent during 2007, 0.18 percent during 2006 and 0.29 percent during 2005. These low loss ratios reflect the quality of BancShares' loan and lease portfolio and are a key indicator of our close monitoring of loan and lease quality. Table 13 provides details concerning the allowance for credit losses and provision for credit losses for the past five years.

Table 14 details the allocation of the allowance for credit losses among the various loan types. The process used to allocate the allowance considers, among other factors, whether the borrower is a retail or commercial customer, whether the loan is secured or unsecured, and whether the loan is an open or closed-end agreement.

**Table 14****ALLOCATION OF ALLOWANCE FOR CREDIT LOSSES**

	2007		2006		December 31 2005		2004		2003	
	Allowance for Credit Losses	Percent of Loans to Total Loans	Allowance for Credit Losses	Percent of Loans to Total Loans	Allowance for Credit Losses (dollars in thousands)	Percent of Loans to Total Loans	Allowance for Credit Losses	Percent of Loans to Total Loans	Allowance for Credit Losses	Percent of Loans to Total Loans
Allowance for loan and lease losses:										
Real estate:										
Construction and land development	\$ 9,918	7.40%	\$ 9,351	7.63%	\$ 8,985	7.94%	\$ 7,704	6.28%	\$ 7,806	6.12%
Commercial mortgage	35,760	36.31	38,463	36.27	37,185	36.44	35,373	35.03	31,161	31.85
Residential mortgage	7,011	9.39	6,954	9.98	6,822	10.53	6,387	10.46	5,577	11.15
Revolving mortgage	5,735	13.63	8,425	12.91	8,712	14.17	11,587	18.30	9,334	19.18
Other mortgage	2,323	1.33	2,145	1.61	2,242	1.79	2,249	1.83	2,113	2.08
Total real estate	60,747	68.06	65,338	68.40	63,946	70.87	63,300	71.90	55,991	70.38
Commercial and industrial	32,743	15.57	34,846	14.86	30,663	12.50	26,794	10.47	25,028	11.23
Consumer	26,925	12.48	22,396	13.24	22,695	13.66	24,072	14.92	21,688	15.65
Lease financing	4,649	3.11	3,562	2.87	2,389	2.42	2,229	2.05	2,518	1.92
Other	412	0.78	723	0.63	576	0.55	743	0.66	901	0.82
Unallocated	11,498		5,139		8,578		6,723		6,178	
Reserve for unfunded commitments	7,297		6,642		6,923		6,971		7,053	

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Total	\$ 144,271	100.00%	\$ 138,646	100.00%	\$ 135,770	100.00%	\$ 130,832	100.00%	\$ 119,357	100.00%
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*Interest Rate Risk.* Interest rate risk results principally from assets and liabilities maturing or repricing at different points in time, from assets and liabilities repricing at the same point in time but in different amounts and from short-term and long-term interest rates changing in different magnitudes, an event frequently described by the resulting impact on the shape of the yield curve. Market interest rates may also have a direct or indirect impact on the interest rate and repricing characteristics of loans and leases that are originated as well as the rate characteristics of our interest-bearing liabilities.

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We assess our interest rate risk by simulating future amounts of net interest income using various interest rate scenarios and comparing those results to forecasted net interest income assuming stable rates. Table 15 provides the impact on net interest income resulting from various interest rate scenarios as of December 31, 2007 and 2006.

**Table 15****INTEREST RATE RISK ANALYSIS**

	<b>Favorable (unfavorable) impact on net interest income compared to stable rate scenario over the 12-month period following:</b>	
	<b>December 31, 2007</b>	<b>December 31, 2006</b>
<b>Assumed rate change</b>		
Most likely	(0.52%)	(0.04%)
Immediate 200 basis point increase	(5.65%)	(0.54%)
Gradual 200 basis point increase	(2.22%)	(1.16%)
Gradual 200 basis point decrease	3.05%	1.86%
Immediate 200 basis point decrease	2.45%	0.65%

We also utilize the market value of equity as a measurement tool in measuring and managing interest rate risk. The market value of equity measures the degree to which the market values of our assets and liabilities will change given a specific degree of movement in interest rates. Our calculation methodology for the market value of equity utilizes a 200-basis point parallel rate shock. As of December 31, 2007, the market value of equity is estimated to increase by 10.1 percent given a 200-basis point immediate decrease in interest rates, and decline by 7.2 percent when interest rates immediately increase by 200 basis points. The estimated amounts for the market value of equity are highly influenced by the relatively longer maturity of the commercial loan component of interest-earning assets than for interest-bearing liabilities.

The maturity distribution and repricing opportunities of interest-earning assets have a significant impact on our interest rate risk. Table 16 provides a loan maturity distribution and information regarding the sensitivity of loans and leases to changes in interest rates. Table 4 includes maturity information for our investment securities.

We do not typically utilize interest rate swaps, floors, collars or other derivative financial instruments to attempt to hedge our rate sensitivity and interest rate risk. However, during the second quarter of 2006, in conjunction with the issuance of \$115.0 million in trust preferred securities, we entered into an interest rate swap to synthetically convert the variable rate coupon on the securities to a fixed rate of 7.125 percent for a period of five years. The interest rate swap is a cash flow derivative under Statement of Financial Accounting Standards No. 133. The derivative is valued each quarter, and changes in the fair value are recorded on the consolidated balance sheet with an offset to other comprehensive income for the effective portion and an offset to the consolidated statements of income for any ineffective portion. The determination of effectiveness is made under the long-haul method.

**Table of Contents****Table 16****LOAN MATURITY DISTRIBUTION AND INTEREST RATE SENSITIVITY**

	Within One Year	December 31, 2007		Total
		One to Five Years	After Five Years	
(thousands)				
<b>Real estate:</b>				
Construction and land development	\$ 392,185	\$ 270,710	\$ 147,923	\$ 810,818
Commercial mortgage	1,263,329	1,734,938	984,229	3,982,496
Residential mortgage	271,865	396,486	360,679	1,029,030
Revolving mortgage	487,144	932,562	74,725	1,494,431
Other mortgage	45,592	64,475	35,485	145,552
<b>Total real estate loans</b>	<b>2,460,115</b>	<b>3,399,171</b>	<b>1,603,041</b>	<b>7,462,327</b>
Commercial and industrial	524,745	682,820	499,829	1,707,394
Consumer	299,382	898,673	170,173	1,368,228
Lease financing	85,150	255,451		340,601
Other	29,105	34,563	21,686	85,354
<b>Total</b>	<b>\$ 3,398,497</b>	<b>\$ 5,270,678</b>	<b>\$ 2,294,729</b>	<b>\$ 10,963,904</b>
<b>Loans maturing after one year with:</b>				
Fixed interest rates		\$ 3,554,545	\$ 1,923,236	\$ 5,477,781
Floating or adjustable rates		1,716,133	371,493	2,087,626
<b>Total</b>		<b>\$ 5,270,678</b>	<b>\$ 2,294,729</b>	<b>\$ 7,565,407</b>

*Liquidity Risk.* Liquidity risk results from the mismatching of asset and liability cash flows. BancShares manages this risk by structuring its balance sheet prudently and by maintaining various borrowing resources to fund potential cash needs. BancShares has historically maintained a strong focus on liquidity, and our deposit base represents our primary liquidity source.

The rate of growth in average deposits was 1.7 percent during 2007, 6.3 percent during 2006 and 6.9 percent during 2005. Short-term borrowings also experienced significant growth during both 2007 and 2006 due to strong customer demand for our cash management products. Through our deposit and cash management product pricing strategies, we have the ability to stimulate or curtail liability growth. Due to its primary focus on commercial customers, ISB has continued to face liquidity challenges caused by rapid loan growth. As a result, ISB has utilized both borrowings from the Federal Home Loan Bank of Atlanta and brokered deposits to augment the liquidity generated from its deposit customers.

In addition to deposits, BancShares maintains additional sources for borrowed funds through federal funds lines of credit and other borrowing facilities. At December 31, 2007, BancShares had access to \$525.0 million in unfunded borrowings through its various sources.

Once we have satisfied our loan demand and other funding needs, residual liquidity is held in cash or invested in overnight and longer-term investment products. At December 31, 2007, these highly-liquid assets totaled \$4.29 billion or 26.5 percent of total assets, compared to \$4.36 billion or 27.7 percent of total assets at December 31, 2006.





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### SEGMENT REPORTING

BancShares conducts its banking operations through its two wholly owned subsidiaries, FCB and ISB. Although FCB and ISB offer similar products and services to customers, each entity operates in distinct geographic markets and has separate management groups. We monitor growth and financial results in these institutions separately and, within each institution, by further geographic segregation.

Although FCB has grown through acquisition in certain markets, throughout its history, much of its expansion has been accomplished on a de novo basis. Since it first opened in 1997, ISB has followed a similar business model for growth and expansion. Because of its size, the costs associated with FCB's current rate of expansion are not material to its financial performance. However, due to the rapid pace of its growth and the number of branch offices that have yet to attain sufficient size for profitability, the financial results and trends of ISB are significantly affected by its current and continuing growth. Each new market ISB enters creates additional operating costs that are typically not fully offset by revenues until the third year of operation. Losses incurred since ISB's inception total \$34.7 million.

*IronStone Bank.* At December 31, 2007, ISB operated 56 facilities in Florida, Georgia, Texas, New Mexico, Arizona, California, Colorado, Oregon, Washington and Missouri. ISB will continue its expansion during 2008, establishing facilities in Kansas and Oklahoma. ISB continues to focus on markets with favorable growth prospects. Our business model for new markets has two requirements. First, we hire experienced bankers who are established in the markets we are entering and who are focused on delivering high quality customer service while maintaining strong asset quality. Second, we occupy attractive and accessible branch facilities. Both of these are costly goals, but we believe that they are critical to establishing a solid foundation for future success in new markets.

ISB's total assets increased from \$2.14 billion at December 31, 2006 to \$2.34 billion at December 31, 2007, an increase of \$204.5 million or 9.6 percent. ISB's total assets represented 14.4 percent of consolidated assets at December 31, 2007 compared to 13.6 percent at December 31, 2006.

ISB recorded a net loss of \$7.7 million during 2007 compared to net income of \$2.2 million during 2006 and a net loss of \$2.9 million in 2005. The \$9.9 million reduction in net income resulted from significantly higher provision for credit losses, higher noninterest expense and lower net interest income. ISB's net interest income decreased \$2.5 million or 3.8 percent during 2007, the result of a significant reduction in the net yield on interest-earning assets. Loans and leases increased \$201.8 million or 10.8 percent from \$1.87 billion at December 31, 2006 to \$2.07 billion at December 31, 2007.

Provision for credit losses increased \$5.5 million or 154.6 percent during 2007, due to higher net charge offs and loan growth. Net charge-offs amounted to \$6.7 million during 2007, compared to \$1.0 million in 2006. This \$5.7 million increase includes \$4.2 million in losses on working capital finance loans.

ISB's noninterest income increased \$2.1 million or 18.7 percent during 2007, primarily the result of higher cardholder and merchant services income and referral fees generated through working capital finance.

Noninterest expense increased \$8.4 million or 11.8 percent during 2007, the result of costs incurred in conjunction with the opening of new branch offices and higher cardholder processing expenses.

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Primarily as a result of continued pressure on net interest income and continued growth in noninterest expenses, ISB will likely continue to be unprofitable during 2008.

*First-Citizens Bank & Trust Company.* At December 31, 2007, FCB operated 340 branches in North Carolina, Virginia, West Virginia, Maryland and Tennessee. During 2007, FCB continued to expand into high-growth areas throughout its footprint with expansion continuing in 2008.

FCB's total assets increased from \$13.33 billion at December 31, 2006 to \$13.58 billion at December 31, 2007, an increase of \$252.7 million or 1.9 percent. FCB's total assets represented 83.8 percent and 84.7 percent of consolidated assets at December 31, 2007 and 2006, respectively.

FCB recorded net income of \$125.2 million during 2007 compared to \$139.1 million during 2006. This represents a \$14.0 million or 10.0 percent decrease in net income, the net impact of higher noninterest expense and provision for credit losses and slightly reduced levels of net interest income offset in part by strong growth in noninterest income.

**Table of Contents****Table 17****SELECTED QUARTERLY DATA**

	2007				2006			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
(thousands, except share data and ratios)								
<b>SUMMARY OF OPERATIONS</b>								
Interest income	\$ 230,826	\$ 232,120	\$ 223,473	\$ 217,637	\$ 219,493	\$ 216,170	\$ 203,784	\$ 190,868
Interest expense	109,197	111,185	103,884	99,448	101,215	96,773	83,567	72,182
Net interest income	121,629	120,935	119,589	118,189	118,278	119,397	120,217	118,686
Provision for credit losses	11,795	17,333	934	3,532	7,462	3,758	2,936	6,766
Net interest income after provision for credit losses	109,834	103,602	118,655	114,657	110,816	115,639	117,281	111,920
Noninterest income	76,534	77,285	72,620	69,031	67,873	70,288	68,326	64,880
Noninterest expense	146,285	146,906	142,878	138,595	130,026	134,123	135,246	131,682
Income before income taxes	40,083	33,981	48,397	45,093	48,663	51,804	50,361	45,118
Income taxes	13,920	11,362	17,546	16,109	15,468	18,877	18,649	16,461
Net income	\$ 26,163	\$ 22,619	\$ 30,851	\$ 28,984	\$ 33,195	\$ 32,927	\$ 31,712	\$ 28,657
Net interest income, taxable equivalent	\$ 123,666	\$ 122,980	\$ 121,409	\$ 119,964	\$ 120,110	\$ 121,082	\$ 120,636	\$ 119,093
<b>SELECTED QUARTERLY AVERAGE BALANCES</b>								
Total assets	\$ 16,276,649	\$ 16,092,009	\$ 15,725,976	\$ 15,572,613	\$ 15,628,835	\$ 15,477,992	\$ 15,322,373	\$ 14,699,290
Investment securities	3,272,015	3,162,011	3,047,753	3,092,261	3,176,845	3,072,113	2,964,308	2,896,711
Loans and leases	10,831,571	10,623,247	10,360,913	10,230,858	10,167,157	10,106,194	9,943,057	9,736,606
Interest-earning assets	14,655,309	14,476,247	14,118,884	13,908,622	13,984,789	13,851,788	13,541,084	13,160,476
Deposits	12,876,549	12,728,527	12,524,786	12,502,206	12,601,708	12,571,525	12,440,125	12,192,664
Interest-bearing liabilities	12,216,067	12,052,307	11,698,285	11,557,940	11,601,752	11,485,378	11,156,821	10,794,420
Long-term obligations	404,367	405,101	405,339	408,277	424,597	500,564	466,259	408,946
Shareholders equity	\$ 1,420,348	\$ 1,385,284	\$ 1,353,739	\$ 1,323,327	\$ 1,292,771	\$ 1,254,551	\$ 1,219,835	\$ 1,196,174
Shares outstanding	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453
<b>SELECTED QUARTER-END BALANCES</b>								
Total assets	\$ 16,212,107	\$ 16,311,870	\$ 16,008,605	\$ 15,853,778	\$ 15,729,697	\$ 15,633,597	\$ 15,530,846	\$ 15,099,564
Investment securities	3,236,835	3,266,150	3,023,799	3,031,798	3,221,048	3,118,025	3,024,780	2,896,962
Loans and leases	10,963,904	10,763,158	10,513,041	10,262,356	10,273,043	10,160,661	10,059,723	9,822,674
Interest-earning assets	14,466,948	14,542,241	14,232,802	14,094,002	13,842,688	13,849,766	13,716,208	13,468,554
Deposits	12,928,544	12,980,447	12,772,322	12,722,532	12,743,324	12,681,150	12,717,247	12,512,557
Interest-bearing liabilities	12,118,967	12,170,559	11,830,904	11,671,127	11,612,372	11,510,073	11,395,473	11,038,192
Long-term obligations	404,392	404,266	405,314	405,356	401,198	424,351	527,478	408,954
Shareholders equity	\$ 1,441,208	\$ 1,401,575	\$ 1,367,980	\$ 1,342,327	\$ 1,310,819	\$ 1,276,608	\$ 1,232,933	\$ 1,207,720
Shares outstanding	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453	10,434,453
<b>PROFITABILITY RATIOS (averages)</b>								

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Rate of return  
(annualized) on:

Total assets	0.64%	0.56%	0.79%	0.75%	0.84%	0.84%	0.84%	0.79%
Shareholders' equity	7.31	6.48	9.14	8.88	10.19	10.41	10.43	9.72
Dividend payout ratio	10.96	12.67	9.29	9.89	8.65	8.70	9.05	10.00

LIQUIDITY AND  
CAPITAL RATIOS  
(averages)

Loans and leases to deposits	84.12%	83.46%	82.72%	81.83%	80.68%	80.39%	79.93%	79.86%
Shareholders' equity to total assets	8.73	8.61	8.61	8.50	8.27	8.11	7.96	8.14
Time certificates of \$100,000 or more to total deposits	18.04	17.67	16.95	16.60	16.17	15.74	15.04	14.44

PER SHARE OF STOCK

Net income	\$ 2.51	\$ 2.17	\$ 2.96	\$ 2.78	\$ 3.18	\$ 3.16	\$ 3.04	\$ 2.75
Cash dividends	0.275	0.275	0.275	0.275	0.275	0.275	0.275	0.275
Class A sales price								
High	181.91	195.66	209.01	214.59	202.64	217.79	201.92	201.78
Low	143.00	152.47	182.10	199.41	183.57	191.00	175.76	174.72
Class B sales price								
High	205.00	211.50	213.00	214.95	205.00	214.00	198.50	191.00
Low	200.00	204.00	207.50	205.50	196.50	198.00	184.00	180.00

Average loan and lease balances include nonaccrual loans and leases. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only, are stated on a taxable-equivalent basis assuming a federal income tax rate of 35% and a state income tax rate of 6.9% for all periods. Stock information related to Class A common stock reflects the sales price, as reported on the NASDAQ Global Select Market. Stock information related to Class B common stock reflects the sales price as reported on the OTC Bulletin Board. As of December 31, 2007, there were 2,122 holders of record of Class A common stock and 391 holders of record of Class B common stock.

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FCB's net interest income decreased \$2.1 million or 0.5 percent during 2007 due to a lower net yield on interest-earning assets. Provision for credit losses increased \$7.2 million or 41.4 percent during 2007 caused by higher net charge-offs and continued loan growth. The increase in net charge-offs includes \$4.2 million in working capital finance losses.

FCB's noninterest income increased \$24.2 million or 9.0 percent during 2007, primarily the result of higher cardholder and merchant services income, fees from wealth management services, deposit service charges and gains from securities transactions. Noninterest expense increased \$38.1 million or 8.2 percent during 2007, due to higher personnel, credit card processing, equipment and occupancy expense.

Other includes the parent company, which during 2007 experienced an \$8.4 million reduction in its net interest expense due to growth in its master note obligations, the proceeds from which were invested in investment securities and overnight repurchase obligations. The parent company's net interest expense was also affected by the 2006 redemption of \$103.1 million of junior subordinated debentures.

## **FOURTH QUARTER ANALYSIS**

BancShares reported net income of \$26.2 million for the quarter ended December 31, 2007, compared to \$33.2 million for the corresponding period of 2006, a decrease of 21.2 percent. Per share income for the fourth quarter 2007 totaled \$2.51 compared to \$3.18 for the same period of 2006. BancShares' results generated an annualized return on average assets of 0.64 percent for the fourth quarter of 2007, compared to 0.84 percent for the same period of 2006. The annualized return on average equity equaled 7.31 percent during the fourth quarter of 2007, compared to 10.19 percent for the same period of 2006. In the fourth quarter, higher noninterest expense and higher provision for credit losses contributed to the decline in net income. These added costs were partially offset by higher net interest and noninterest income.

Net interest income increased \$3.4 million or 2.8 percent in the fourth quarter of 2007, compared to the same period of 2006. The taxable-equivalent net yield on interest-earning assets decreased from 3.41 percent in the fourth quarter of 2006 to 3.35 percent for the fourth quarter of 2007.

Average interest-earning assets increased \$670.5 million to \$14.66 billion from the fourth quarter of 2006 to the fourth quarter of 2007. Average loans and leases outstanding during the fourth quarter of 2007 equaled \$10.83 billion, an increase of \$664.4 million or 6.5 percent over 2006. The yield on interest-earning assets increased 5 basis points from 6.26 percent in 2006 to 6.31 percent in 2007.

Average interest-bearing liabilities increased \$614.3 million to \$12.22 billion. Average time deposits increased \$350.9 million or 6.8 percent to \$5.48 billion while average short-term borrowings increased \$257.4 million or 21.8 percent to \$1.44 billion due to strong growth among master note borrowings and repurchase obligations. The rate on average interest-bearing liabilities increased 9 basis points to 3.55 percent in 2007.

The provision for credit losses increased \$4.3 million or 58.1 percent in the fourth quarter of 2007, compared to the same period of 2006 due to higher net charge-offs and loan growth. Net charge-offs were \$8.4 million during the fourth quarter of 2007, compared to \$7.0 million during the same period of 2006.

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Noninterest income increased \$8.7 million or 12.8 percent during the fourth quarter. Deposit service charges increased \$3.1 million or 17.3 percent in the quarter while cardholder and merchant services income increased \$2.4 million or 11.0 percent due to favorable volume growth. Fees from wealthy management services increased \$1.4 million or 27.6 percent for the fourth quarter of 2007, the result of our expanded focus on trust and broker-dealer services.

Noninterest expense increased \$16.3 million or 12.5 percent during the fourth quarter of 2007, when compared to the same period of 2006. Salaries increased \$4.6 million or 7.9 percent from the fourth quarter of 2006 to the fourth quarter of 2007. Occupancy costs increased \$1.2 million or 8.8 percent from \$17.1 million during the fourth quarter of 2006 to \$18.5 million during the fourth quarter of 2007. Higher personnel and occupancy costs are primarily related to the continued expansion of the branch network. Among other expense, credit card processing fees increased \$1.5 million or 17.3 percent due to higher transaction volume in the fourth quarter of 2007 when compared to the fourth quarter of 2006. Legal costs increased \$1.3 million during the fourth quarter of 2007 due to heightened loan collection activities.

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Table 17 provides quarterly information for each of the quarters in 2007 and 2006. Table 18 analyzes the components of changes in net interest income between the fourth quarter of 2007 and 2006.

**Table 18****CONSOLIDATED TAXABLE EQUIVALENT RATE/VOLUME VARIANCE ANALYSIS FOURTH QUARTER**

	2007			2006			Increase (decrease) due to:		
	Average Balance	Interest Income/Expense	Yield/Rate	Average Balance	Interest Income/Expense	Yield/Rate	Volume	Yield/Rate	Total Change
(dollars in thousands)									
<b>Assets</b>									
Loans and leases	\$ 10,831,571	\$ 186,426	6.83%	\$ 10,167,157	\$ 178,565	6.97%	\$ 11,561	\$ (3,700)	\$ 7,861
<b>Investment securities:</b>									
U. S. Government	3,197,797	39,178	4.89	3,098,167	33,262	4.28	1,139	4,777	5,916
State, county and municipal	4,949	83	6.65	5,847	122	8.28	(17)	(22)	(39)
Other	69,269	773	4.43	72,831	844	4.60	(41)	(30)	(71)
Total investment securities	3,272,015	40,034	4.88	3,176,845	34,228	4.30	1,081	4,725	5,806
Overnight investments	551,723	6,403	4.60	640,787	8,532	5.28	(1,108)	(1,021)	(2,129)
Total interest-earning assets	\$ 14,655,309	\$ 232,863	6.31%	\$ 13,984,789	\$ 221,325	6.26%	\$ 11,534	\$ 4	\$ 11,538
<b>Liabilities</b>									
<b>Deposits:</b>									
Checking With Interest	\$ 1,384,226	\$ 536	0.15%	\$ 1,477,601	\$ 464	0.12%	\$ (34)	\$ 106	\$ 72
Savings	546,410	299	0.22	606,635	326	0.21	(37)	10	(27)
Money market accounts	2,964,472	24,181	3.24	2,784,676	23,125	3.29	1,449	(393)	1,056
Time deposits	5,476,849	63,973	4.63	5,125,904	56,664	4.39	4,046	3,263	7,309
Total interest-bearing deposits	10,371,957	88,989	3.40	9,994,816	80,579	3.20	5,424	2,986	8,410
Short-term borrowings	1,439,743	13,362	3.68	1,182,339	13,461	4.52	2,668	(2,767)	(99)
Long-term obligations	404,367	6,846	6.72	424,597	7,175	6.70	(346)	17	(329)
Total interest-bearing liabilities	\$ 12,216,067	\$ 109,197	3.55%	\$ 11,601,752	\$ 101,215	3.46%	\$ 7,746	\$ 236	\$ 7,982
Interest rate spread			2.76%			2.80%			
Net interest income and net yield on interest-earning assets		\$ 123,666	3.35%		\$ 120,110	3.41%	\$ 3,788	\$ (232)	\$ 3,556

Average loans and leases includes nonaccrual loans and leases. Yields related to loans, leases and securities exempt from both federal and state income taxes, federal income taxes only, or state income taxes only, are stated on a taxable-equivalent basis assuming a statutory federal income tax rate of 35% and a state income tax rate of 6.9% for each period.

**COMMITMENTS AND CONTRACTUAL OBLIGATIONS**



As a normal part of its business, BancShares, FCB, ISB and other subsidiaries enter into various contractual obligations and commercial commitments. Table 19 identifies significant obligations and commitments as of December 31, 2007.

## **LEGAL PROCEEDINGS**

On February 24, 2006 DataTreasury Corporation ( DataTreasury ) filed a lawsuit in the United States District Court for the Eastern District of Texas against a number of large financial institutions including BancShares and FCB alleging patent infringement. DataTreasury claims to be the owner of multiple patents that cover check processing, and seeks to enjoin the defendants from infringing those patents and to recover damages, including royalty payment for checks processed since February 2000 and for checks processed in the future, costs and attorneys' fees. The United States Patent and Trademark Office recently issued reexamination certificates with respect to two of four patents at issue in the claims asserted against BancShares and FCB, reaffirming all of the claims in these patents and allowing DataTreasury to include additional claims. BancShares and FCB challenge the validity of these patents, and claim that even if the patents are valid, BancShares and FCB are not liable for infringement because BancShares does not process checks and FCB's check processing system does not infringe the patents. BancShares and FCB strenuously deny liability and are vigorously defending their positions. BancShares and FCB also have placed certain software and equipment vendors on notice of claims for defense and for indemnification in the event DataTreasury prevails.

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

In addition to claims that have been brought against BancShares, there are also exposures related to unasserted claims that may or may not be initiated. These unasserted claims relate to relationships with customers, supervisory agencies and other governmental agencies that have authority over BancShares and its subsidiaries. Unless and until those claims are made, we are unable to estimate the ultimate liability that may exist.

**Table 19****COMMITMENTS AND CONTRACTUAL OBLIGATIONS**

Type of obligation	Payments due by period				Total
	Less than 1 year	1-3 years	4-5 years (thousands)	Thereafter	
<b>Contractual obligations:</b>					
Deposits	\$ 12,293,715	\$ 435,264	\$ 187,107	\$ 12,458	\$ 12,928,544
Short-term borrowings	1,305,287				1,305,287
Long-term obligations	1,273	683	784	401,652	404,392
Operating leases	15,582	22,702	15,704	60,272	114,260
<b>Total contractual obligations</b>	<b>\$ 13,615,857</b>	<b>\$ 458,649</b>	<b>\$ 203,595</b>	<b>\$ 474,382</b>	<b>\$ 14,752,483</b>
<b>Commitments:</b>					
Loan commitments	\$ 1,266,300	\$ 965,016	\$ 155,976	\$ 2,585,223	\$ 4,972,515
Standby letters of credit	45,945	5,668	83		51,696
Affordable housing partnerships	7,304	1,434	140		8,878
<b>Total commitments</b>	<b>\$ 1,319,549</b>	<b>\$ 972,118</b>	<b>\$ 156,199</b>	<b>\$ 2,585,223</b>	<b>\$ 5,033,089</b>

**TRANSACTIONS WITH RELATED PERSONS**

BancShares related persons include our directors and officers, their immediate family members and any businesses or entities they control. There are several other financial institutions that, as a result of significant common ownership, are viewed as related persons. We routinely conduct business with these individuals and entities. Some of these relationships with related persons and the entities they control affect our consolidated statements of income. Fees from processing services included \$29.2 million, \$26.1 million and \$23.0 million recorded during 2007, 2006 and 2005, for services we provided to related persons, and fee income recognized from the largest individual related institution totaled \$18.0 million, \$16.9 million and \$14.4 million, during the respective periods.

During 2007, 2006 and 2005, we recognized legal expense of \$3.8 million, \$4.4 million and \$4.3 million to the law firm that serves as our General Counsel and employs a member of our board of directors.

Certain of these transactions with related persons also affect our consolidated balance sheets. At December 31, 2007 and 2006, loans and leases outstanding include \$38.2 million and \$34.7 million in loans to related persons. Investment securities available for sale include an equity investment in an entity controlled by related persons with a carrying value of \$23.8 million and \$25.1 million at December 31, 2007 and 2006, respectively. The carrying value of this equity investment is established based upon the quoted price per share as of December 31 in the over-the-counter market on the OTC Bulletin Board. Short-term borrowings include \$13.7 million and \$41.3 million in federal funds purchased from financial institutions controlled by related persons at December 31, 2007 and 2006. Additionally, BancShares had off balance sheet obligations for unfunded loan commitments to related persons that totaled \$20.5 million and \$20.9 million at December 31, 2007 and 2006, respectively.

#### **CURRENT ACCOUNTING AND REGULATORY ISSUES**

In June 2006, the FASB issued Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies uncertainty in income taxes recognized by establishing a recognition threshold and a measurement attribute for the financial statement treatment of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 resulted in a reduction in the liability for unrecognized tax benefits, which was offset by a \$962,000 adjustment to the beginning balance of retained earnings.

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In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 Fair Value Measurements (Statement 157). Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 does not require any new fair value measurements, but clarifies and standardizes some divergent practices that have emerged since prior guidance was issued. Statement 157 creates a three-level hierarchy under which individual fair value estimates are to be ranked based on the relative reliability of the inputs used in the valuation. This hierarchy is the basis for the disclosure requirements, with fair value estimates based on the least reliable inputs requiring more extensive disclosures about the valuation method used and the gains and losses associated with those estimates. We adopted Statement 157 on January 1, 2008, and the adoption did not have a material impact on financial condition, results of operations, or liquidity.

In September 2006, the FASB issued Summary of Statement No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (Statement 158). Statement 158 requires sponsors of defined benefit and other post-retirement plans to recognize the overfunded or underfunded status of that plan as an asset or liability in the sponsor's statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The recognition of the funded status of the defined benefit plan and additional disclosures outlined in Statement 158 were reflected in BancShares' December 31, 2006 consolidated financial statements. Statement 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, although that requirement is not effective until 2008.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities (Statement 159). Statement 159 allows an entity to elect to measure certain financial assets and liabilities at fair value with changes in fair value recognized in the income statement each period. The statement also requires additional disclosures to identify the effects of an entity's fair value election on its earnings. We adopted Statement 159 on January 1, 2008, and the adoption did not have a material impact on financial condition, results of operations, or liquidity.

Management is not aware of any current recommendations by regulatory authorities that, if implemented, would have or would be reasonably likely to have a material effect on liquidity, capital ratios or results of operations.

## **FORWARD-LOOKING STATEMENTS**

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

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

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

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Factors that could influence the accuracy of those forward-looking statements include, but are not limited to, the financial success or changing strategies of our customers, customer acceptance of our services, products and fee structure, the competitive nature of the financial services industry, our ability to compete effectively against other financial institutions in our banking markets, actions of government regulators, the level of market interest rates and our ability to manage our interest rate risk, changes in general economic conditions that affect our loan portfolio, the abilities of our borrowers to repay their loans, the values of real estate and other loan collateral, and other developments or changes in our business that we do not expect.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We have no obligation to update these forward-looking statements.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

First Citizens BancShares, Inc.

We have audited the accompanying consolidated balance sheets of First Citizens BancShares, Inc. and subsidiaries (BancShares) as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of BancShares' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BancShares as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A to the consolidated financial statements, effective January 1, 2007, BancShares adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, and effective December 31, 2006, BancShares adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of BancShares' internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 28, 2008, expressed an unqualified opinion on the effectiveness of BancShares' internal control over financial reporting.

Raleigh, North Carolina

February 28, 2008

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**MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of First Citizens BancShares, Inc. (BancShares) is responsible for establishing and maintaining adequate internal control over financial reporting. BancShares' internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

BancShares' management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. Based on that assessment, we believe that, as of December 31, 2007, the company's internal control over financial reporting is effective based on those criteria.

BancShares' independent auditors have issued an audit report on the company's internal control over financial reporting. This report appears on page 39.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

First Citizens BancShares, Inc.

We have audited First Citizens BancShares, Inc. and subsidiaries (BancShares) s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. BancShares management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on BancShares internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, BancShares maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.



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We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of BancShares as of December 31, 2007 and 2006 and for each of the years in the three-year period ended December 31, 2007, and our report dated February 28, 2008, expressed an unqualified opinion on those consolidated financial statements. As discussed in Note A to the consolidated financial statements, effective January 1, 2007, BancShares adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, and effective December 31, 2006, BancShares adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

Raleigh, North Carolina

February 28, 2008

**Table of Contents****CONSOLIDATED BALANCE SHEETS****First Citizens BancShares, Inc. and Subsidiaries**

	<b>December 31</b>	
	<b>2007</b>	<b>2006</b>
	<b>(thousands, except share data)</b>	
<b>ASSETS</b>		
Cash and due from banks	\$ 793,788	\$ 1,010,984
Overnight investments	266,209	348,597
Investment securities available for sale (cost of \$3,174,505 in 2007 and \$2,990,444 in 2006)	3,229,241	3,001,890
Investment securities held to maturity (fair value of \$7,776 in 2007 and \$218,333 in 2006)	7,594	219,158
Loans and leases	10,963,904	10,273,043
Less allowance for loan and lease losses	136,974	132,004
Net loans and leases	10,826,930	10,141,039
Premises and equipment	757,694	702,926
Income earned not collected	79,343	71,562
Goodwill	102,625	102,625
Other intangible assets	5,858	8,000
Other assets	142,825	122,916
Total assets	\$ 16,212,107	\$ 15,729,697
<b>LIABILITIES</b>		
Deposits:		
Noninterest-bearing	\$ 2,519,256	\$ 2,682,997
Interest-bearing	10,409,288	10,060,327
Total deposits	12,928,544	12,743,324
Short-term borrowings	1,305,287	1,150,847
Long-term obligations	404,392	401,198
Other liabilities	132,676	123,509
Total liabilities	14,770,899	14,418,878
<b>SHAREHOLDERS EQUITY</b>		
Common stock:		
Class A \$1 par value (11,000,000 shares authorized; 8,756,778 shares issued for each period)	8,757	8,757
Class B \$1 par value (2,000,000 shares authorized; 1,677,675 shares issued for each period)	1,678	1,678
Surplus	143,766	143,766
Retained earnings	1,246,473	1,148,372
Accumulated other comprehensive income	40,534	8,246
Total shareholders equity	1,441,208	1,310,819
Total liabilities and shareholders equity	\$ 16,212,107	\$ 15,729,697

See accompanying Notes to Consolidated Financial Statements.



**Table of Contents****CONSOLIDATED STATEMENTS OF INCOME****First Citizens BancShares, Inc. and Subsidiaries**

	Year Ended December 31		
	2007	2006	2005
	(thousands, except share and per share data)		
<b>INTEREST INCOME</b>			
Loans and leases	\$ 727,581	\$ 683,412	\$ 574,384
Investment securities:			
U. S. Government	140,986	112,461	73,472
State, county and municipal	220	235	252
Other	3,100	3,304	2,224
Total investment securities interest and dividend income	144,306	116,000	75,948
Overnight investments	32,169	30,903	19,208
<b>Total interest income</b>	<b>904,056</b>	<b>830,315</b>	<b>669,540</b>
<b>INTEREST EXPENSE</b>			
Deposits	341,236	280,178	176,631
Short-term borrowings	55,126	41,431	14,966
Long-term obligations	27,352	32,128	26,554
<b>Total interest expense</b>	<b>423,714</b>	<b>353,737</b>	<b>218,151</b>
<b>Net interest income</b>	<b>480,342</b>	<b>476,578</b>	<b>451,389</b>
Provision for credit losses	33,594	20,922	33,514
<b>Net interest income after provision for credit losses</b>	<b>446,748</b>	<b>455,656</b>	<b>417,875</b>
<b>NONINTEREST INCOME</b>			
Cardholder and merchant services	97,070	86,103	75,298
Service charges on deposit accounts	77,827	72,561	77,376
Wealth management services	49,305	42,213	34,726
Fees from processing services	32,531	29,631	25,598
Insurance commissions	7,735	6,942	6,390
Mortgage income	6,305	5,494	5,361
ATM income	6,515	6,803	7,842
Other service charges and fees	15,318	15,996	16,902
Securities gains (losses)	1,376	(659)	(492)
Other	1,488	6,283	8,665
<b>Total noninterest income</b>	<b>295,470</b>	<b>271,367</b>	<b>257,666</b>
<b>NONINTEREST EXPENSE</b>			
Salaries and wages	243,871	228,472	212,997
Employee benefits	52,733	50,445	51,517
Occupancy expense	56,922	52,153	46,912
Equipment expense	56,404	52,490	50,291
Other	164,734	147,517	135,154
<b>Total noninterest expense</b>	<b>574,664</b>	<b>531,077</b>	<b>496,871</b>

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Income before income taxes	167,554	195,946	178,670
Income taxes	58,937	69,455	65,808
Net income	\$ 108,617	\$ 126,491	\$ 112,862

PER SHARE INFORMATION

Net income per share	\$ 10.41	\$ 12.12	\$ 10.82
Average shares outstanding	10,434,453	10,434,453	10,434,453

See accompanying Notes to Consolidated Financial Statements.

**Table of Contents****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY****First Citizens BancShares, Inc. and Subsidiaries**

	Class A Common Stock	Class B Common Stock	Surplus (thousands, except share data)	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total Shareholders Equity
Balance at December 31, 2004	\$ 8,757	\$ 1,678	\$ 143,766	\$ 927,621	\$ 4,488	\$ 1,086,310
Comprehensive income:						
Net income				112,862		112,862
Unrealized securities losses arising during period, net of \$4,367 deferred tax benefit					(6,933)	(6,933)
Less: reclassification adjustment for losses included in net income, net of \$194 deferred tax benefit					(298)	(298)
Unrealized securities losses, net of deferred taxes					(6,635)	(6,635)
Total comprehensive income						106,227
Cash dividends				(11,478)		(11,478)
Balance at December 31, 2005	8,757	1,678	143,766	1,029,005	(2,147)	1,181,059
Adjustment resulting from adoption of :						
Staff Accounting Bulletin No. 108, net of \$2,803 deferred tax				4,354		4,354
SFAS No. 158, net of \$1,610 deferred tax					2,502	2,502
Comprehensive income:						
Net income				126,491		126,491
Unrealized securities gains arising during period, net of \$4,315 deferred tax					8,577	8,577
Less: reclassification adjustment for losses included in net income, net of \$260 deferred tax benefit					(399)	(399)
Unrealized securities gains, net of deferred taxes					8,976	8,976
Change in unrecognized loss on cash flow hedge, net of \$708 deferred tax benefit					(1,085)	(1,085)
Total comprehensive income						134,382
Cash dividends				(11,478)		(11,478)
Balance at December 31, 2006	8,757	1,678	143,766	1,148,372	8,246	1,310,819
Adjustment resulting from adoption of FASB Interpretation No. 48				962		962
Comprehensive income:						
Net income				108,617		108,617
Unrealized securities gains arising during period, net of \$17,453 deferred tax					27,213	27,213
Less: reclassification adjustment for gains included in net income, net of \$543 deferred tax					833	833

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Unrealized securities gains, net of deferred taxes						26,380	26,380
Change in unrecognized loss on cash flow hedge, net of \$1,406 deferred tax benefit						(2,155)	(2,155)
Change in prepaid pension asset, net of \$5,190 deferred tax						8,063	8,063
Total comprehensive income							140,905
Cash dividends						(11,478)	(11,478)
Balance at December 31, 2007	\$ 8,757	\$ 1,678	\$ 143,766	\$ 1,246,473	\$	40,534	\$ 1,441,208

At December 31, 2007, Accumulated Other Comprehensive Income includes \$33,209 in unrealized gains on investment securities available for sale, \$10,565 in pension asset recognized under FASB Statement No. 158, and an unrealized loss of \$3,240 on a cash flow hedge.

See accompanying Notes to Consolidated Financial Statements.

**Table of Contents****CONSOLIDATED STATEMENTS OF CASH FLOWS****First Citizens BancShares, Inc. and Subsidiaries**

	2007	For the Year Ended 2006 (thousands)	2005
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 108,617	\$ 126,491	\$ 112,862
Adjustments to reconcile net income to cash provided by operating activities:			
Amortization of intangibles	2,142	2,318	2,453
Provision for credit losses	33,594	20,922	33,514
Deferred tax expense (benefit)	1,597	694	(1,573)
Change in current taxes payable	497	5,394	1,581
Depreciation	51,822	48,286	45,075
Change in accrued interest payable	(1,091)	19,777	15,005
Change in income earned not collected	(7,781)	(9,526)	(14,305)
Securities losses (gains)	(1,376)	659	492
Origination of loans held for sale	(509,655)	(488,220)	(535,897)
Proceeds from sale of loans	507,591	508,883	731,913
Loss (gain) on sale of loans	633	(1,246)	(4,680)
Gain on sale of branches		(826)	
Loss on premises and equipment, net	1,886	272	
Net amortization of premiums and discounts	(4,175)	(5,307)	(1,436)
Net change in other assets	(28,415)	(12,793)	1,779
Net change in other liabilities	6,509	366	(15,100)
Net cash provided by operating activities	162,395	216,144	371,683
<b>INVESTING ACTIVITIES</b>			
Net change in loans outstanding	(717,401)	(654,312)	(511,261)
Purchases of investment securities held to maturity		(26,074)	(264,700)
Purchases of investment securities available for sale	(1,661,277)	(1,265,212)	(1,334,214)
Proceeds from maturities of investment securities held to maturity	211,816	444,807	507,119
Proceeds from maturities of investment securities available for sale	1,480,591	573,429	277,939
Proceeds from sales of securities	1,392	994	
Net change in overnight investments	82,388	132,415	(97,269)
Dispositions of premises and equipment	2,164	6,438	9,542
Additions to premises and equipment	(106,482)	(118,694)	(123,948)
Purchase and sale of branches, net of cash transferred		(19,450)	18,343
Net cash used by investing activities	(706,809)	(925,659)	(1,518,449)
<b>FINANCING ACTIVITIES</b>			
Net change in time deposits	341,399	590,132	603,248
Net change in demand and other interest-bearing deposits	(156,179)	(113)	198,855
Net change in short-term borrowings	154,440	345,715	329,386
Origination of long-term obligations	180	121,408	125,000
Redemption of long-term obligation	(1,144)	(103,093)	
Cash dividends paid	(11,478)	(11,478)	(11,478)
Net cash provided by financing activities	327,218	942,571	1,245,011



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Change in cash and due from banks	(217,196)	233,056	98,245
Cash and due from banks at beginning of period	1,010,984	777,928	679,683
Cash and due from banks at end of period	\$ 793,788	\$ 1,010,984	\$ 777,928
CASH PAYMENTS FOR:			
Interest	\$ 424,805	\$ 373,514	\$ 203,146
Income taxes	57,765	61,795	65,860
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Unrealized securities gains (losses)	\$ 43,290	\$ 11,446	\$ (10,808)
Unrealized loss on cash flow hedge	(3,561)	(1,793)	
Prepaid pension benefit	13,253	4,112	

See accompanying Notes to Consolidated Financial Statements.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollars in thousands)**

**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation and Consolidation**

First Citizens BancShares, Inc. (BancShares) is a financial holding company with two banking subsidiaries: First-Citizens Bank & Trust Company, headquartered in Raleigh, North Carolina (FCB), which operates branches in North Carolina, Virginia, West Virginia, Maryland and Tennessee; and IronStone Bank (ISB), a federally-chartered thrift institution with branch offices in Florida, Georgia, Texas, Arizona, California, New Mexico, Colorado, Oregon and Washington. ISB also operates loan production offices in certain of these states as well as Missouri and plans to open additional loan production offices during 2008 in Oklahoma and Kansas.

FCB and ISB offer full-service banking services designed to meet the needs of retail and commercial customers in the markets in which they operate. The services offered include transaction and savings deposit accounts, commercial and consumer lending, trust, asset management and broker-dealer services, insurance services and other activities incidental to commercial banking. BancShares is also the parent company of Neuse, Incorporated, which owns some of the real property from which ISB operates its branches.

FCB has other subsidiaries that support its full-service banking operation. First Citizens Investor Services and IronStone Securities are registered broker-dealers in securities that provide investment services, including sales of annuities and third party mutual funds. Neuse Financial Services, Inc. is a title insurance agency.

On January 1, 2007, American Guaranty Insurance Company (AGI), a property and casualty insurance company, and Triangle Life Insurance Company (TLI), a credit life and credit accident and health insurance company were sold to an unrelated party.

The accounting and reporting policies of BancShares and its subsidiaries are in accordance with accounting principles generally accepted in the United States of America and, with regard to the banking subsidiaries, conform to general industry practices. The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates made by BancShares in the preparation of its consolidated financial statements are the determination of the allowance for credit losses, pension plan assumptions and income taxes.

Intercompany accounts and transactions have been eliminated. Certain amounts for prior years have been reclassified to conform to statement presentations for 2007. However, the reclassifications have no effect on shareholders' equity or net income as previously reported.

### **Investment Securities**

Investment securities available for sale are carried at their fair value with unrealized gains and losses, net of deferred income taxes, recorded as a component of other comprehensive income within shareholders' equity. Gains and losses realized from the sales of securities available for sale are determined by specific identification and are included in noninterest income.

BancShares has the ability and the positive intent to hold investment securities held to maturity until the scheduled maturity date. These securities are stated at cost adjusted for amortization of premium and accretion of discount. Accreted discounts and amortized premiums are included in interest income on an effective yield basis.

Investment securities are periodically evaluated to determine whether the investment is other than temporarily impaired. If an investment security is determined to be other than temporarily impaired, the security is written down to its fair value with an offsetting securities loss.

At December 31, 2007 and 2006, BancShares had no investment securities held for trading purposes.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Dollars in thousands)**

**Overnight Investments**

Overnight investments include federal funds sold and interest-bearing demand deposit balances in other banks.

**Loans and Leases**

Loans and leases that are held for investment purposes are carried at the principal amount outstanding. Loans that are classified as held for sale are carried at the lower of aggregate cost or fair value. Interest on substantially all loans is accrued and credited to interest income on a constant yield basis based upon the daily principal amount outstanding.

**Loan Fees**

Fees collected and certain costs incurred related to loan originations are deferred and amortized as an adjustment to interest income over the life of the related loans. Deferred fees and costs are recorded as an adjustment to loans outstanding using a method that approximates a constant yield.

**Allowance for Loan and Lease Losses and Reserve for Unfunded Commitments**

The allowance for loan and lease losses (ALLL) represents management's estimate of probable credit losses within the loan and lease portfolio. The reserve for unfunded commitments (RUC) represents the estimate of probable credit losses among off-balance sheet loan commitments. Adjustments to the ALLL and the RUC are established by charges to the provision for credit losses. To determine the appropriate amount of the ALLL and RUC, management evaluates the risk characteristics of the loan and lease portfolio and outstanding loan commitments under current economic conditions and considers such factors as the financial condition of the borrower, fair value of collateral and other items that, in management's opinion, deserve current recognition in estimating credit losses.

Management considers the established ALLL adequate to absorb probable losses that relate to loans and leases outstanding as of December 31, 2007. Management considers the established RUC adequate to absorb probable losses that relate to off-balance sheet loan commitments

outstanding as of December 31, 2007. Future adjustments to the ALLL and the RUC may be necessary based on changes in economic and other conditions. Additionally, various regulatory agencies, as an integral part of their examination process, periodically review BancShares' ALLL and the RUC. Such agencies may require the recognition of adjustments to the ALLL and RUC based on their judgments of information available to them at the time of their examination.

#### **Nonaccrual Loans, Impaired Loans and Other Real Estate**

Accrual of interest on certain residential mortgage loans is discontinued when the loan is more than three payments past due. Accrual of interest on all other loans and leases is discontinued when management deems that collection of additional principal or interest is doubtful. Residential mortgage loans return to an accrual status when the loan balance is less than three payments past due. Other loans and leases are returned to an accrual status when both principal and interest are current and the loan is determined to be performing in accordance with the applicable terms.

Management considers a loan to be impaired when based on current information and events, it is probable that a borrower will be unable to pay all amounts due according to contractual terms of the loan agreement. Impaired loans are valued by either the discounted expected cash flow method using the loan's original effective interest rate or the collateral value. When the ultimate collectibility of an impaired loan's principal is doubtful, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has been foregone.

Other real estate is valued at the lower of the loan balance at the time of foreclosure or estimated fair value net of selling costs and is included in other assets. Once acquired, other real estate is periodically reviewed to ensure that the fair value of the property supports the carrying value, with writedowns recorded when necessary. Gains and losses resulting from the sale or writedown of other real estate and income and expenses related to the operation of other real estate are recorded in other expense.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Dollars in thousands)**

**Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation and amortization. For financial reporting purposes, depreciation and amortization are computed by the straight-line method and are expensed over the estimated useful lives of the assets, which range from 25 to 40 years for premises and three to 10 years for furniture, software and equipment. Leasehold improvements are amortized over the terms of the respective leases or the useful lives of the improvements, whichever is shorter. Gains and losses on dispositions are recorded in other expense. Maintenance and repairs are charged to occupancy expense or equipment expense as incurred.

**Goodwill and Other Intangible Assets**

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is tested at least annually for impairment.

Other intangible assets with estimable lives are amortized on a straight-line basis over their estimated useful lives, which are periodically reviewed for reasonableness.

**Income Taxes**

Income tax expense is based on income before income taxes and generally differs from income taxes paid due to deferred income taxes and benefits arising from income and expenses being recognized in different periods for financial and income tax reporting purposes. BancShares uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of BancShares' assets and liabilities at enacted rates expected to be in effect when such amounts are realized or settled.

BancShares continually monitors and evaluates the potential impact of current events on the estimates used to establish income tax expenses and income tax liabilities. On a periodic basis, BancShares evaluates its income tax positions based on current tax law, positions taken by various tax auditors within the jurisdictions that BancShares is required to file income tax returns, as well as potential or pending audits or assessments by such tax auditors.

BancShares and its subsidiaries file a consolidated federal income tax return. BancShares and its subsidiaries each file separate state income tax returns except where unitary filing is required.

### **Derivative Financial Instruments**

Derivative financial instruments include interest rate swaps, caps, floors, collars, options or other financial instruments designed to hedge exposures to interest rate risk or for speculative purposes. During 2006, BancShares entered into an interest rate swap that is a cash flow derivative under Statement of Financial Accounting Standards No. 133. The derivative is valued each quarter, and changes in the fair value are recorded on the consolidated balance sheet with an offset to other comprehensive income for the effective portion and an offset to the consolidated statements of income for any ineffective portion. The assessment of effectiveness is performed using the long-haul method. There are no speculative derivative financial instruments in any period.

### **Per Share Data**

Net income per share has been computed by dividing net income by the average number of both classes of common shares outstanding during each period. The average number of shares outstanding for 2007, 2006 and 2005 was 10,434,453. BancShares had no potential common stock outstanding in any period.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Dollars in thousands)**

Cash dividends per share apply to both Class A and Class B common stock. Shares of Class A common stock carry one vote per share, while shares of Class B common stock carry 16 votes per share.

**Current Accounting Matters**

In June 2006, the FASB issued Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies uncertainty in income taxes recognized by establishing a recognition threshold and a measurement attribute for the financial statement treatment of a tax position taken or expected to be taken in a tax return. We adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 resulted in a reduction in the liability for unrecognized tax benefits, resulting in a \$962 increase to the beginning balance of retained earnings.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 Fair Value Measurements (Statement 157). Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 does not require any new fair value measurements, but clarifies and standardizes some divergent practices that have emerged since prior guidance was issued. Statement 157 creates a three-level hierarchy under which individual fair value estimates are to be ranked based on the relative reliability of the inputs used in the valuation. This hierarchy is the basis for the disclosure requirements, with fair value estimates based on the least reliable inputs requiring more extensive disclosures about the valuation method used and the gains and losses associated with those estimates. BancShares adopted Statement 157 on January 1, 2008, with no material impact on the financial condition, results of operations, or liquidity.

In September 2006, the FASB issued Summary of Statement No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (Statement 158). Statement 158 requires sponsors of defined benefit and other post-retirement plans to recognize the overfunded or underfunded status of that plan as an asset or liability in the sponsor's statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Statement 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, although that requirement is not effective until 2008.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities (Statement 159). Statement 159 allows an entity to elect to measure certain financial assets and liabilities at fair value with changes in fair value recognized in the income statement each period. The statement also requires additional disclosures to identify the effects of an entity's fair value election on its earnings. BancShares adopted Statement 159 on January 1, 2008, with no material impact on financial condition, results of operations, or liquidity.



**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)****NOTE B INVESTMENT SECURITIES**

The aggregate values of investment securities at December 31 along with gains and losses determined on an individual security basis are as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Investment securities available for sale</b>				
2007				
U. S. Government	\$ 3,129,743	\$ 30,209	\$ 1,110	\$ 3,158,842
Equity securities	33,614	24,023		57,637
State, county and municipal	3,377	11	16	3,372
Other	7,771	1,619		9,390
<b>Total investment securities available for sale</b>	<b>\$ 3,174,505</b>	<b>\$ 55,862</b>	<b>\$ 1,126</b>	<b>\$ 3,229,241</b>
2006				
U. S. Government	\$ 2,940,810	\$ 1,218	\$ 16,338	\$ 2,925,690
Equity securities	35,171	26,532		61,703
State, county and municipal	4,290	10	43	4,257
Other	10,173	67		10,240
<b>Total investment securities available for sale</b>	<b>\$ 2,990,444</b>	<b>\$ 27,827</b>	<b>\$ 16,381</b>	<b>\$ 3,001,890</b>
<b>Investment securities held to maturity</b>				
2007				
U. S. Government	\$ 5,760	\$ 109	\$ 26	\$ 5,843
State, county and municipal	1,584	99		1,683
Other	250			250
<b>Total investment securities held to maturity</b>	<b>\$ 7,594</b>	<b>\$ 208</b>	<b>\$ 26</b>	<b>\$ 7,776</b>
2006				
U. S. Government	\$ 217,330	\$ 54	\$ 1,008	\$ 216,376
State, county and municipal	1,578	129		1,707
Other	250			250
<b>Total investment securities held to maturity</b>	<b>\$ 219,158</b>	<b>\$ 183</b>	<b>\$ 1,008</b>	<b>\$ 218,333</b>

The following table provides maturity information for investment securities at December 31. Callable securities are assumed to mature on their earliest call date.

	2007		2006	
	Cost	Fair Value	Cost	Fair Value
<b>Investment securities available for sale</b>				
Maturing in:				
One year or less	\$ 1,668,239	\$ 1,676,017	\$ 1,515,069	\$ 1,504,843
One through five years	1,380,012	1,401,718	1,369,763	1,366,267
Five through 10 years	6,791	6,782	6,807	6,572
Over 10 years	85,849	87,087	63,634	62,505
Equity securities	33,614	57,637	35,171	61,703
Total investment securities available for sale	\$ 3,174,505	\$ 3,229,241	\$ 2,990,444	\$ 3,001,890
<b>Investment securities held to maturity</b>				
Maturing in:				
One year or less	\$ 250	\$ 250	\$ 210,232	\$ 209,296
One through five years	149	153	401	407
Five through 10 years	5,563	5,612	46	46
Over 10 years	1,632	1,761	8,479	8,584
Total investment securities held to maturity	\$ 7,594	\$ 7,776	\$ 219,158	\$ 218,333

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

The amount of securities gains (losses) reported includes the following:

	Year ended December 31,		
	2007	2006	2005
Gross gains on sales of investment securities available for sale	\$ 1,376	\$ 328	\$
Other than temporary impairment losses		(987)	(469)
Other			(23)
 Total securities gains (losses)	 \$ 1,376	 \$ (659)	 \$ (492)

In conjunction with the securitization and sale of revolving mortgage loans during 2005, BancShares retained a residual interest in the securitized assets in the form of an interest-only strip, which is included within investment securities available for sale and is carried at its estimated fair value. Quoted market prices are not readily available for residual interests, so the fair value was estimated based on various factors that may have an impact on the fair value of the residual interests. The assumed discount rate was 10 percent; the assumed rate of credit losses was 10 basis points; the estimated weighted average loan life was 3.3 years. Based on the assumptions used, the estimated fair value of the retained residual interest equaled \$11,586 at the date of the securitization. Based on changes that occurred after the date of the securitization, other than temporary impairments were recorded during 2006 and 2005. The carrying value of the residual interest was \$9,390 at December 31, 2007, \$10,240 at December 31, 2006 and \$11,902 at December 31, 2005.

The following table provides additional information regarding unrealized losses as of December 31:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2007</b>						
Investment securities available for sale:						
U.S. Government	\$ 145,612	\$ 237	\$ 208,711	\$ 873	\$ 354,323	\$ 1,110
Equity securities						
State, county and municipal	25		2,163	16	2,188	16
 Total	 \$ 145,637	 \$ 237	 \$ 210,874	 \$ 889	 \$ 356,511	 \$ 1,126
Investment securities held to maturity:						
U.S. Government	\$	\$	\$ 48	\$ 26	\$ 48	\$ 26
State, county and municipal						

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Other

Total	\$	\$	\$ 48	\$ 26	\$ 48	\$ 26
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**December 31, 2006**

Investment securities available for sale:

U.S. Government	\$ 835,311	\$ 2,867	\$ 1,635,549	\$ 13,471	\$ 2,470,860	\$ 16,338
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Equity securities

State, county and municipal	389	1	3,080	42	3,469	43
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Total	\$ 835,700	\$ 2,868	\$ 1,638,629	\$ 13,513	\$ 2,474,329	\$ 16,381
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Investment securities held to maturity:

U.S. Government	\$	\$	\$ 209,451	\$ 1,008	\$ 209,451	\$ 1,008
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State, county and municipal

Other

Total	\$	\$	\$ 209,451	\$ 1,008	\$ 209,451	\$ 1,008
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**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

Investment securities with an aggregate fair value of \$210,922 have had continuous unrealized losses for more than twelve months as of December 31, 2007. The aggregate amount of the unrealized losses among those 99 securities was \$915 at December 31, 2007. These securities include U.S. Government, government agency and state, county and municipal securities. The unrealized losses relate to fixed-rate debt securities that have incurred fair value reductions due to higher market interest rates since the respective purchase date. The unrealized losses are not likely to reverse unless and until market interest rates decline to the levels that existed when the securities were purchased. Since none of the unrealized losses relate to the marketability of the securities or the issuer's ability to honor redemption obligations, none of the securities are deemed to be other than temporarily impaired.

Investment securities having an aggregate carrying value of \$2,402,221 at December 31, 2007 and \$2,401,839 at December 31, 2006, were pledged as collateral to secure public funds on deposit, to secure certain short-term borrowings and for other purposes as required by law.

**NOTE C LOANS AND LEASES**

Loans and leases outstanding at December 31 include the following:

	2007	2006
Real estate:		
Construction and land development	\$ 810,818	\$ 783,680
Commercial mortgage	3,982,496	3,725,752
Residential mortgage	1,029,030	1,025,235
Revolving mortgage	1,494,431	1,326,403
Other mortgage	145,552	165,223
<b>Total real estate loans</b>	<b>7,462,327</b>	<b>7,026,293</b>
Commercial and industrial	1,707,394	1,526,818
Consumer	1,368,228	1,360,524
Lease financing	340,601	294,366
Other	85,354	65,042
<b>Total loans and leases</b>	<b>\$ 10,963,904</b>	<b>\$ 10,273,043</b>

During 2005, BancShares completed the securitization and sale of \$256,232 of its revolving mortgage loans. The transaction generated a pre-tax gain of \$2,874, which is included in other noninterest income. BancShares continues to service the assets that were sold. The transaction was

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accounted for under the provisions of Statement of Financial Accounting Standards No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Statement 140). The transaction was completed using a Qualified Special Purpose Entity (QSPE) which, in accordance with Statement 140, is a legally isolated, bankruptcy remote entity beyond the control of the seller. The QSPE is therefore not included within the consolidated financial statements. BancShares received cash totaling \$240,399 from the sale, net of the \$7,816 of loans retained by the trust and \$8,017 for cash collections and fees retained by the advisors.

In conjunction with the securitization and sale, BancShares established a servicing asset that represented the estimated fair value of the right to service the loans that were securitized and sold. This asset is being amortized over the estimated servicing life of 149 months.

	2007	2006	2005
Carrying value of servicing asset at January 1	\$ 936	\$ 1,179	\$
Servicing asset created from securitization and sale			1,401
Amortization expense recognized during the year	187	243	222
Impairment recognized during the year	190		
Carrying value of servicing asset at December 31	\$ 559	\$ 936	\$ 1,179

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

At December 31, 2007, 20.6 percent of total loans and leases represent loans to customers in medical-related fields, compared to 18.7 percent at December 31, 2006. There were no foreign loans outstanding during either period, nor were there any loans to finance highly leveraged transactions. Substantially all loans and leases are to customers domiciled within BancShares' principal market areas.

At December 31, 2007 loans totaling \$245,165 were pledged to secure debt obligations, compared to \$274,692 at December 31, 2006.

At December 31, 2007 and 2006 nonperforming loans and leases totaled \$13,021 and \$14,882, respectively, all of which are nonaccrual. Gross interest income on nonperforming loans that would have been recorded had these loans been performing was \$1,200, \$1,271 and \$551, respectively, during 2007, 2006 and 2005. Interest income recognized on nonperforming loans was \$465, \$226 and \$821 during the respective periods. As of December 31, 2007 and 2006, the balance of other real estate was \$6,893 and \$6,028. Loans transferred to other real estate totaled \$4,779, \$4,338 and \$6,431 during 2007, 2006 and 2005. Loans past due 90 days or more and still accruing totaled \$7,124 and \$5,185 at December 31, 2007 and 2006, respectively.

In each period, BancShares originated much of its residential mortgage loan production through correspondent mortgage banks. Loan sale activity for 2007, 2006 and 2005 is summarized below:

	2007	2006	2005
Loans held for sale at December 31	\$ 75,822	\$ 80,805	\$ 90,923
For the year ended December 31:			
Loans sold	508,224	507,637	727,233
Net gain (loss) on sale of loans	(633)	1,246	4,680

**NOTE D ALLOWANCE FOR CREDIT LOSSES**

Activity in the allowance for credit losses, which includes the allowance for loan and lease losses and the reserve for unfunded commitments, is summarized as follows:

	Allowance for Loan and Lease Losses	Reserve for Unfunded Commitments	Allowance for Credit Losses
Balance at December 31, 2004	\$ 123,861	\$ 6,971	\$ 130,832

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Allowance released from sale of loans	(1,537)	(48)	(1,585)
Provision for credit losses	33,514		33,514
Loans and leases charged off	(32,911)		(32,911)
Loans and leases recovered	5,920		5,920
Net charge-offs	(26,991)		(26,991)
Balance at December 31, 2005	128,847	6,923	135,770
Provision for credit losses	21,203	(281)	20,922
Loans and leases charged off	(24,353)		(24,353)
Loans and leases recovered	6,307		6,307
Net charge-offs	(18,046)		(18,046)
Balance at December 31, 2006	132,004	6,642	138,646
Provision for credit losses	32,939	655	33,594
Loans and leases charged off	(32,690)		(32,690)
Loans and leases recovered	4,721		4,721
Net charge-offs	(27,969)		(27,969)
Balance at December 31, 2007	\$ 136,974	\$ 7,297	\$ 144,271



**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

At December 31, 2007 and 2006, impaired loans, exclusive of those loans evaluated collectively as a homogeneous group, totaled \$10,621 and \$11,557, respectively, all of which were classified as nonaccrual. Total allowances of \$2,148 and \$1,874 have been established for impaired loans outstanding as of December 31, 2007 and 2006, respectively. Allowances have been established for all impaired loans.

The average recorded investment in impaired loans during the years ended December 31, 2007, 2006 and 2005 was \$10,844, \$13,986 and \$8,480, respectively. For the years ended December 31, 2007, 2006 and 2005, BancShares recognized cash basis interest income on those impaired loans of \$391, \$153 and \$113 respectively.

During early 2008, due to deteriorating borrower cash flow and recognition of reductions in collateral value, we identified \$23,067 in residential construction loans where collection of additional interest is doubtful. These loans were placed on nonaccrual status during the first quarter of 2008. Allowances associated with these loans totaled \$1,202 following their classification as nonaccrual.

**NOTE E PREMISES AND EQUIPMENT**

Major classifications of premises and equipment at December 31 are summarized as follows:

	<b>2007</b>	<b>2006</b>
Land	\$ 163,314	\$ 152,313
Premises and leasehold improvements	656,640	595,325
Furniture and equipment	297,193	273,866
 Total	 1,117,147	 1,021,504
Less accumulated depreciation and amortization	359,453	318,578
 Total premises and equipment	 \$ 757,694	 \$ 702,926

There were no premises pledged to secure borrowings at December 31, 2007 and 2006.

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BancShares leases certain premises and equipment under various lease agreements that provide for payment of property taxes, insurance and maintenance costs. Generally, operating leases provide for one or more renewal options on the same basis as current rental terms. However, certain leases require increased rentals under cost of living escalation clauses. Some leases also provide purchase options.

Future minimum rental commitments for noncancellable operating leases with initial or remaining terms of one or more years consisted of the following at December 31, 2007:

Year Ending December 31:	
2008	\$ 15,582
2009	13,079
2010	9,623
2011	8,417
2012	7,287
Thereafter	60,272
 Total minimum payments	 \$ 114,260

Total rent expense for all operating leases amounted to \$18,034 in 2007, \$15,207 in 2006 and \$14,433 in 2005, net of rent income, which totaled \$1,930, \$1,962 and \$1,977 during 2007, 2006 and 2005.

### NOTE F DEPOSITS

Deposits at December 31 are summarized as follows:

	2007	2006
Demand	\$ 2,519,256	\$ 2,682,997
Checking With Interest	1,459,123	1,600,925
Money market accounts	2,961,794	2,755,502
Savings	536,933	593,861
Time	5,451,438	5,110,039
 Total deposits	 \$ 12,928,544	 \$ 12,743,324

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

Time deposits with a minimum denomination of \$100 totaled \$2,323,768 and \$2,061,676 at December 31, 2007 and 2006, respectively.

At December 31, 2007 the scheduled maturities of time deposits were:

2008	\$ 4,816,609
2009	293,236
2010	142,028
2011	128,415
2012	58,692
Thereafter	12,458
<b>Total time deposits</b>	<b>\$ 5,451,438</b>

**NOTE G SHORT-TERM BORROWINGS**

Short-term borrowings at December 31 are as follows:

	<b>2007</b>	<b>2006</b>
Master notes	\$ 923,424	\$ 741,029
Repurchase agreements	286,090	251,135
Notes payable to Federal Home Loan Bank of Atlanta	50,000	75,000
Federal funds purchased	23,893	66,066
Other	21,880	17,617
<b>Total short-term borrowings</b>	<b>\$ 1,305,287</b>	<b>\$ 1,150,847</b>

At December 31, 2007, BancShares and its subsidiaries had unused credit lines allowing access to overnight borrowings of up to \$525,000 on an unsecured basis. Additionally, under various borrowing arrangements with the Federal Reserve and the Federal Home Loan Bank of Atlanta, BancShares and its subsidiaries have access, on a secured basis, to additional borrowings as needed.

**NOTE H LONG-TERM OBLIGATIONS**

Long-term obligations at December 31 include:

	2007	2006
Junior subordinated debenture at 8.05 percent maturing March 5, 2028	\$ 154,640	\$ 154,640
Junior subordinated debenture at 3-month LIBOR plus 1.75 percent maturing June 30, 2036	118,557	118,557
Subordinated notes payable at 5.125 percent maturing June 1, 2015	125,000	125,000
Obligations under capitalized leases extending to July 2026	6,015	3,001
Note payable at 7.50 percent maturing on October 17, 2022	180	
 Total long-term obligations	 \$ 404,392	 \$ 401,198

The 8.05 percent junior subordinated debenture issued in 1998 (the 1998 Debenture) is held by FCB/NC Capital Trust I. FCB/NC Capital Trust I purchased the 1998 Debenture with the proceeds from the \$150,000 in 8.05 percent trust preferred capital securities issued in 1998 (the 1998 Preferred Securities). The 1998 Debenture is the sole asset of the trust. The 1998 Preferred Securities are redeemable in whole or in part after March 1, 2008 at a premium that declines until 2018, when the redemption price equals the par value.

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

The variable rate junior subordinated debenture issued in 2006 (the 2006 Debenture) is held by FCB/NC Capital Trust III. FCB/NC Capital Trust III purchased the 2006 Debenture with the proceeds from the \$115,000 in adjustable rate trust preferred securities issued in 2006 (the 2006 Preferred Securities). The 2006 Debenture is the sole asset of the trust. The 2006 Preferred Securities are redeemable in whole or in part after June 30, 2011.

The 2006 Preferred Securities and the 2006 Debenture were issued with a variable rate of 175 basis points above the 3-month LIBOR. During the second quarter of 2006, BancShares entered into an interest rate swap to synthetically convert the variable rate coupon on the securities to a fixed rate of 7.125 percent for a period of five years.

FCB/NC Capital Trust I and FCB/NC Capital Trust III are grantor trusts established by BancShares for the purpose of issuing trust preferred capital securities.

The subordinated notes issued during 2005 are unsecured obligations of FCB and are junior to existing and future senior indebtedness and obligations to depositors and general or secured creditors.

Long-term obligations maturing in each of the five years subsequent to December 31, 2007 include:

2008	\$ 1,273
2009	330
2010	353
2011	379
2012	405
Thereafter	401,652
<b>Total long-term obligations</b>	<b>\$ 404,392</b>

**NOTE I ESTIMATED FAIR VALUES**

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Fair value estimates are made at a specific point in time based on relevant market information and information about each financial instrument. Where information regarding the fair value of a financial instrument is available, those values are used, as is the case with investment securities and residential mortgage loans. In these cases, an open market exists in which those financial instruments are actively traded.

Because no market exists for many financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. For these financial instruments with a fixed interest rate, an analysis of the related cash flows was the basis for estimating fair values. The expected cash flows were then discounted to the valuation date using an appropriate discount rate. The discount rates used represent the rates under which similar transactions would be currently negotiated. Generally, the fair value of variable rate financial instruments equals the book value.

	December 31, 2007		December 31, 2006	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and due from banks	\$ 793,788	\$ 793,788	\$ 1,010,984	\$ 1,010,984
Overnight investments	266,209	266,209	348,597	348,597
Investment securities available for sale	3,229,241	3,229,241	3,001,890	3,001,890
Investment securities held to maturity	7,594	7,776	219,158	218,333
Loans, net of allowance for loan and lease losses	10,826,930	11,242,024	10,141,039	9,944,260
Income earned not collected	79,343	79,343	71,562	71,562
Deposits	12,928,544	12,989,047	12,743,324	12,805,792
Short-term borrowings	1,305,287	1,305,287	1,150,847	1,150,847
Long-term obligations	404,392	406,639	401,198	403,488
Accrued interest payable	62,288	62,288	63,379	63,379

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Dollars in thousands)**

At December 31, 2007, the \$115,000 interest rate swap had a fair value of \$5,354, which is included in other liabilities. At December 31, 2006, the fair value of the swap was \$1,793.

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

**NOTE J EMPLOYEE BENEFIT PLANS**

BancShares sponsors benefit plans for its qualifying employees including a noncontributory defined benefit pension plan and a 401(k) savings plan. Both of the plans are qualified under the Internal Revenue Code. BancShares also maintains agreements with certain executives that provide supplemental benefits that are paid upon death or separation from service at an agreed-upon age.

*Defined Benefit Pension Plan*

Employees who qualify under length of service and other requirements participate in a noncontributory defined benefit pension plan. Under the plan, benefits are based on years of service and average earnings. The policy is to fund amounts approximating the maximum amount that is deductible for federal income tax purposes. BancShares contributed \$20,000 in 2007, \$25,000 in 2006 and \$30,000 in 2005. The plan's assets consist of investments in FCB's common trust funds, which include listed common stocks and fixed income securities, as well as investments in mid-cap, small-cap, REIT and international stocks through unaffiliated money managers.

BancShares discontinued offering benefits under the defined benefit pension plan to employees hired after March 31, 2007. Employees hired on or before March 31, 2007 were allowed the option of continued participation in the defined benefit plan and the existing 401(k) plan or enrollment in an enhanced 401(k) benefit plan beginning January 1, 2008. Employees who elected to enroll in the enhanced 401(k) benefit plan discontinued the accrual of additional years of service under the defined benefit plan after January 1, 2008. Based on the elections made by participants, a curtailment charge of \$763 was recorded during 2007.

*Benefit Obligations*

The following table calculates the projected benefit obligation at December 31, 2007 and 2006:

	<b>2007</b>	<b>2006</b>
Benefit obligation at beginning of year	\$ 300,981	\$ 296,709
Service cost	14,428	14,408
Interest cost	18,388	16,598
Actuarial gain	(16,571)	(16,200)
Transfer to related parties	(8)	(225)
Benefits paid	(10,767)	(10,309)
Plan amendments	1,064	
Benefit obligation at end of year	\$ 307,515	\$ 300,981

The accumulated benefit obligation for the plan at December 31, 2007 and 2006 equaled \$248,992 and \$242,130, respectively. The plan uses a measurement date of December 31.

The assumptions used to determine the benefit obligations as of December 31 are as follows:

	<b>2007</b>	<b>2006</b>
Discount rate	6.25%	5.75%
Rate of compensation increase	4.25%	4.25%



**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)***Plan Assets*

The following table describes the changes in plan assets during 2007 and 2006. Employer contributions and benefits paid include only those amounts contributed directly to or paid directly from plan assets.

	<b>2007</b>	<b>2006</b>
Fair value of plan assets at beginning of year	\$ 352,425	\$ 296,619
Actual return on plan assets	20,531	41,373
Employer contributions	20,000	25,000
Transfer to related parties	(9)	(258)
Benefits paid	(10,767)	(10,309)
Fair value of plan assets at end of year	\$ 382,180	\$ 352,425

The following table describes the actual allocation of plan assets as of December 31, 2007 and 2006 and the projected allocation for 2008. The expected long-term rate of return on plan assets was 8.50% at December 31, 2007 and 2006.

	<b>2008 Target</b>	<b>Actual, December 31,</b>	
		<b>2007</b>	<b>2006</b>
Equity securities	60%	59%	61%
Debt securities	40%	40%	38%
Cash and equivalents		1%	1%
Total	100%	100%	100%

Investment decisions regarding the plan's assets seek to achieve a favorable annual return through a diversified portfolio that will provide needed capital appreciation and cash flow to allow both current and future benefit obligations to be paid. The target asset mix may change if the objectives for the plan's assets or risk tolerance change or if a major shift occurs in the expected long-term risk and reward characteristics of one or more asset classes.

*Funded Status*

The funded status of the plan, which represents the prepaid pension asset included within other assets on the consolidated balance sheet, is:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Fair value of plan assets	\$ 382,180	\$ 352,425
Benefit obligation	307,515	300,981
<b>Funded status</b>	<b>74,665</b>	<b>51,444</b>
Amounts not yet recognized:		
Unrecognized net loss		
Unrecognized prior service cost		
<b>Net asset recognized</b>	<b>\$ 74,665</b>	<b>\$ 51,444</b>
Prepaid benefit cost	\$ 74,665	\$ 51,444
Accrued benefit cost		
<b>Net asset recognized</b>	<b>\$ 74,665</b>	<b>\$ 51,444</b>
Accumulated other comprehensive income, excluding income taxes		
Net gain	\$ 19,602	\$ 6,314
Less prior service cost	2,237	2,202
<b>Accumulated other comprehensive income, excluding income taxes</b>	<b>\$ 17,365</b>	<b>\$ 4,112</b>

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

At December 31, 2007 and 2006, the fair value of plan assets exceeded both the projected benefit obligation and the accumulated benefit obligation.

*Cash Flows*

During 2008, BancShares anticipates making contributions to the pension plan totaling \$10,000. Following are estimated payments to pension plan participants in the indicated periods:

	<b>Projected Benefit payments</b>
2008	\$ 10,581
2009	11,440
2010	12,441
2011	13,586
2012	14,971
2013-2017	97,879

*Net Periodic Cost*

The following table shows the components of periodic benefit cost related to the pension plan for the years ended December 31, 2007, 2006 and 2005.

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Service cost	\$ 14,428	\$ 14,408	\$ 13,504
Interest cost	18,388	16,598	16,101
Expected return on assets	(25,716)	(22,776)	(18,893)
Amortization of prior service cost	266	231	283
Amortization of net actuarial loss	1,902	2,924	2,836
Total net periodic benefit cost	9,268	11,385	13,831
Curtailment cost	763		

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Total net periodic benefit cost	\$ 10,031	\$ 11,385	\$ 13,831
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The assumptions used to determine the net periodic benefit cost for the years ended December 31, 2007, 2006 and 2005 are as follows:

	2007	2006	2005
Discount rate	5.75%	5.50%	5.75%
Rate of compensation increase	4.25%	4.25%	4.75%
Expected return on plan assets	8.50%	8.50%	8.50%

### *401(k) Savings Plan*

Employees are also eligible to participate in a 401(k) plan after 31 days of service through deferral of portions of their salary. Based on the employee's contribution, BancShares matches up to 75 percent of the employee contribution. BancShares made participating contributions of \$6,863, \$6,381 and \$5,965 during 2007, 2006 and 2005, respectively.

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)***Additional Benefits for Executives and Directors and Officers of Acquired Entities*

FCB and ISB have entered into contractual agreements with certain executives that provide payments for a period of ten years following separation from service at an agreed-upon age. These agreements also provide a death benefit in the event a participant dies before the term of the agreement ends. FCB has also assumed liability for contractual obligations to directors and officers of acquired entities.

The following table provides the accrued liability as of December 31, 2007 and 2006 and the changes in the accrued liability during the years then ended.

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Present value of accrued liability as of January 1	\$ 17,358	\$ 18,119
Benefit expense	1,491	
Benefits paid	(725)	(851)
Benefits forfeited	(213)	(475)
Interest cost	17	565
Present value of accrued liability as of December 31	\$ 17,928	\$ 17,358
Discount rate at December 31	6.25%	5.75%

**NOTE K NONINTEREST EXPENSE**

Other noninterest expense for the years ended December 31 included the following:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Cardholder and merchant processing	\$ 41,882	\$ 37,286	\$ 32,067
Cardholder reward programs	12,529	9,228	5,878
Telecommunications	10,501	9,844	9,873
Postage	9,614	8,926	8,045
Advertising	7,499	7,212	7,206
Processing fees paid to third parties	7,004	5,845	4,332

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Legal	6,410	5,244	4,124
Courier service	5,401	6,624	5,076
Other	63,894	57,308	58,553
Total other noninterest expense	\$ 164,734	\$ 147,517	\$ 135,154

**NOTE L INCOME TAXES**

At December 31, income tax expense consisted of the following:

	2007	2006	2005
Current tax expense			
Federal	\$ 53,794	\$ 62,389	\$ 59,190
State	3,546	6,372	8,191
Total current tax expense	57,340	68,761	67,381
Deferred tax expense (benefit)			
Federal	941	(146)	(2,120)
State	656	840	547
Total deferred tax expense (benefit)	1,597	694	(1,573)
Total income tax expense	\$ 58,937	\$ 69,455	\$ 65,808

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

Income tax expense differed from the amounts computed by applying the federal income tax rate of 35 percent to pretax income as a result of the following:

	2007	2006	2005
Income taxes at statutory rates	\$ 58,644	\$ 68,581	\$ 62,535
Increase (reduction) in income taxes resulting from:			
Nontaxable income on loans, leases and investments, net of nondeductible expenses	(1,419)	(1,053)	(797)
State and local income taxes, including change in valuation allowance, net of federal income tax benefit	2,731	4,688	5,680
Tax credits	(1,771)	(1,645)	(1,128)
Other, net	752	(1,116)	(482)
<b>Total income tax expense</b>	<b>\$ 58,937</b>	<b>\$ 69,455</b>	<b>\$ 65,808</b>

The net deferred tax asset included the following components at December 31:

	2007	2006
Allowance for loan and lease losses	\$ 54,664	\$ 52,414
Executive separation from service agreements	7,064	6,833
State operating loss carryforward	1,249	959
Unrealized loss on cash flow hedge	2,114	708
FIN48 gross-up	9,761	
Other	6,588	5,080
<b>Gross deferred tax asset</b>	<b>81,440</b>	<b>65,994</b>
Less valuation allowance	785	694
<b>Deferred tax asset</b>	<b>80,655</b>	<b>65,300</b>
Accelerated depreciation	5,693	7,085
Lease financing activities	11,783	12,825
Pension asset	29,422	20,292
Net unrealized gains (losses) included in comprehensive income	21,402	4,576
Net deferred loan fees and costs	5,444	4,533
Intangible asset	9,460	8,023
Other	5,541	3,610

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Deferred tax liability	88,745	60,944
Net deferred tax (liability) asset	\$ (8,090)	\$ 4,356

The valuation allowance necessary to reduce BancShares' gross state deferred tax asset to the amount that is more likely than not to be realized was \$785 and \$694 at December 31, 2007 and 2006, respectively.

With few exceptions, BancShares and its subsidiaries are no longer subject to U.S. federal, or state and local income tax examinations by tax authorities for years before 2004.

BancShares adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN48), on January 1, 2007. As a result of the implementation of FIN48, BancShares recognized a \$962 decrease in the liability for unrecognized income tax benefits, which was accounted for as an increase to the beginning balance of retained earnings during 2007.



**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

A reconciliation of the beginning and ending amount of unrecognized income tax benefits follows. Unrecognized state tax benefits are not adjusted for the impact of federal taxes.

	<b>2007</b>
Unrecognized tax benefits at beginning of year	\$ 10,068
Additions based on tax positions related to current year	2,586
Additions based on tax positions related to prior years	2,792
Reductions based on lapse of statute	(4,106)
Settlements	
Unrecognized tax benefits at end of year	\$ 11,340

Included in the balance at December 31, 2007, are \$9,761 of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Additions based on tax positions related to prior years primarily relate to interest. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The total amount of unrecognized income tax benefits as of January 1, 2007 and December 31, 2007 that, if recognized, would affect the effective tax rate is \$1,178 and \$1,579 (net of the federal benefit on state tax issues) respectively.

BancShares recognizes accrued interest and penalties related to unrecognized tax benefits in tax expense. Accrued interest and penalties on unrecognized income tax benefits totaled \$700 and \$800 as of January 1, 2007 and December 31, 2007 respectively.

**NOTE M TRANSACTIONS WITH RELATED PERSONS**

BancShares, FCB and ISB have had, and expect to have in the future, banking transactions in the ordinary course of business with directors, officers and their associates (Related Persons). An analysis of changes in the aggregate amounts of loans to Related Persons for the year ended December 31, 2007 is as follows:

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Balance at beginning of year	\$ 34,660
New loans	16,242
Repayments	12,722
Balance at end of year	\$ 38,180

In addition to these outstanding loan balances there is \$20,496 available to Related Persons in unfunded loan commitments.

BancShares provides processing and operational services to other financial institutions. Certain of these institutions are deemed to be Related Persons since significant shareholders of BancShares are also deemed to be significant shareholders of the other banks. During 2007, 2006 and 2005, BancShares received \$29,234, \$26,057 and \$23,961, respectively, for services rendered to these Related Persons, substantially all of which is included in fees from processing services and relates to data processing services. The amount recorded from the largest individual institution totaled \$17,960, \$16,914 and \$14,433 for 2007, 2006 and 2005, respectively.

Other expense includes \$3,773, \$4,376 and \$4,299 in legal expense incurred during 2007, 2006 and 2005, respectively, for the firm that serves as BancShares' general counsel. The senior attorney of that firm is a Related Person since he is member of BancShares' board of directors.

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

Investment securities available for sale includes an investment in a financial institution controlled by Related Persons. This investment had a carrying value of \$23,788 and \$25,085 at December 31, 2007 and 2006, respectively. For each period, the investment had a cost of \$508. Short-term borrowings includes \$13,700 and \$41,300 in federal funds purchased from financial institutions controlled by Related Persons at December 31, 2007 and 2006.

**NOTE N BUSINESS COMBINATIONS**

On January 1, 2007, BancShares completed the sale of American Guaranty Insurance Company and Triangle Life Insurance Company. During the fourth quarter of 2006, BancShares completed the sale of the principal assets of T-TECH, Inc. (T-TECH). T-TECH provided payment processing services to third parties. T-TECH was subsequently dissolved. These transactions did not have a material impact on the consolidated financial statements.

BancShares and its banking subsidiaries have participated in various business transactions involving branch offices. All of the acquisitions have been accounted for as purchases, with the results of operations included in BancShares consolidated financial statements after the transaction date.

The following table provides information regarding the acquisitions and divestitures of branches that have been consummated during the three-year period ended December 31, 2007:

<b>Year</b>	<b>Transaction</b>	<b>Assets<sup>1</sup></b>	<b>Deposits</b>
2006	Sale of one branch by First Citizens Bank	\$ (278)	\$ (20,553)
2005	Purchase of one branch by First Citizens Bank	1,783	20,957

-

<sup>1</sup> Excludes the transfer of cash and recognition of goodwill and intangible assets

The pro forma impact of the acquisitions and divestitures as though they had been made at the beginning of the periods presented is not material to BancShares consolidated financial statements.

**NOTE O GOODWILL AND INTANGIBLE ASSETS**

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The following table summarizes goodwill activity during 2007 and 2006:

	<b>2007</b>	<b>2006</b>
Balance, January 1	\$ 102,625	\$ 102,735
Goodwill written off due to sale of branch		(110)
Balance, December 31	\$ 102,625	\$ 102,625

The following information relates to other intangible assets, all of which are being amortized over their estimated useful lives:

	<b>2007</b>	<b>2006</b>
Balance, January 1	\$ 8,000	\$ 10,318
Amortization	(2,142)	(2,318)
Balance, December 31	\$ 5,858	\$ 8,000

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

Based on current estimated useful lives and current carrying values, BancShares anticipates amortization expense for intangible assets in subsequent periods will be:

2008	\$ 2,049
2009	1,656
2010	1,534
2011	248
2012	202
Beyond 2012	169
	<b>\$ 5,858</b>

**NOTE P REGULATORY REQUIREMENTS**

Various regulatory agencies have established guidelines that evaluate capital adequacy based on risk-adjusted assets. An additional capital computation evaluates tangible capital based on tangible assets. Minimum capital requirements set forth by the regulatory agencies require a Tier 1 capital ratio of no less than 4 percent of risk-weighted assets, a total capital ratio of no less than 8 percent of risk-weighted assets, and a leverage capital ratio of no less than 3 percent of tangible assets. To meet the FDIC's well-capitalized standards, the Tier 1 and total capital ratios must be at least 6 percent and 10 percent, respectively. Failure to meet minimum capital requirements may result in certain actions by regulators that could have a direct material effect on the consolidated financial statements.

Based on the most recent notifications from its regulators, FCB and ISB are well-capitalized under the regulatory framework for prompt corrective action. Management believes that as of December 31, 2007 BancShares, FCB and ISB met all capital adequacy requirements to which they are subject and was not aware of any conditions or events that would affect FCB's and ISB's well-capitalized status.

Following is an analysis of capital ratios for BancShares, FCB and ISB as of December 31, 2007 and 2006.

	December 31, 2007			December 31, 2006		
	Amount	Ratio	Requirement for Well-Capitalized	Amount	Ratio	Requirement for Well-Capitalized
BancShares						

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Tier 1 capital	\$ 1,557,190	13.02%	6.00%	\$ 1,456,947	12.93%	6.00%
Total capital	1,836,763	15.36	10.00	1,732,026	15.37	10.00
Leverage capital	1,557,190	9.63	5.00	1,456,947	9.39	5.00
<b>FCB</b>						
Tier 1 capital	1,188,599	12.23	6.00	1,104,132	11.95	6.00
Total capital	1,433,069	14.75	10.00	1,344,202	14.55	10.00
Leverage capital	1,188,599	8.81	5.00	1,104,132	8.33	5.00
<b>ISB</b>						
Tier 1 capital	261,500	11.94	6.00	245,402	12.56	6.00
Total capital	286,301	13.07	10.00	268,978	13.77	10.00
Leverage capital	261,500	11.21	5.00	245,402	11.52	5.00

The Board of Directors of FCB may declare a dividend on a portion of its undivided profits as it deems appropriate, subject to the requirements of the FDIC and the General Statutes of North Carolina, without prior regulatory approval. As of December 31, 2007, the amount was \$956,007. However, to preserve its well-capitalized status, the maximum amount of the dividend was limited to \$461,427. Dividends declared by FCB amounted to \$43,830 in 2007, \$39,952 in 2006 and \$32,194 in 2005.

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**FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Dollars in thousands)**

BancShares and its banking subsidiaries are subject to various requirements imposed by state and federal banking statutes and regulations, including regulations requiring the maintenance of noninterest-bearing reserve balances at the Federal Reserve Bank. Banks are allowed to reduce the required balances by the amount of vault cash. For 2007 the requirements averaged \$169,386 for FCB and \$9,502 for ISB.

**NOTE Q COMMITMENTS AND CONTINGENCIES**

In order to meet the financing needs of its customers, BancShares and its subsidiaries have financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve elements of credit, interest rate or liquidity risk.

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. Established credit standards control the credit-risk exposure associated with these commitments. In some cases, BancShares requires that collateral be pledged to secure the commitment. At December 31, 2007 and 2006, BancShares had unused commitments totaling \$4,972,515 and \$4,453,178 respectively.

Standby letters of credit are commitments guaranteeing performance of a customer to a third party. Those guarantees are issued primarily to support public and private borrowing arrangements. In order to minimize its exposure, BancShares' credit policies govern the issuance of standby letters of credit. At December 31, 2007 and 2006, BancShares had standby letters of credit amounting to \$51,696 and \$47,666, respectively.

DataTreasury Corporation ( DataTreasury ) has sued a number of large financial institutions including BancShares and FCB alleging patent infringement. DataTreasury claims to be the owner of multiple patents that cover check processing, and seeks royalty payment for checks processed since February 2000 and for checks processed in the future. The United States Patent and Trademark Office recently issued reexamination certificates with respect to two of four patents at issue in the claims asserted against BancShares and FCB, reaffirming all of the claims in these patents and allowing DataTreasury to include additional claims. BancShares and FCB challenge the validity of these patents, and claim that even if the patents are valid, BancShares and FCB are not liable for infringement because BancShares does not process checks and FCB's check processing system does not infringe the patents. BancShares and FCB strenuously deny liability and are vigorously defending their positions. BancShares and FCB also have placed certain software and equipment vendors on notice of claims for defense and for indemnification in the event DataTreasury prevails.

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

**NOTE R SEGMENT DISCLOSURES**

BancShares conducts its banking operations through its two wholly-owned subsidiaries, FCB and ISB. Although FCB and ISB offer similar products and services to customers, each entity operates in distinct geographic markets and has separate management groups. Additionally, the financial results and trends of ISB reflect the de novo nature of its growth.

FCB is a mature banking institution that operates from a single charter from its branch network in North Carolina, Virginia, West Virginia, Maryland and Tennessee. ISB began operations in 1997 and operates from a thrift charter in Florida, Georgia, Texas, New Mexico, Arizona, California, Oregon, Washington, Colorado and Missouri. ISB's significance to BancShares' consolidated financial results continues to grow.



**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Dollars in thousands)**

Management has determined that FCB and ISB are reportable business segments. In the aggregate, FCB and its consolidated subsidiaries, which are integral to its branch operation, and ISB account for more than 90 percent of consolidated assets, revenues and net income. The Other category in the accompanying table includes activities of the parent company and Neuse, Incorporated, a subsidiary that owns real property used in the banking operation.

The adjustments in the accompanying tables represent the elimination of the impact of certain inter-company transactions. The adjustments for interest income and interest expense neutralize the earnings and cost of inter-company borrowings. The adjustments to noninterest income and noninterest expense reflect the elimination of management fees and other service fees paid from one company to another within BancShares consolidated group.

The following table provides selected financial information for BancShares reportable business segments:

	<b>2007</b>					
	<b>ISB</b>	<b>FCB</b>	<b>Other</b>	<b>Total</b>	<b>Adjustments</b>	<b>Consolidated</b>
Interest income	\$ 141,071	\$ 752,383	\$ 44,884	\$ 938,338	\$ (34,282)	\$ 904,056
Interest expense	77,257	322,374	58,365	457,996	(34,282)	423,714
Net interest income (expense)	63,814	430,009	(13,481)	480,342		480,342
Provision for credit losses	9,034	24,560		33,594		33,594
Net interest income (expense) after provision for credit losses	54,780	405,449	(13,481)	446,748		446,748
Noninterest income	13,509	291,496	421	305,426	(9,956)	295,470
Noninterest expense	79,933	504,173	514	584,620	(9,956)	574,664
Income (loss) before income taxes	(11,644)	192,772	(13,574)	167,554		167,554
Income taxes	(3,935)	67,579	(4,707)	58,937		58,937
Net income (loss)	\$ (7,709)	\$ 125,193	\$ (8,867)	\$ 108,617	\$	\$ 108,617
<b>At December 31, 2007</b>						
Total assets	\$ 2,341,223	\$ 13,582,263	\$ 2,595,256	\$ 18,518,742	\$ (2,306,635)	\$ 16,212,107
Loans and leases	2,071,681	8,892,223		10,963,904		10,963,904
Allowance for loan and lease losses	23,648	113,326		136,974		136,974
Deposits	1,856,927	11,129,545		12,986,472	(57,928)	12,928,544

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	2006					
	ISB	FCB	Other	Total	Adjustments	Consolidated
Interest income	\$ 124,895	\$ 702,596	\$ 31,345	\$ 858,836	\$ (28,521)	\$ 830,315
Interest expense	58,593	270,460	53,205	382,258	(28,521)	353,737
Net interest income (expense)	66,302	432,136	(21,860)	476,578		476,578
Provision for credit losses	3,548	17,374		20,922		20,922
Net interest income (expense) after provision for credit losses	62,754	414,762	(21,860)	455,656		455,656
Noninterest income	11,383	267,340	1,177	279,900	(8,533)	271,367
Noninterest expense	71,500	466,034	2,076	539,610	(8,533)	531,077
Income (loss) before income taxes	2,637	216,068	(22,759)	195,946		195,946
Income taxes	456	76,919	(7,920)	69,455		69,455
Net income (loss)	\$ 2,181	\$ 139,149	\$ (14,839)	\$ 126,491	\$	\$ 126,491
At December 31, 2006						
Total assets	\$ 2,136,683	\$ 13,329,580	\$ 2,249,501	\$ 17,715,764	\$ (1,986,067)	\$ 15,729,697
Loans and leases	1,869,884	8,403,159		10,273,043		10,273,043
Allowance for loan and lease losses	22,446	109,558		132,004		132,004
Deposits	1,763,095	11,027,482		12,790,577	(47,253)	12,743,324

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands)

			2005				
	ISB	FCB	Other	Total	Adjustments	Consolidated	
Interest income	\$ 97,840	\$ 571,127	\$ 11,622	\$ 680,589	\$ (11,049)	\$ 669,540	
Interest expense	36,622	161,895	30,683	229,200	(11,049)	218,151	
Net interest income (expense)	61,218	409,232	(19,061)	451,389		451,389	
Provision for credit losses	8,029	25,485		33,514		33,514	
Net interest income (expense) after provision for credit losses	53,189	383,747	(19,061)	417,875		417,875	
Noninterest income	7,692	255,995	1,547	265,234	(7,568)	257,666	
Noninterest expense	65,150	437,198	2,091	504,439	(7,568)	496,871	
Income (loss) before income taxes	(4,269)	202,544	(19,605)	178,670		178,670	
Income taxes	(1,390)	74,001	(6,803)	65,808		65,808	
Net income (loss)	\$ (2,879)	\$ 128,543	\$ (12,802)	\$ 112,862	\$	\$ 112,862	
At December 31, 2005							
Total assets	\$ 1,855,981	\$ 12,720,711	\$ 1,913,563	\$ 16,490,255	\$ (1,837,627)	\$ 14,652,628	
Loans and leases	1,679,883	7,976,347		9,656,230		9,656,230	
Allowance for loan and lease losses	19,443	109,404		128,847		128,847	
Deposits	1,423,456	10,798,361		12,221,817	(47,959)	12,173,858	

**NOTE 5 FIRST CITIZENS BANCSHARES, INC. (PARENT COMPANY)**

First Citizens BancShares, Inc.'s principal assets are its investments in and receivables from its subsidiaries. Its sources of income are dividends and interest income. The Parent Company's condensed balance sheets as of December 31, 2007 and 2006, and the related condensed statements of income and cash flows for the years ended December 31, 2007, 2006 and 2005 are as follows:

**CONDENSED BALANCE SHEETS**

Assets	December 31	
	2007	2006
Cash	\$ 28,364	\$ 9,403

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Investment securities	315,490	217,423
Investment in subsidiaries	1,625,072	1,494,838
Due from subsidiaries	641,643	563,445
Other assets	46,753	54,948
<b>Total assets</b>	<b>\$ 2,657,322</b>	<b>\$ 2,340,057</b>
<b>Liabilities and Shareholders' Equity</b>		
Short-term borrowings	\$ 923,424	\$ 741,029
Long-term obligations	273,197	273,197
Other liabilities	19,493	15,012
Shareholders' equity	1,441,208	1,310,819
<b>Total liabilities and shareholders' equity</b>	<b>\$ 2,657,322</b>	<b>\$ 2,340,057</b>

**Table of Contents****FIRST CITIZENS BANCSHARES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Dollars in thousands)

**CONDENSED STATEMENTS OF INCOME**

	Year Ended December 31		
	2007	2006	2005
Interest income	\$ 44,884	\$ 31,109	\$ 11,446
Interest expense	58,610	53,679	31,048
Net interest expense	(13,726)	(22,570)	(19,602)
Dividends from subsidiaries	43,830	44,952	32,194
Other income (loss)	421	(175)	(202)
Other operating expense	2,084	1,670	1,553
Income before income tax benefit and equity in undistributed net income of subsidiaries	28,441	20,537	10,837
Income tax benefit	(5,414)	(8,570)	(7,516)
Income before equity in undistributed net income of subsidiaries	33,855	29,107	18,353
Equity in undistributed net income of subsidiaries	74,762	97,384	94,509
Net income	\$ 108,617	\$ 126,491	\$ 112,862

**CONDENSED STATEMENTS OF CASH FLOWS**

	Year Ended December 31		
	2007	2006	2005
<b>OPERATING ACTIVITIES</b>			
Net income	\$ 108,617	\$ 126,491	\$ 112,862
Adjustments			
Undistributed net income of subsidiaries	(74,762)	(97,384)	(94,509)
Net amortization of premiums and discounts	(247)	308	(215)
Securities gains		(328)	
Change in other assets	11,149	5,762	2,420
Change in other liabilities	1,695	6,518	(2,495)
Net cash provided by operating activities	46,452	41,367	18,063

**INVESTING ACTIVITIES**

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Net change in due from subsidiaries	(78,198)	(132,618)	(286,537)
Purchases of investment securities	(149,906)	(161,655)	(34,837)
Maturities of investment securities	53,696	70,585	3,517
Investment in subsidiaries	(24,000)	(36,404)	(10,677)
<b>Net cash used by investing activities</b>	<b>(198,408)</b>	<b>(260,092)</b>	<b>(328,534)</b>
<b>FINANCING ACTIVITIES</b>			
Net change in short-term borrowings	182,395	220,444	307,198
Origination of long-term obligations		118,557	
Redemption of long-term obligations		(103,093)	
Cash dividends paid	(11,478)	(11,478)	(11,478)
<b>Net cash provided by financing activities</b>	<b>170,917</b>	<b>224,430</b>	<b>295,720</b>
Net change in cash	18,961	5,705	(14,751)
Cash balance at beginning of year	9,403	3,698	18,449
Cash balance at end of year	\$ 28,364	\$ 9,403	\$ 3,698
<b>Cash payments for</b>			
Interest	\$ 58,159	\$ 54,214	\$ 30,415
Income taxes	57,765	61,795	65,860
<b>Supplemental disclosure of noncash investing and financing activities:</b>			
Unrealized securities gains (losses)	43,290	11,446	(10,808)
Unrealized loss on cash flow hedge	(3,561)	(1,793)	

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 28, 2008

FIRST CITIZENS BANCSHARES, INC. (Registrant)

/s/ FRANK B. HOLDING, JR.\*

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**Frank B. Holding, Jr.**

**President and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the Registrant and in the capacities indicated on February 28, 2008.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ LEWIS R. HOLDING*	Chairman	February 28, 2008
<hr/>		
<b>Lewis R. Holding</b>		
/s/ FRANK B. HOLDING*	Executive Vice Chairman	February 28, 2008
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<b>Frank B. Holding</b>		
/s/ FRANK B. HOLDING, JR.*	President and Chief Executive Officer	February 28, 2008
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<b>Frank B. Holding, Jr.</b>		
/s/ KENNETH A. BLACK	Vice President, Treasurer, and Chief Financial Officer (principal financial and accounting officer)	February 28, 2008
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<b>Kenneth A. Black</b>		
/s/ JOHN M. ALEXANDER, JR. *	Director	February 28, 2008

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<b>John M. Alexander, Jr.</b>		
/s/ CARMEN HOLDING AMES *	Director	February 28, 2008
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<b>Carmen Holding Ames</b>		
/s/ VICTOR E. BELL, III *	Director	February 28, 2008
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<b>Victor E. Bell, III</b>		
/s/ GEORGE H. BROADRICK *	Director	February 28, 2008
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<b>George H. Broadrick</b>		
/s/ HOPE HOLDING CONNELL *	Director	February 28, 2008
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<b>Hope Holding Connell</b>		
/s/ HUBERT M. CRAIG, III *	Director	February 28, 2008
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<b>Hubert M. Craig, III</b>		
/s/ H. LEE DURHAM, JR. *	Director	February 28, 2008
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<b>H. Lee Durham, Jr.</b>		
/s/ LEWIS M. FETTERMAN *	Director	February 28, 2008
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<b>Lewis M. Fetterman</b>		
/s/ DANIEL L. HEAVNER *	Director	February 28, 2008
<hr/>		
<b>Daniel L. Heavner</b>		
	Director	
<hr/>		
<b>Charles B.C. Holt</b>		



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<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ LUCIUS S. JONES *	Director	February 28, 2008
<hr/>		
<b>Lucius S. Jones</b>		
/s/ ROBERT E. MASON, IV *	Director	February 28, 2008
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<b>Robert E. Mason, IV</b>		
/s/ ROBERT T. NEWCOMB *	Director	February 28, 2008
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<b>Robert T. Newcomb</b>		
/s/ LEWIS T. NUNNELEE, II *	Director	February 28, 2008
<hr/>		
<b>Lewis T. Nunnelee, II</b>		
/s/ JAMES M. PARKER *	Director	February 28, 2008
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<b>James M. Parker</b>		
/s/ RALPH K. SHELTON *	Director	February 28, 2008
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<b>Ralph K. Shelton</b>		
/s/ R. C. SOLES, JR. *	Director	February 28, 2008
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<b>R. C. Soles, Jr.</b>		
/s/ DAVID L. WARD, JR *	Director	February 28, 2008
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**David L. Ward, Jr.**

\* Kenneth A. Black hereby signs this Annual Report on Form 10-K on February 28, 2008, on behalf of each of the indicated persons for whom he is attorney-in-fact pursuant to a Power of Attorney filed herewith.

By: /s/ **KENNETH A. BLACK**  
**Kenneth A. Black**  
**As Attorney-In-Fact**

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**EXHIBIT INDEX**

- 3.1 Certificate of Incorporation of the Registrant, as amended (incorporated by reference from Registrant's Form 10-K for the year ended December 31, 1992)
- 3.2 Bylaws of the Registrant, as amended (incorporated by reference from Registrant's Form 8-K dated January 25, 2008)
- 4.1 Specimen of Registrant's Class A Common Stock certificate (incorporated by reference from Registrant's Form 10-K for the year ended December 31, 1993)
- 4.2 Specimen of Registrant's Class B Common Stock certificate (incorporated by reference from Registrant's Form 10-K for the year ended December 31, 1993)
- 4.3 Amended and Restated Trust Agreement of FCB/NC Capital Trust I (incorporated by reference from Registration No. 333-59039)
- 4.4 Form of Guarantee Agreement (incorporated by reference from Registration No. 333-59039)
- 4.5 Junior Subordinated Indenture dated March 5, 1998 between Registrant and Bankers Trust Company, as Debenture Trustee (incorporated by reference from Registration No. 333-59039)
- 4.6 Indenture dated June 1, 2005 between Registrant's subsidiary First-Citizens Bank & Trust Company and Deutsche Bank Trust Company Americas, as Trustee (incorporated by reference from Registrant's 8-K dated June 1, 2005)
- 4.7 First Supplemental Indenture dated June 1, 2005 between Registrant's subsidiary First-Citizens Bank & Trust Company and Deutsche Bank Trust Company Americas, as Trustee (incorporated by reference from Registrant's Form 8-K dated June 1, 2005)
- 4.8 Amended and Restated Trust Agreement of FCB/NC Capital Trust III (incorporated by reference from Registrant's Form 10-Q for the quarter ended June 30, 2006)
- 4.9 Guarantee Agreement relating to Registrant's guarantee of the capital securities of FCB/NC Capital Trust III (incorporated by reference from Registrant's Form 10-Q for the quarter ended June 30, 2006)
- 4.10 Junior Subordinated Debenture dated May 18, 2006 between Registrant and Wilmington Trust Company, as Debenture Trustee (incorporated by reference from Registrant's Form 10-Q for the quarter ended June 30, 2006)
- 10.1 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007 between Registrant's Subsidiary First-Citizens Bank & Trust Company and Lewis R. Holding (incorporated by reference from Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.2 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 28, 2007 between Registrant's Subsidiary First-Citizens Bank & Trust Company and Frank B. Holding (incorporated by reference from Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.3 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007 between Registrant's Subsidiary First-Citizens Bank & Trust Company and James B. Hyler, Jr. (incorporated by reference from Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.4 Offer of employment by Registrant's Subsidiary First-Citizens Bank & Trust Company to Carol B. Yochem dated August 3, 2005 (incorporated by reference to Registrant's 2006 Form 10-K)
- 10.5 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007, between Registrant's Subsidiary First-Citizens Bank & Trust Company and Carol B. Yochem (incorporated by reference to Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.6 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007, between Registrant's Subsidiary First-Citizens Bank & Trust Company and Kenneth A. Black (incorporated by reference to Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.8 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007 between Registrant's Subsidiary First-Citizens Bank & Trust Company and Frank B. Holding, Jr. (incorporated by reference from Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.9 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007 between Registrant's Subsidiary First-Citizens Bank & Trust Company and Hope Holding Connell (incorporated by reference to Registrant's Form 10-Q for the quarter ended September 30, 2007)

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- 10.10 Consultation Agreement dated July 24, 2006, between Registrant's subsidiary, First-Citizens Bank & Trust Company, and George H. Broadrick (incorporated by reference to Registrant's 2006 Form 10-K)
- 10.11 Executive Consultation, Separation from Service and Death Benefit Agreement dated September 17, 2007, between Registrant's Subsidiary IronStone Bank and James M. Parker (incorporated by reference from Registrant's Form 10-Q for the quarter ended September 30, 2007)
- 10.13 Article IV Section 4.1.d of the Agreement and Plan of Reorganization and Merger by and among First Investors Savings Bank, Inc., SSB, First-Citizens Bank & Trust Company and First Citizens BancShares, Inc., dated October 25, 1995, located at page II-38 of Registrant's S-4 Registration Statement filed with the SEC on December 19, 1994 (Registration No. 33-84514)
- 10.14 Article IV Section 4.1.e of the Agreement and Plan of Reorganization and Merger by and among State Bank and First-Citizens Bank & Trust Company and First Citizens BancShares, Inc., dated October 25, 1995, located at page I-36 of Registrant's S-4 Registration Statement filed with the SEC on November 16, 1994 (Registration No. 33-86286)
- 21 Subsidiaries of the Registrant (filed herewith)
- 24 Power of Attorney (filed herewith)
- 31.1 Certification of Lewis R. Holding, Chief Executive Officer prior to January 28, 2008 (filed herewith)
- 31.2 Certification of Frank B. Holding, Jr., Chief Executive Officer effective January 28, 2008 (filed herewith)
- 31.3 Certification of Chief Financial Officer (filed herewith)
- 32 Certification of Chief Executive Officer and Chief Financial Officer (filed herewith)
- 99.1 Proxy Statement for Registrant's 2008 Annual Meeting (separately filed)

**COPIES OF EXHIBITS ARE AVAILABLE UPON WRITTEN REQUEST TO**

**KENNETH A. BLACK, CHIEF FINANCIAL OFFICER OF FIRST CITIZENS BANCSHARES, INC.**