Nonaccrual Loans

When a loan is placed on nonaccrual status, the accrual of interest is discontinued and all previously accrued and unpaid interest is charged against income. Commercial loans are placed on nonaccrual status when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due. Such loans are also placed on nonaccrual status when the principal or interest is past due ninety days or more, unless the loan is both well secured and in the process of collection. Residential mortgage loans that have principal and interest payments that have become past due 150 days are placed on nonaccrual status unless such loans are both well secured and in the process of collection. Home equity, automobile, and other consumer loans and leases that have principal and interest payments that have become past due ninety days are placed on nonaccrual status unless the loan is both well secured and in the process of collection. Nonaccrual commercial loans, other than loans modified in a TDR, are accounted for on the cost recovery method. Nonaccrual residential mortgage loans and nonaccrual consumer loans are accounted for on the cash basis method. Nonaccrual loans may be returned to accrual status when all delinquent interest and principal payments become current in accordance with the loan agreement or when the loan is both well-secured and in the process of collection.

Commercial loans on nonaccrual status, as well as commercial loans above a specified threshold are subject to an individual review to identify charge-offs. Residential mortgage loans and credit card loans that have principal and interest payments that have become past due 180 days are charged off to the ALLL, unless such loans are both well-secured and in the process of collection. Home equity, automobile and other consumer loans and leases that have principal and interest payments that have become past due one hundred and twenty days are charged off to the ALLL, unless such loans are both well-secured and in the process of collection.

Restructured Loans

A loan is accounted for as a TDR if the Bancorp, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. A TDR typically involves a modification of terms such as a reduction of the stated interest rate or face amount of the loan, a reduction of accrued interest, or an extension of the maturity date(s) at a stated interest rate lower than the current market rate for a new loan with similar risk. The Bancorp measures the impairment loss of a TDR based on the difference between the original loan's carrying amount and the present value of expected future cash flows discounted at the original, effective yield of the loan. Beginning with the first quarter of 2009, based on published guidance with respect to TDRs from certain banking regulators and to conform to general practices within the banking industry, the Bancorp determined it was appropriate to maintain consumer loans modified as part of a TDR on accrual status, provided there is reasonable assurance of repayment and of performance according to the modified terms based upon a current, well-documented credit evaluation. Management believes this policy is reflective of regulatory guidance and provides better comparability to other financial institutions. TDRs on commercial loans remain on nonaccrual status until a six-month payment history is sustained. During the nonaccrual period, TDRs on commercial loans are accounted for using the cash basis method for income recognition, provided that full repayment of principal under the modified terms of the loan is reasonably assured.

Impaired Loans

A loan is considered to be impaired when, based on current information and events, it is probable that the Bancorp will be unable to collect all amounts due (including both principal and interest) according to the contractual terms of the loan agreement. For loans modified in a TDR, the contractual terms of the loan agreement refer to the terms specified in the original loan agreement. A loan restructured in a TDR is no longer considered impaired in years after the restructuring if the restructuring agreement specifies a rate equal to or greater than the rate the Bancorp was willing to accept at the time of the restructuring for a new loan with comparable risk and the loan is not impaired based on the terms specified by the restructuring agreement. Refer to the ALLL section for discussion regarding the Bancorp's methodology for identifying impaired loans and determination of the need for a loss accrual.

Loans Held for Sale

Loans held for sale represent conforming fixed rate residential mortgage loan originations intended to be sold in the secondary market, commercial loans and other loans that management has an active plan to sell. Loans held for sale may be carried at the lower of cost or fair value, or carried at fair value where the Bancorp has elected the fair value option of accounting under U.S. GAAP. The Bancorp has elected to measure residential mortgage loans originated as held for sale under the fair value option. For loans in which the Bancorp has not elected the fair value option, the lower of cost or fair value is determined at the individual loan level.

Management's intent to sell residential mortgage loans classified as held for sale may change over time due to such factors as changes in the overall liquidity in markets or changes in characteristics specific to certain loans held for sale. Consequently, these loans may be reclassified to loans held for investment and, thereafter, reported within the Bancorp's residential mortgages class of portfolio loans and leases. In such cases, the residential mortgage loans will continue to be measured at fair value. The fair value of residential mortgage loans is estimated based upon mortgage-backed securities prices and spreads to those prices or, for certain ARM loans, discounted cash flow models that may incorporate the anticipated portfolio composition, credit spreads of asset-backed securities with similar collateral, and market conditions. The anticipated portfolio composition includes the effects of interest rate spreads and discount rates due to loan characteristics such as the state in which the loan was originated, the loan amount and the ARM margin. These fair value marks are recorded as a component of noninterest income in mortgage banking net revenue. The Bancorp generally has commitments to sell residential mortgage loans held for sale in the secondary market. Gains or losses on sales are recognized in mortgage banking net revenue upon delivery.

Loans held for sale are placed on nonaccrual status consistent with the Bancorp's nonaccrual policy for portfolio loans and leases.

Other Real Estate Owned

OREO, which is included in other assets, represents property acquired through foreclosure or other proceedings and is carried at the lower of cost or fair value, less costs to sell. All OREO property is periodically evaluated and decreases in carrying value are recognized as reductions in other noninterest income in the Consolidated Statements of Income.

Allowance for Loan and Lease Losses

The Bancorp disaggregates its portfolio loans and leases into portfolio segments for purposes of determining the ALLL. The Bancorp's portfolio segments include commercial, residential mortgage, and consumer. The Bancorp further disaggregates its portfolio segments into classes for purposes of monitoring and assessing credit quality based on certain risk characteristics. Classes within the commercial portfolio segment include