

FIRST HORIZON NATIONAL CORP  
Form 10-Q  
August 08, 2008

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

(Mark one)

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from \_\_\_\_ to \_\_\_\_

Commission file number 001-15185

CIK number 0000036966

FIRST HORIZON NATIONAL CORPORATION  
(Exact name of registrant as specified in its charter)

Tennessee  
(State or other jurisdiction of  
incorporation or organization)

62-0803242  
(I.R.S. Employer  
Identification No.)

165 Madison Avenue, Memphis, Tennessee  
(Address of principal executive offices)

38103  
(Zip Code)

(901) 523-4444  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year,  
if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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 definitions of "accelerated filer," "large accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes      No  x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding on June 30, 2008
Common Stock, \$.625 par value	195,751,330

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FIRST HORIZON NATIONAL CORPORATION

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PART I.

FINANCIAL INFORMATION

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This financial information reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the interim periods presented.

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## CONSOLIDATED CONDENSED STATEMENTS OF CONDITION

First Horizon National Corporation

(Dollars in thousands)(Unaudited)	June 30		Dec 31, 2007
	2008	2007	
<b>Assets:</b>			
Cash and due from banks	\$ 838,376	\$ 799,428	\$ 1,000,000
Federal funds sold and securities purchased under agreements to resell	1,166,982	1,121,052	1,000,000
Total cash and cash equivalents	2,005,358	1,920,480	2,000,000
Interest-bearing deposits with other financial institutions	39,829	58,241	1,000,000
Trading securities	1,473,815	2,291,704	1,000,000
Trading securities - divestiture	89,239	-	1,000,000
Loans held for sale	2,554,030	3,330,489	3,000,000
Loans held for sale - divestiture	-	-	2,000,000
Securities available for sale	2,896,688	3,374,583	3,000,000
Securities held to maturity (fair value of \$240 on June 30, 2008; \$271 on June 30, 2007; and \$242 on December 31, 2007)	240	270	1,000,000
Loans, net of unearned income	22,225,232	22,382,303	22,000,000
Less: Allowance for loan losses	575,149	229,919	3,000,000
Total net loans	21,650,083	22,152,384	21,000,000
Mortgage servicing rights, net	903,634	1,522,966	1,000,000
Mortgage servicing rights - divestiture	235,761	-	1,000,000
Goodwill	192,408	279,825	1,000,000
Other intangible assets, net	48,615	61,947	1,000,000
Capital markets receivables	994,571	1,240,456	5,000,000
Premises and equipment, net	344,410	438,807	3,000,000
Real estate acquired by foreclosure	141,857	67,499	1,000,000
Other assets	1,908,795	1,654,433	1,000,000
Other assets - divestiture	70,628	-	1,000,000
<b>Total assets</b>	<b>\$ 35,549,961</b>	<b>\$ 38,394,084</b>	<b>\$ 37,000,000</b>
<b>Liabilities and shareholders' equity:</b>			
<b>Deposits:</b>			
Savings	\$ 4,041,352	\$ 3,520,757	\$ 3,000,000
Time deposits	2,468,521	2,885,307	2,000,000
Other interest-bearing deposits	1,880,678	1,822,076	1,000,000
Interest-bearing deposits-divestiture	-	-	1,000,000
Certificates of deposit \$100,000 and more	1,953,432	8,016,808	3,000,000
Certificates of deposit \$100,000 and more - divestiture	-	-	1,000,000
Interest-bearing	10,343,983	16,244,948	11,000,000
Noninterest-bearing	4,453,332	5,516,735	5,000,000
Noninterest-bearing - divestiture	296,632	-	1,000,000
Total deposits	15,093,947	21,761,683	17,000,000
Federal funds purchased and securities sold under agreements to repurchase	2,620,014	3,841,251	4,000,000
Federal funds purchased and securities sold under agreements to repurchase - divestiture	-	-	1,000,000
Trading liabilities	464,225	658,533	5,000,000
Commercial paper and other short-term borrowings	5,998,810	246,815	3,000,000
Term borrowings	5,783,407	5,828,138	6,000,000
Other collateralized borrowings	767,010	821,966	8,000,000
Total long-term debt	6,550,417	6,650,104	6,000,000
Capital markets payables	868,883	1,144,029	5,000,000
Other liabilities	959,476	1,332,910	1,000,000

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Other liabilities-divestiture	1,466	-	
Total liabilities	32,557,238	35,635,325	34,5
Preferred stock of subsidiary	295,277	295,277	2
Shareholders' equity			
Preferred stock - no par value (5,000,000 shares authorized, but unissued)	-	-	
Common stock - \$.625 par value (shares authorized - 400,000,000; shares issued and outstanding - 195,751,330 on June 30, 2008; 126,236,535 on June 30, 2007; and 126,366,177 on December 31, 2007)	122,345	78,898	
Capital surplus	980,428	352,138	3
Undivided profits	1,646,272	2,120,014	1,7
Accumulated other comprehensive (loss)/ income, net	(51,599)	(87,568)	
Total shareholders' equity	2,697,446	2,463,482	2,
Total liabilities and shareholders' equity	\$ 35,549,961	\$ 38,394,084	\$ 37,

See accompanying notes to consolidated condensed financial statements.

Certain previously reported amounts have been reclassified to agree with current presentation.

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CONSOLIDATED CONDENSED STATEMENTS OF INCOME  (Dollars in thousands except per share data)(Unaudited)	First Horizon National Corporation			
	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2008	2007	2008	2007
Interest income:				
Interest and fees on loans	\$ 285,419	\$ 413,254	\$ 617,095	\$ 823,681
Interest on investment securities	39,212	47,105	79,947	101,375
Interest on loans held for sale	54,217	65,923	112,655	124,768
Interest on trading securities	30,182	50,069	66,078	90,632
Interest on other earning assets	6,455	18,552	16,153	37,632
Total interest income	415,485	594,903	891,928	1,178,088
Interest expense:				
Interest on deposits:				
Savings	18,362	29,919	44,250	55,950
Time deposits	25,540	33,555	57,042	66,592
Other interest-bearing deposits	3,556	6,808	9,462	13,697
Certificates of deposit \$100,000 and more	17,361	110,630	48,429	216,906
Interest on trading liabilities	9,400	14,272	19,015	30,633
Interest on short-term borrowings	49,425	68,932	119,474	136,096
Interest on long-term debt	52,946	91,355	127,269	181,363
Total interest expense	176,590	355,471	424,941	701,237
Net interest income	238,895	239,432	466,987	476,851
Provision for loan losses	220,000	44,408	460,000	72,894
Net interest income after provision for loan losses	18,895	195,024	6,987	403,957
Noninterest income:				
Capital markets	122,338	85,054	253,795	172,167
Deposit transactions and cash management	46,797	43,079	89,350	82,437
Mortgage banking	172,418	71,300	331,130	144,397
Trust services and investment management	8,883	10,628	17,992	20,316
Insurance commissions	6,822	7,674	14,966	17,463
Gains/(losses) from loan sales and securitizations	(6,984)	9,615	(11,081)	19,278
Equity securities gains/(losses), net	(972)	(995)	64,043	2,967
Debt securities gains/(losses), net	-	(19)	931	6,292
Losses on divestitures	(429)	-	(1,424)	-
All other income and commissions	50,173	53,963	88,420	98,170
Total noninterest income	399,046	280,299	848,122	563,487
Adjusted gross income after provision for loan losses	417,941	475,323	855,109	967,444
Noninterest expense:				
Employee compensation, incentives and benefits	277,078	258,191	564,548	504,534
Occupancy	30,018	33,402	58,609	62,186
Equipment rentals, depreciation and maintenance	18,268	21,791	33,279	39,404
Operations services	19,124	17,457	38,088	35,278
Communications and courier	11,477	10,746	22,481	22,286
Amortization of intangible assets	2,182	2,623	4,622	5,448
All other expense	107,696	113,030	182,493	191,116
Total noninterest expense	465,843	457,240	904,120	860,252
(Loss)/income before income taxes	(47,902)	18,083	(49,011)	107,192
(Benefit)/provision for income taxes	(28,821)	(3,861)	(36,967)	14,941
(Loss)/income from continuing operations	(19,081)	21,944	(12,044)	92,251
Income from discontinued operations, net of tax	-	179	883	419
Net (loss)/income	\$ (19,081)	\$ 22,123	\$ (11,161)	\$ 92,670

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Earnings/(loss) per common share (Note 7)	\$	(.11)	\$	.18	\$	(.07)	\$	.74
Diluted earnings/(loss) per common share (Note 7)	\$	(.11)	\$	.17	\$	(.07)	\$	.72
Weighted average common shares (Note 7)		171,680		125,873		148,898		125,609
Diluted average common shares (Note 7)		171,680		128,737		148,898		128,720

See accompanying notes to consolidated condensed financial statements.

Certain previously reported amounts have been reclassified to agree with current presentation.



CONSOLIDATED CONDENSED STATEMENTS OF SHAREHOLDERS' EQUITY (Dollars in thousands)(Unaudited)	First Horizon National Corporation	
	2008	2007
Balance, January 1	\$ 2,135,596	\$ 2,462,390
Adjustment to reflect change in accounting for tax benefits (FIN 48)	-	(862)
Adjustment to reflect adoption of measurement date provisions for SFAS No. 158	-	6,233
Adjustment to reflect change in accounting for purchases of life insurance (EITF Issue No. 06-5)	-	(548)
Adjustment to reflect adoption of measurement date provisions for SFAS No. 157	(12,502)	-
Adjustment to reflect change in accounting for split dollar life insurance arrangements (EITF Issue No. 06-4)	(8,530)	-
Net income/(loss)	(11,161)	92,670
Other comprehensive income/(loss):		
Unrealized fair value adjustments, net of tax:		
Cash flow hedges	(6)	(29)
Securities available for sale	(4,999)	(25,963)
Recognized pension and other employee benefit plans net periodic benefit costs	1,506	2,562
Comprehensive (loss)/income	(14,660)	69,240
Cash dividends declared	(64,426)	(113,450)
Common stock issuance (69 million shares issued at \$10 per share net of offering costs)	659,762	-
Common stock repurchased	(214)	(1,096)
Common stock issued for:		
Stock options and restricted stock	572	30,506
Excess tax benefit from stock-based compensation arrangements	(1,531)	6,029
Stock-based compensation expense	3,379	5,009
Other	-	31
Balance, June 30	\$ 2,697,446	\$ 2,463,482

See accompanying notes to consolidated condensed financial statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS		First Horizon National Corporation	
		Six Months Ended June 30	
(Dollars in thousands)(Unaudited)		2008	2007
Operating Activities	Net (loss)/income	\$ (11,161)	\$ 92,670
	Adjustments to reconcile net (loss)/income to net cash provided/(used) by operating activities:		
	Provision for loan losses	460,000	72,894
	(Benefit)/provision for deferred income tax	(36,967)	14,941
	Depreciation and amortization of premises and equipment	23,075	27,231
	Amortization of intangible assets	4,622	5,448
	Net other amortization and accretion	23,901	42,386
	Decrease in derivatives, net	(34,458)	58,724
	Market value adjustment on mortgage servicing rights	2,992	(100,230)
	Provision for foreclosure reserve	8,386	6,101
	Loss on divestiture	1,424	-
	Stock-based compensation expense	3,379	5,009
	Excess tax benefit from stock-based compensation arrangements	1,531	(6,029)
	Equity securities gains, net	(64,043)	(2,967)
	Debt securities gains, net	(931)	(6,292)
	Gains on repurchases of debt	(12,596)	-
	Net losses on disposal of fixed assets	4,723	588
	Net (increase)/decrease in:		
	Trading securities	171,252	(60,959)
	Loans held for sale	939,182	(456,912)
	Capital markets receivables	(470,152)	(508,174)
	Interest receivable	28,900	11,013
	Other assets	(48,514)	119,737
	Net increase/(decrease) in:		
	Capital markets payables	282,525	344,540
	Interest payable	(39,776)	5,600
	Other liabilities	(298,889)	(48,599)
	Trading liabilities	(91,919)	(131,424)
	Total adjustments	857,647	(607,374)
	Net cash provided/(used) by operating activities	846,486	(514,704)
Investing Activities	Available for sale securities:		
	Sales	89,839	624,240
	Maturities	421,799	368,577
	Purchases	(313,613)	(469,738)
	Premises and equipment:		
	Purchases/(Sales)	11,738	(15,322)
	Net decrease in securitization retained interests classified as trading securities	35,276	-
	Net increase in loans	(176,354)	(367,402)
	Net increase in interest-bearing deposits with other financial institutions	(407)	(40,200)
	Cash payments related to divestitures	(113,300)	-

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	Net cash (used)/provided by investing activities	(45,022)	100,155
Financing Activities	Common stock:		
	Exercise of stock options	511	30,571
	Cash dividends paid	(25,220)	(112,085)
	Repurchase of shares	(214)	(1,096)
	Issuance of shares	659,762	-
	Excess tax benefit from stock-based compensation arrangements	(1,531)	6,029
	Long-term debt:		
	Issuance	25,002	1,076,909
	Payments	(180,762)	(227,604)
	Cash paid for repurchase of debt	(139,454)	-
	Issuance of preferred stock of subsidiary	-	8
	Repurchase of preferred stock of subsidiary	-	(1)
	Net increase/(decrease) in:		
	Deposits	(1,739,180)	1,548,452
	Short-term borrowings	345,265	(2,132,246)
	Net cash (used)/provided by financing activities	(1,055,821)	188,937
	Net decrease in cash and cash equivalents	(254,357)	(225,612)
Cash and cash equivalents at beginning of period	2,259,715	2,146,092	
Cash and cash equivalents at end of period	\$ 2,005,358	\$ 1,920,480	
Total interest paid	463,052	694,751	
Total income taxes paid	182,964	13,782	

See accompanying notes to consolidated condensed financial statements.

Certain previously reported amounts have been reclassified to agree with current presentation.

Note 1 - Financial Information

The unaudited interim consolidated condensed financial statements of First Horizon National Corporation (FHN), including its subsidiaries, have been prepared in conformity with accounting principles generally accepted in the United States of America and follow general practices within the industries in which it operates. This preparation requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates and assumptions are based on information available as of the date of the financial statements and could differ from actual results. In the opinion of management, all necessary adjustments have been made for a fair presentation of financial position and results of operations for the periods presented. The operating results for the interim 2008 periods are not necessarily indicative of the results that may be expected going forward. For further information, refer to the audited consolidated financial statements in the 2007 Annual Report to shareholders.

**Investment Securities.** Venture capital investments are classified as securities available for sale and are carried at fair value. Upon adoption of Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157) on January 1, 2008, unrealized gains and losses on such securities are recognized prospectively in noninterest income. Prior to FHN's adoption of SFAS No. 157, venture capital investments were initially valued at cost based on their unmarketable nature. Subsequently, these investments were adjusted to reflect changes in valuation as a result of public offerings or other-than-temporary declines in value.

**Loans Held for Sale and Securitization and Residual Interests.** Loans originated or purchased for resale, together with mortgage loans previously sold which may be unilaterally called by FHN, are included in loans held for sale in the consolidated statements of condition. Effective January 1, 2008, upon adoption of Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159), FHN elected the fair value option on a prospective basis for almost all types of mortgage loans originated for sale purposes. Such loans are carried at fair value, with changes in the fair value of these loans recognized in the mortgage banking noninterest income section of the Consolidated Condensed Statements of Income. For mortgage loans originated for sale for which the fair value option is elected, loan origination fees are recorded by FHN when earned and related direct loan origination costs are recognized when incurred. Interests retained from the securitization of such loans are included as a component of trading securities on the Consolidated Condensed Statements of Condition, with related cash receipts and payments classified prospectively in investing activities on the Consolidated Condensed Statements of Cash Flows based on the purpose for which such financial assets were retained. See Note 13 – Fair Values of Assets and Liabilities for additional information.

FHN continues to account for all mortgage loans held for sale which were originated prior to 2008 and for mortgage loans held for sale for which fair value accounting has not been elected at the lower of cost or market value. For such loans, net origination fees and costs are deferred and included in the basis of the loans in calculating gains and losses upon sale. Gains and losses realized from the sale of these assets are included in noninterest income. Interests retained from the sale of such loans are included as a component of trading securities on the Consolidated Condensed Statements of Condition.

**Accounting Changes.** Effective January 1, 2008, FHN adopted SFAS No. 159 which allows an irrevocable election to measure certain financial assets and liabilities at fair value on an instrument-by-instrument basis, with unrealized gains and losses recognized currently in earnings. Under SFAS No. 159, the fair value option may only be elected at the time of initial recognition of a financial asset or liability or upon the occurrence of certain specified events. Additionally, SFAS No. 159 provides that application of the fair value option must be based on the fair value of an entire financial asset or liability and not selected risks inherent in those assets or liabilities. SFAS No. 159 requires that assets and liabilities which are measured at fair value pursuant to the fair value option be reported in the financial statements in a manner that separates those fair values from the carrying amounts of similar assets and liabilities which are measured using another measurement attribute. SFAS No. 159 also provides expanded disclosure requirements regarding the effects of electing the fair value option on the financial statements. Upon adoption of

SFAS No. 159, FHN elected the fair value option on a prospective basis for almost all types of mortgage loans originated for sale purposes. Additionally, in accordance with SFAS No. 159's amendment of Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities", FHN began prospectively classifying cash flows associated with its retained interests in securitizations recognized as trading securities within investing activities in the Consolidated Condensed Statements of Cash Flows.

Effective January 1, 2008, FHN adopted SEC Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" (SAB No. 109) prospectively for derivative loan commitments issued or modified after that date. SAB No. 109 rescinds SAB No. 105's prohibition on inclusion of expected net future cash flows related to loan servicing activities in the fair value measurement of a written loan commitment. SAB No. 109 also applies to any loan commitments for which fair value accounting is elected under SFAS No. 159. FHN did not elect fair value accounting for any other loan commitments under SFAS No. 159.

## Note 1 - Financial Information (continued)

The prospective application of SAB No. 109 and the prospective election to recognize substantially all new mortgage loan originations at fair value under SFAS No. 159 resulted in a positive impact of \$58.1 million on first quarter 2008 pre-tax earnings. This represents the estimated value of mortgage servicing rights included in (1) interest rate lock commitments entered into in first quarter 2008 that remained on the balance sheet at quarter end and (2) mortgage warehouse loans originated in first quarter 2008 accounted for at elected fair value which remained on the balance sheet at quarter end. Second quarter 2008 earnings were negatively impacted by \$20.9 million related to the adoption of SAB No. 109 and SFAS No. 159 as loans and commitments remaining on the balance sheet at the end of first quarter 2008 were sold.

Effective January 1, 2008, FHN adopted SFAS No. 157 for existing fair value measurement requirements related to financial assets and liabilities as well as to non-financial assets and liabilities which are remeasured at least annually. In February 2008, the FASB staff issued FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157" (FSP FAS 157-2), which delayed the effective date of SFAS No. 157 until fiscal years beginning after November 15, 2008, for non-financial assets and liabilities which are recognized at fair value on a non-recurring basis. SFAS No. 157 establishes a hierarchy to be used in performing measurements of fair value. Additionally, SFAS No. 157 emphasizes that fair value should be determined from the perspective of a market participant while also indicating that valuation methodologies should first reference available market data before using internally developed assumptions. SFAS No. 157 also provides expanded disclosure requirements regarding the effects of fair value measurements on the financial statements. Upon the adoption of the provisions of SFAS No. 157 for financial assets and liabilities as well as non-financial assets and liabilities remeasured at least annually on January 1, 2008, a negative after-tax cumulative-effect adjustment of \$12.5 million was made to the opening balance of undivided profits for interest rate lock commitments which FHN previously measured under the guidance of EITF 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities" (EITF 02-3). The effect of the change in accounting for these interest rate lock commitments produced a \$15.7 million negative effect on first quarter 2008 pre-tax earnings as the \$14.2 million positive effect of delivering the loans associated with the commitments existing at the beginning of the quarter was more than offset by a negative impact of \$29.9 million for commitments remaining on the balance sheet at quarter end that was previously deferred under EITF 02-3 until delivery of the associated loans. Second quarter 2008 earnings were positively impacted by a net of \$13.7 million related to the adoption of SFAS No. 157 as (1) FHN continued to deliver loans that had been commitments upon adoption of SFAS No. 157, (2) some commitments existing at March 31, 2008 were delivered as loans during the second quarter and (3) additional commitments that would have been deferred under EITF 02-3 were made. FHN continues to assess the financial impacts of applying the provisions of SFAS No. 157 to non-financial assets and liabilities which are recognized at fair value on a non-recurring basis.

Effective January 1, 2008, FHN adopted FASB Staff Position No. FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" (FSP FAS 157-1), which amends SFAS No. 157 to exclude Statement of Financial Accounting Standards No. 13, "Accounting for Leases" (SFAS No. 13), and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under SFAS No. 13 from its scope. The adoption of FSP FAS 157-1 had no effect on FHN's statement of condition or results of operations.

Effective January 1, 2008, FHN adopted EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (EITF 06-4). EITF 06-4 requires that a liability be recognized for contracts written to employees which provide future postretirement benefits that are covered by endorsement split-dollar life insurance arrangements because such obligations are not considered to be effectively settled upon entering into the related insurance arrangements. FHN recognized a decrease to undivided profits of \$8.5 million, net of tax, upon adoption of EITF 06-4.

Effective January 1, 2008, FHN adopted FASB Staff Position No. FIN 39-1, "Amendment of FASB Interpretation No. 39" (FSP FIN 39-1). FSP FIN 39-1 permits the offsetting of fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparty under the same master netting arrangement. Upon adoption of FSP FIN 39-1, entities were permitted to change their previous accounting policy election to offset or not offset fair value amounts recognized for derivative instruments under master netting arrangements. FSP FIN 39-1 requires additional disclosures for derivatives and collateral associated with master netting arrangements, including the separate disclosure of amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral under master netting arrangements as of the end of each reporting period for entities that made an accounting policy decision to not offset fair value amounts. FHN retained its previous accounting policy election to not offset fair value amounts recognized for derivative instruments under master netting arrangements upon adoption of FSP FIN 39-1.

## Note 1 - Financial Information (continued)

FHN also adopted FASB Statement 133 Implementation Issue No. E23, "Issues Involving the Application of the Shortcut Method under Paragraph 68" (DIG E23) as of January 1, 2008, for hedging relationships designated on or after such date. DIG E23 amends SFAS No. 133 to explicitly permit use of the shortcut method for hedging relationships in which an interest rate swap has a nonzero fair value at inception of the hedging relationship which is attributable solely to the existence of a bid-ask spread in the entity's principal market under SFAS No. 157. Additionally, DIG E23 allows an entity to apply the shortcut method to a qualifying fair value hedge when the hedged item has a trade date that differs from its settlement date because of generally established conventions in the marketplace in which the transaction to acquire or issue the hedged item is executed. Preexisting shortcut hedging relationships were analyzed as of DIG E23's adoption date to determine whether they complied with the revised shortcut criteria at their inception or should be dedesignated prospectively. The adoption of DIG E23 had no effect on FHN's financial position or results of operations as all of FHN's preexisting hedging relationships met the requirements of DIG E23 at their inception.

Effective January 1, 2007, FHN adopted Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments" (SFAS No. 155), which permits fair value remeasurement for hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation. Additionally, SFAS No. 155 clarifies the accounting guidance for beneficial interests in securitizations. Under SFAS No. 155, all beneficial interests in a securitization require an assessment in accordance with SFAS No. 133 to determine if an embedded derivative exists within the instrument. In addition, effective January 1, 2007, FHN adopted Derivatives Implementation Group Issue B40, "Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets" (DIG B40). DIG B40 provides an exemption from the embedded derivative test of paragraph 13(b) of SFAS No. 133 for instruments that would otherwise require bifurcation if the test is met solely because of a prepayment feature included within the securitized interest and prepayment is not controlled by the security holder. Since FHN presents all retained interests in its proprietary securitizations as trading securities and due to the clarifying guidance of DIG B40, the impact of adopting SFAS No. 155 was immaterial to the results of operations.

Effective January 1, 2007, FHN adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) which provides guidance for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on the classification and disclosure of uncertain tax positions in the financial statements. Upon adoption of FIN 48, FHN recognized a cumulative effect adjustment to the beginning balance of undivided profits in the amount of \$.9 million for differences between the tax benefits recognized in the statements of condition prior to the adoption of FIN 48 and the amounts reported after adoption.

Effective January 1, 2007, FHN adopted EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance" (EITF 06-5). EITF 06-5 provides that in addition to cash surrender value, the asset recognized for a life insurance contract should consider certain other provisions included in a policy's contractual terms with additional amounts being discounted if receivable beyond one year. Additionally, EITF 06-5 requires that the determination of the amount that could be realized under an insurance contract be performed at the individual policy level. FHN recognized a reduction of undivided profits in the amount of \$.5 million as a result of adopting EITF 06-5.

Effective January 1, 2007, FHN elected early adoption of the final provisions of Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS No. 158), which required that the annual measurement date of a plan's assets and liabilities be as of the date of the financial statements. As a result of adopting the measurement date provisions of SFAS No. 158, total equity was increased by \$6.2 million on January 1, 2007, consisting of a reduction to undivided profits of \$2.1 million and a credit to accumulated other comprehensive income of \$8.3 million.



Accounting Changes Issued but Not Currently Effective. In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States. As the GAAP hierarchy will reside in accounting literature established by the FASB upon adoption of SFAS No. 162, it will become explicitly and directly applicable to preparers of financial statements.

Note 1 - Financial Information (continued)

SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The adoption of SFAS No. 162 will have no effect on FHN's statement of condition or results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133" (SFAS No. 161). SFAS No. 161 requires enhanced disclosures related to derivatives accounted for in accordance with SFAS No. 133 and reconsiders existing disclosure requirements for such derivatives and any related hedging items. The disclosures provided in SFAS No. 161 will be required for both interim and annual reporting periods. SFAS No. 161 is effective prospectively for periods beginning after November 15, 2008. FHN is currently assessing the effects of adopting SFAS No. 161.

In February 2008, FASB Staff Position No. FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" (FSP FAS 140-3), was issued. FSP FAS 140-3 permits a transferor and transferee to separately account for an initial transfer of a financial asset and a related repurchase financing that are entered into contemporaneously with, or in contemplation of, one another if certain specified conditions are met at the inception of the transaction. FSP FAS 140-3 requires that the two transactions have a valid and distinct business or economic purpose for being entered into separately and that the repurchase financing not result in the initial transferor regaining control over the previously transferred financial asset. FSP FAS 140-3 is effective prospectively for initial transfers executed in reporting periods beginning on or after November 15, 2008. FHN is currently assessing the financial impact of adopting FSP FAS 140-3.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141-R, "Business Combinations" (SFAS No. 141-R) and Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51" (SFAS No. 160). SFAS No. 141-R requires that an acquirer recognize the assets acquired and liabilities assumed in a business combination, as well as any noncontrolling interest in the acquiree, at their fair values as of the acquisition date, with limited exceptions. Additionally, SFAS No. 141-R provides that an acquirer cannot specify an effective date for a business combination that is separate from the acquisition date. SFAS No. 141-R also provides that acquisition-related costs which an acquirer incurs should be expensed in the period in which the costs are incurred and the services are received. SFAS No. 160 requires that acquired assets and liabilities be measured at full fair value without consideration to ownership percentage. Under SFAS No. 160, any non-controlling interests in an acquiree should be presented as a separate component of equity rather than on a mezzanine level. Additionally, SFAS No. 160 provides that net income or loss should be reported in the consolidated income statement at its consolidated amount, with disclosure on the face of the consolidated income statement of the amount of consolidated net income which is attributable to the parent and noncontrolling interests, respectively. SFAS No. 141-R and SFAS No. 160 are effective prospectively for periods beginning on or after December 15, 2008, with the exception of SFAS No. 160's presentation and disclosure requirements which should be retrospectively applied to all periods presented. FHN is currently assessing the financial impact of adopting SFAS No. 141-R and SFAS No. 160.

In June 2007, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position 07-1, "Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies" (SOP 07-1), which provides guidance for determining whether an entity is within the scope of the AICPA's Investment Companies Guide. Additionally, SOP 07-1 provides certain criteria that must be met in order for investment company accounting applied by a subsidiary or equity method investee to be retained in the financial statements of the parent company or an equity method investor. SOP 07-1 also provides expanded disclosure requirements regarding the retention of such investment company accounting in the consolidated financial statements. In May 2007, FASB Staff Position No. FIN

46(R)- 7, “Application of FASB Interpretation No. 46(R) to Investment Companies” (FSP FIN 46(R)-7) was issued. FSP FIN 46(R)-7 amends FIN 46(R) to provide a permanent exception to its scope for companies within the scope of the revised Investment Companies Guide under SOP 07-1. In February 2008, the FASB issued FASB Staff Position No. SOP 07-1-1, “The Effective Date of AICPA Statement of Position 07-1” which indefinitely defers the effective date of SOP 07-1 and FSP FIN 46(R)-7.

## Note 2 - Acquisitions/Divestitures

In June 2008, FHN announced that it had reached a definitive agreement with MetLife Bank, N.A. (“MetLife”), a wholly-owned subsidiary of MetLife, Inc., for the sale of more than 230 retail and wholesale mortgage origination offices nationwide as well as its loan origination and servicing platform. As part of the transaction, MetLife will acquire substantially all of FHN’s mortgage origination pipeline, related hedges and certain fixed assets, including software, but will not acquire any portion of FHN’s mortgage loan warehouse. First Horizon will retain its mortgage operations in and around Tennessee, continuing to originate home loans for customers in its banking market footprint. FHN also agreed with MetLife for the sale of servicing assets, and related hedges, on approximately \$20 billion of first lien mortgage loans and associated custodial deposits. Additionally, FHN has entered into a subservicing agreement with MetLife for the remainder of FHN’s servicing portfolio. The transaction is expected to close in third quarter 2008. MetLife has agreed to pay book value for the assets and liabilities it is acquiring, subject to adjustment as discussed below. The assets and liabilities related to the mortgage operations being divested are included in the Mortgage Banking segment and are reflected as “divestiture” on the Consolidated Condensed Statements of Condition for the reporting period ending June 30, 2008.

As part of the pending transaction with Metlife, FHN has agreed to a purchase price reduction of up to \$10.0 million. To the extent that prior to the closing date FHN incurs certain specified costs, then the purchase price adjustment is to decrease by the amount of such costs. The purchase price adjustment will be decreased by \$1.0 million for each month that the closing date is delayed past August 31, 2008 for certain reasons other than First Horizon’s breach of closing conditions or the failure to obtain the approval of the Government National Mortgage Association, up to \$5.0 million maximum reduction of the purchase price adjustment. FHN currently expects the transaction to close in third quarter 2008.

Due to efforts initiated by FHN in 2007 to improve profitability, in July 2007 management decided to pursue the sale, closure, or consolidation of 34 full-service First Horizon Bank branches in Atlanta, Baltimore, Dallas and Northern Virginia. In September 2007, it was announced that agreements for the sale of all 34 of the branches had been reached. Aggregate gains of \$15.7 million were recognized in fourth quarter 2007 from the disposition of 15 of the branches. Additionally, losses of \$1.0 million and \$0.4 million were recognized in the first and second quarters of 2008, respectively, from the disposition of the remaining First Horizon Bank branches. These transactions resulted in the transfer of certain loans, certain fixed assets (including branch locations) and assumption of all the deposit relationships of the First Horizon Bank branches that were divested. The assets and liabilities related to the First Horizon Bank branches were included in the Regional Banking segment and were reflected as “divestiture” on the Consolidated Condensed Statements of Condition for reporting periods ending prior to June 30, 2008. The losses realized in the first and second quarters of 2008 from the disposition of First Horizon Bank branches are included in the noninterest income section of the Consolidated Condensed Statements of Income as losses on divestitures.

In addition to the divestitures mentioned above, FHN acquires or divests assets from time to time in transactions that are considered business combinations or divestitures but are not material to FHN individually or in the aggregate.

## Note 3 - Loans

The composition of the loan portfolio is detailed below:

(Dollars in thousands)	June 30 2008	2007	December 31 2007
<b>Commercial:</b>			
Commercial, financial and industrial	\$ 7,717,110	\$ 7,218,582	\$ 7,140,087
Real estate commercial	1,463,726	1,389,963	1,294,922
Real estate construction	2,271,533	2,830,856	2,753,475
<b>Retail:</b>			
Real estate residential	8,196,622	7,614,887	7,791,885
Real estate construction	1,513,845	2,158,775	2,008,289
Other retail	138,970	149,157	144,019
Credit card receivables	195,703	194,715	204,812
Real estate loans pledged against other collateralized borrowings	727,723	825,368	766,027
Loans, net of unearned income	22,225,232	22,382,303	22,103,516
Allowance for loan losses	575,149	229,919	342,341
<b>Total net loans</b>	<b>\$ 21,650,083</b>	<b>\$ 22,152,384</b>	<b>\$ 21,761,175</b>

Nonperforming loans consist of loans which management has identified as impaired, other nonaccrual loans and loans which have been restructured. On June 30, 2008 and 2007, there were no significant outstanding commitments to advance additional funds to customers whose loans had been restructured. The following table presents nonperforming loans on:

(Dollars in thousands)	June 30 2008	2007	December 31 2007
Impaired loans	\$ 372,494	\$ 50,761	\$ 126,612
Other nonaccrual loans*	397,524	89,747	180,475
<b>Total nonperforming loans</b>	<b>\$ 770,018</b>	<b>\$ 140,508</b>	<b>\$ 307,087</b>

\*On June 30, 2008 and 2007, and on December 31, 2007, other nonaccrual loans included \$9.9 million, \$12.5 million, and \$23.8 million, respectively, of loans held for sale.

Certain previously reported amounts have been reclassified to agree with current presentation.

Generally, interest payments received on impaired loans are applied to principal. Once all principal has been received, additional payments are recognized as interest income on a cash basis. The following table presents information concerning impaired loans:

(Dollars in thousands)	Three Months Ended June 30	
	2008	2007
Total interest on impaired loans	\$ 198	\$ 154
Average balance of impaired loans	273,521	39,042

Certain previously reported amounts have been reclassified to agree with current presentation.

Activity in the allowance for loan losses related to non-impaired loans, impaired loans, and for the total allowance for the three months ended June 30, 2008 and 2007, is summarized as follows:

(Dollars in thousands)	Non-impaired	Impaired	Total
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Balance on December 31, 2006	\$	206,292	\$	9,993	\$	216,285
Provision for loan losses		57,582		15,312		72,894
Divestitures/acquisitions/transfers		(9,671)		-		(9,671)
Charge-offs		(41,661)		(14,497)		(56,158)
Recoveries		5,900		669		6,569
Net charge-offs		(35,761)		(13,828)		(49,589)
Balance on June 30, 2007	\$	218,442	\$	11,477	\$	229,919
Balance on December 31, 2007	\$	325,297	\$	17,044	\$	342,341
Provision for loan losses		379,364		80,636		460,000
Divestitures/acquisitions/transfers		(382)		-		(382)
Charge-offs		(140,331)		(92,810)		(233,141)
Recoveries		5,848		483		6,331
Net charge-offs		(134,483)		(92,327)		(226,810)
Balance on June 30, 2008	\$	569,796	\$	5,353	\$	575,149

Certain previously reported amounts have been reclassified to agree with current presentation.

## Note 4 - Mortgage Servicing Rights

FHN recognizes all its classes of mortgage servicing rights (MSR) at fair value. Classes of MSR are determined in accordance with FHN's risk management practices and market inputs used in determining the fair value of the servicing asset. The balance of MSR included on the Consolidated Condensed Statements of Condition represents the rights to service approximately \$98.2 billion of mortgage loans on June 30, 2008, for which a servicing right has been capitalized.

Since sales of MSR tend to occur in private transactions and the precise terms and conditions of the sales are typically not readily available, there is a limited market to refer to in determining the fair value of MSR. As such, like other participants in the mortgage banking business, FHN relies primarily on a discounted cash flow model to estimate the fair value of its MSR. This model calculates estimated fair value of the MSR using predominant risk characteristics of MSR, such as interest rates, type of product (fixed vs. variable), age (new, seasoned, or moderate), agency type and other factors. FHN uses assumptions in the model that it believes are comparable to those used by brokers and other service providers. FHN also periodically compares its estimates of fair value and assumptions with brokers, service providers, and recent market activity and against its own experience. Due to ongoing disruptions in the mortgage market, since third quarter 2007, more emphasis has been placed on third party broker price discovery and, when available, observable market trades in valuation modeling for MSR.

Following is a summary of changes in capitalized MSR as of June 30, 2008 and 2007:

(Dollars in thousands)	First Liens	Second Liens	HELOC
Fair value on January 1, 2007	\$ 1,495,215	\$ 24,091	\$ 14,636
Addition of mortgage servicing rights	185,257	7,995	1,832
Reductions due to loan payments	(124,359)	(4,547)	(2,837)
Changes in fair value due to:			
Changes in current market interest rates	100,215	66	-
Reclassification to trading assets	(174,547)	-	-
Other changes in fair value	(54)	3	-
Fair value on June 30, 2007	\$ 1,481,727	\$ 27,608	\$ 13,631
Fair value on January 1, 2008	\$ 1,122,415	\$ 25,832	\$ 11,573
Addition of mortgage servicing rights	179,176	-	1,102
Reductions due to loan payments	(76,046)	(4,354)	(1,198)
Reductions due to sale	(116,113)	-	-
Changes in fair value due to:			
Changes in valuation model inputs or assumptions	1,814	(3,343)	(2,165)
Other changes in fair value	(42)	3	741
Fair value on June 30, 2008	\$ 1,111,204	\$ 18,138	\$ 10,053

In conjunction with capital management initiatives, FHN modified Pooling and Servicing Agreements (PSA) on its private securitizations during the second quarter of 2007 to segregate the retained yield component from the master servicing fee. The retained yield of \$174.5 million was reclassified from mortgage servicing rights to trading securities on the Consolidated Condensed Statements of Condition.

## Note 5 - Intangible Assets

The following is a summary of intangible assets, net of accumulated amortization, included in the Consolidated Condensed Statements of Condition:

(Dollars in thousands)	Goodwill	Other Intangible Assets*
December 31, 2006	\$ 275,582	\$ 64,530
Amortization expense	-	(5,448)
Divestitures	-	(60)
Additions**	4,243	2,925
June 30, 2007	\$ 279,825	\$ 61,947
December 31, 2007	\$ 192,408	\$ 56,907
Amortization expense	-	(4,622)
Impairment	-	(4,034)
Divestitures	-	(26)
Additions**	-	390
June 30, 2008	\$ 192,408	\$ 48,615

\* Represents customer lists, acquired contracts, premium on purchased deposits, and covenants not to compete.

\*\* Preliminary purchase price allocations on acquisitions are based upon estimates of fair value and are subject to change.

The gross carrying amount of other intangible assets subject to amortization is \$133.6 million on June 30, 2008, net of \$85.0 million of accumulated amortization. Estimated aggregate amortization expense for the remainder of 2008 is expected to be \$3.6 million and is expected to be, \$6.1 million, \$5.8 million, \$5.6 million and \$4.2 million for the twelve-month periods of 2009, 2010, 2011 and 2012, respectively.

The following is a summary of goodwill detailed by reportable segments for the six months ended June 30:

(Dollars in thousands)	Regional Banking	Mortgage Banking	Capital Markets	Total
December 31, 2006	\$ 94,276	\$ 66,240	\$ 115,066	\$ 275,582
Additions*	-	4,243	-	4,243
June 30, 2007	\$ 94,276	\$ 70,483	\$ 115,066	\$ 279,825
December 31, 2007	\$ 77,342	\$ -	\$ 115,066	\$ 192,408
June 30, 2008	\$ 77,342	\$ -	\$ 115,066	\$ 192,408

\* Preliminary purchase price allocations on acquisitions are based upon estimates of fair value and are subject to change.



## Note 6 - Regulatory Capital

FHN is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on FHN's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, specific capital guidelines that involve quantitative measures of assets, liabilities and certain derivatives as calculated under regulatory accounting practices must be met. Capital amounts and classification are also subject to qualitative judgment by the regulators about components, risk weightings and other factors. Quantitative measures established by regulation to ensure capital adequacy require FHN to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets (leverage). Management believes, as of June 30, 2008, that FHN met all capital adequacy requirements to which it was subject.

The actual capital amounts and ratios of FHN and FTBNA are presented in the table below. In addition, FTBNA must also calculate its capital ratios after excluding financial subsidiaries as defined by the Gramm-Leach-Bliley Act of 1999. Based on this calculation FTBNA's Total Capital, Tier 1 Capital and Leverage ratios were 13.87 percent, 9.90 percent and 8.10 percent, respectively, on June 30, 2008, and were 11.73 percent, 8.11 percent and 6.65 percent, respectively, on June 30, 2007.

(Dollars in thousands)	First Horizon National Corporation		First Tennessee Bank National Association	
	Amount	Ratio	Amount	Ratio
On June 30, 2008:				
Actual:				
Total Capital	\$ 4,376,408	15.15%	\$ 4,195,535	14.65%
Tier 1 Capital	3,034,698	10.51	2,936,767	10.25
Leverage	3,034,698	8.45	2,936,767	8.24
For Capital Adequacy Purposes:				
Total Capital	2,310,774	> 8.00	2,291,784	> 8.00
Tier 1 Capital	1,155,387	> 4.00	1,145,892	> 4.00
Leverage	1,436,005	> 4.00	1,425,665	> 4.00
To Be Well Capitalized Under Prompt Corrective Action Provisions:				
Total Capital			2,864,730	> 10.00
Tier 1 Capital			1,718,838	> 6.00
Leverage			1,782,082	> 5.00
On June 30, 2007:				
Actual:				
Total Capital	\$ 4,027,528	12.90%	\$ 3,797,809	12.31%
Tier 1 Capital	2,711,329	8.68	2,581,611	8.37
Leverage	2,711,329	7.00	2,581,611	6.72
For Capital Adequacy Purposes:				
Total Capital	2,497,928	> 8.00	2,468,136	> 8.00
Tier 1 Capital	1,248,964	> 4.00	1,234,068	> 4.00
Leverage	1,549,325	> 4.00	1,537,335	> 4.00
To Be Well Capitalized Under Prompt				

Corrective Action Provisions:			
Total Capital	3,085,170	>	10.00
Tier 1 Capital	1,851,102	>	6.00
Leverage	1,921,669	>	5.00

## Note 7 - Earnings Per Share

The following table shows a reconciliation of earnings per common share to diluted earnings per common share:

(In thousands, except per share data)	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Net (loss)/income from continuing operations	\$ (19,081)	\$ 21,944	\$ (12,044)	\$ 92,251
Income from discontinued operations, net of tax	-	179	883	419
Net (loss)/income	\$ (19,081)	\$ 22,123	\$ (11,161)	\$ 92,670
Weighted average common shares	171,680	125,873	148,898	125,609
Effect of dilutive securities	-	2,864	-	3,111
Diluted average common shares	171,680	128,737	148,898	128,720
Earnings/(loss) per common share				
Net (loss)/income from continuing operations	\$ (.11)	\$ .18	\$ (.08)	\$ .74
Income from discontinued operations, net of tax	-	-	.01	-
Earnings/(loss) per common share	\$ (.11)	\$ .18	\$ (.07)	\$ .74
Diluted earnings/(loss) per common share				
Net (loss)/income from continuing operations	\$ (.11)	\$ .17	\$ (.08)	\$ .72
Income from discontinued operations, net of tax	-	-	.01	-
Diluted earnings/(loss) per common share	\$ (.11)	\$ .17	\$ (.07)	\$ .72

Equity awards of 16,797 and 7,850 with weighted average exercise prices of \$33.67 and \$42.62 per share for the three months ended June 30, 2008 and 2007, respectively, and of 8,175 and 5,843 with weighted average exercise prices of \$34.67 and \$42.46 per share for the six months ended June 30, 2008 and 2007, respectively, were not included in the computation of diluted earnings per common share because such shares would have had an antidilutive effect on earnings per common share.

Note 8 - Contingencies and Other Disclosures

Contingencies. Contingent liabilities arise in the ordinary course of business, including those related to litigation. Various claims and lawsuits are pending against FHN and its subsidiaries. Although FHN cannot predict the outcome of these lawsuits, after consulting with counsel, management is of the opinion that when resolved, these lawsuits will not have a material adverse effect on the consolidated financial statements of FHN.

In November 2000, a complaint was filed in state court in Jackson County, Missouri against FHN's subsidiary, First Horizon Home Loans. The case generally concerned the charging of certain loan origination fees, including fees permitted by Kansas and federal law but allegedly restricted or not permitted by Missouri law, when First Horizon Home Loans or its predecessor, McGuire Mortgage Company, made certain second-lien mortgage loans. Among other relief, plaintiffs sought a refund of fees, a repayment and forgiveness of loan interest, prejudgment interest, punitive damages, loan rescission, and attorneys' fees. As a result of mediation, FHN entered into a final settlement agreement related to the McGuire lawsuit. The settlement has received final approval by the court, the court has entered its order making the settlement final, there have been no appeals, and the time for any appeals has expired. In connection with this settlement, FHN agreed to pay, under agreed circumstances using an agreed methodology, an aggregate of up to approximately \$36 million. The period during which claims under the settlement can be made ended in 2007. Claims have been evaluated and objections made pursuant to the agreed upon challenge process. The challenge process has not yet concluded. Unchallenged claims have been paid, and as claims are paid, the reserve is reduced. At June 30, 2008, claims paid have totaled approximately \$27 million and the total reserve remaining for this matter, based on the claims received and FHN's evaluation of them to date, is approximately \$3.7 million.

The loss reserve for this matter reflects an estimate of the amount that ultimately would be paid under the settlement. The amount reserved reflects the amount and value of claims actually received by the claims deadline plus fees and expenses that the settlement requires FHN to pay, all of which together are less than the maximum amount possible under the settlement. The ultimate amount paid under the settlement agreement is not expected to be higher than the amount reserved at present, and may be lower in the event some of the claims are reduced or rejected for reasons set forth in the settlement, and in any event cannot exceed the settlement amount.

Other disclosures – Indemnification agreements and guarantees. In the ordinary course of business, FHN enters into indemnification agreements for legal proceedings against its directors and officers and standard representations and warranties for underwriting agreements, merger and acquisition agreements, loan sales, contractual commitments, and various other business transactions or arrangements. The extent of FHN's obligations under these agreements depends upon the occurrence of future events; therefore, it is not possible to estimate a maximum potential amount of payouts that could be required with such agreements.

FHN is a member of the Visa USA network. On October 3, 2007, the Visa organization of affiliated entities completed a series of global restructuring transactions to combine its affiliated operating companies, including Visa USA, under a single holding company, Visa Inc. ("Visa"). Upon completion of the reorganization, the members of the Visa USA network remained contingently liable for certain Visa litigation matters. Based on its proportionate membership share of Visa USA, FHN recognized a contingent liability of \$55.7 million within noninterest expense in fourth quarter 2007 related to this contingent obligation.

In March 2008, Visa completed its initial public offering (IPO). Visa funded an escrow account from IPO proceeds that will be used to make payments related to the Visa litigation matters. Upon funding of the escrow, FHN reversed \$30.0 million of the contingent liability previously recognized with a corresponding credit to noninterest expense for its proportionate share of the escrow account. A portion of FHN's Class B shares of Visa were redeemed as part of the IPO resulting in \$65.9 million of equity securities gains in first quarter 2008.

After the partial share redemption in conjunction with the IPO, FHN holds approximately 2.4 million Class B shares of Visa, which are included in the Consolidated Condensed Statement of Condition at their historical cost of

\$0. Transfer of these shares is restricted for a minimum of three years with the shares ultimately being converted into Class A shares of Visa. The final conversion ratio, which is presently estimated to approximate 70 percent, will fluctuate based on the ultimate settlement of the Visa litigation matters for which FHN has a proportionate contingent obligation.

First Horizon Home Loans, a division of First Tennessee Bank National Association, services a mortgage loan portfolio of \$102.7 billion on June 30, 2008, a significant portion of which is held by GNMA, FNMA, FHLMC or private security holders. In connection with its servicing activities, First Horizon Home Loans guarantees the receipt of the scheduled principal and interest payments on the underlying loans. In the event of customer non-performance on the loan, First Horizon Home Loans is obligated to make the payment to the security holder. Under the terms of the servicing agreements, First Horizon Home Loans can utilize payments received from other prepaid loans in order to make the security holder whole.

Note 8 - Contingencies and Other Disclosures (continued)

In the event payments are ultimately made by First Horizon Home Loans to satisfy this obligation, for loans sold with no recourse, all funds are recoverable from the government agency at foreclosure sale.

First Horizon Home Loans is also subject to losses in its loan servicing portfolio due to loan foreclosures and other recourse obligations. Certain agencies have the authority to limit their repayment guarantees on foreclosed loans resulting in certain foreclosure costs being borne by servicers. In addition, First Horizon Home Loans has exposure on all loans sold with recourse. First Horizon Home Loans has various claims for reimbursement, repurchase obligations, and/or indemnification requests outstanding with government agencies or private investors. First Horizon Home Loans has evaluated all of its exposure under recourse obligations based on factors, which include loan delinquency status, foreclosure expectancy rates and claims outstanding. Accordingly, First Horizon Home Loans had an allowance for losses on the mortgage servicing portfolio of \$38.5 million and \$14.6 million on June 30, 2008 and 2007, respectively. First Horizon Home Loans has sold certain mortgage loans with an agreement to repurchase the loans upon default. For the single-family residential loans, in the event of borrower nonperformance, First Horizon Home Loans would assume losses to the extent they exceed the value of the collateral and private mortgage insurance, FHA insurance or VA guarantees. On June 30, 2008 and 2007, First Horizon Home Loans had single-family residential loans with outstanding balances of \$92.4 million and \$110.5 million, respectively, that were serviced on a full recourse basis. On June 30, 2008 and 2007, the outstanding principal balance of loans sold with limited recourse arrangements where some portion of the principal is at risk and serviced by First Horizon Home Loans was \$3.6 billion and \$3.2 billion, respectively. Additionally, on June 30, 2008 and 2007, \$1.8 billion and \$4.8 billion, respectively, of mortgage loans were outstanding which were sold under limited recourse arrangements where the risk is limited to interest and servicing advances.

FHN has securitized and sold HELOC and second-lien mortgages which are held by private security holders, and on June 30, 2008, the outstanding principal balance of these loans was \$231.3 million and \$61.4 million, respectively. On June 30, 2007, the outstanding principal balance of securitized and sold HELOC and second-lien mortgages was \$303.1 million and \$82.5 million, respectively. In connection with its servicing activities, FTBNA does not guarantee the receipt of the scheduled principal and interest payments on the underlying loans but does have residual interests of \$7.8 million and \$33.7 million on June 30, 2008 and 2007, respectively, which are available to make the security holder whole in the event of credit losses. FHN has projected expected credit losses in the valuation of the residual interest.

## Note 9 – Pension and Other Employee Benefits

Pension plan. FHN provides pension benefits to employees retiring under the provisions of a noncontributory, defined benefit pension plan. Employees of FHN's mortgage division and certain insurance subsidiaries are not covered by the pension plan. Pension benefits are based on years of service, average compensation near retirement and estimated social security benefits at age 65. The annual funding is based on an actuarially determined amount using the entry age cost method. The Pension Plan was closed to new participants on September 1, 2007.

FHN also maintains nonqualified pension plans for certain employees. These plans are intended to provide supplemental retirement income to the participants including situations where benefits under the pension plan have been limited under the tax code. All benefits provided under these plans are unfunded and payments to plan participants are made by FHN.

Other employee benefits. FHN provides postretirement medical insurance to full-time employees retiring under the provisions of the FHN Pension Plan. The postretirement medical plan is contributory with retiree contributions adjusted annually. The plan is based on criteria that are a combination of the employee's age and years of service and utilizes a two-step approach. For any employee retiring on or after January 1, 1995, FHN contributes a fixed amount based on years of service and age at time of retirement. FHN's postretirement benefits include prescription drug benefits. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) introduced a prescription drug benefit under Medicare Part D as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. FHN anticipates the plan to be actuarially equivalent through 2012.

Effective January 1, 2007, FHN adopted the final provisions of SFAS No. 158, which required that the annual measurement date of a plan's assets and liabilities be as of the date of the financial statements. As a result of adopting the measurement provisions of SFAS No. 158, undivided profits were reduced by \$2.1 million, net of tax, and accumulated other comprehensive income was credited by \$8.3 million, net of tax.

The components of net periodic benefit cost for the three months ended June 30 are as follows:

(Dollars in thousands)	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
Components of net periodic benefit cost/(benefit)				
Service cost	\$ 4,206	\$ 4,327	\$ 71	\$ 75
Interest cost	7,345	6,154	610	278
Expected return on plan assets	(11,792)	(10,637)	(439)	(441)
Amortization of prior service cost/(benefit)	216	220	(44)	(44)
Recognized losses/(gains)	494	1,810	(58)	(178)
Amortization of transition obligation	-	-	247	247
Net periodic cost/(benefit)	\$ 469	\$ 1,874	\$ 387	\$ (63)
FAS 88 Settlement Expense	\$ 715	\$ -	\$ -	\$ -
Total FAS 87 and FAS 88 Expense (Income)	\$ 1,184	\$ 1,874	\$ 387	\$ (63)

The components of net periodic benefit cost for the six months ended June 30 are as follows:

(Dollars in thousands)	Pension Benefits		Postretirement Benefits	
	2008	2007	2008	2007
Components of net periodic benefit cost/(benefit)				
Service cost	\$ 8,414	\$ 8,654	\$ 143	\$ 150
Interest cost	14,685	12,308	1,220	556
Expected return on plan assets	(23,583)	(21,274)	(878)	(882)
Amortization of prior service cost/(benefit)	433	440	(88)	(88)
Recognized losses/(gains)	987	3,620	(116)	(356)
Amortization of transition obligation	-	-	494	494
Net periodic cost/(benefit)	\$ 936	\$ 3,748	\$ 775	\$ (126)
FAS 88 Settlement Expense	\$ 715	\$ -	\$ -	\$ -
Total FAS 87 and FAS 88 Expense (Income)	\$ 1,651	\$ 3,748	\$ 775	\$ (126)

In second quarter 2008, distributions from a non-qualified postretirement plan in conjunction with an early retirement triggered settlement accounting. In accordance with its practice, FHN performed a rereasurement of the plan in conjunction with the settlement and recognized \$.7 million of settlement expense.

FHN expects to make no contributions to the pension plan or to the other employee benefit plans in 2008.



## Note 10 – Business Segment Information

FHN has five business segments, Regional Banking, Capital Markets, National Specialty Lending, Mortgage Banking and Corporate. The Regional Banking segment offers financial products and services, including traditional lending and deposit taking, to retail and commercial customers in Tennessee and surrounding markets. Additionally, Regional Banking provides investments, insurance, financial planning, trust services and asset management, credit card, cash management, and check clearing services. The Capital Markets segment consists of traditional capital markets securities activities, structured finance, equity research, investment banking, loan sales, portfolio advisory, and correspondent banking. The National Specialty Lending segment consists of traditional consumer and construction lending activities in other national markets. The Mortgage Banking segment consists of core mortgage banking elements including originations and servicing and the associated ancillary revenues related to these businesses. The Corporate segment consists of restructuring, repositioning and efficiency initiatives, gains and losses on repurchases of debt, unallocated corporate expenses, expense on subordinated debt issuances and preferred stock, bank- owned life insurance, unallocated interest income associated with excess equity, net impact of raising incremental capital, revenue and expense associated with deferred compensation plans, funds management, and venture capital. Periodically, FHN adapts its segments to reflect changes in expense allocations among segments. Previously reported amounts have been reclassified to agree with current presentation.

In first quarter 2008, FHN revised its business line segments to better align with its strategic direction, representing a focus on its regional banking franchise and capital markets business. To implement this change, the prior Retail/Commercial Banking segment was split into its major components with the national portions of consumer lending and construction lending assigned to a new National Specialty Lending segment that more appropriately reflects the ongoing wind down of these businesses. Additionally, correspondent banking was shifted from Retail/Commercial Banking to the Capital Markets segment to better represent the complementary nature of these businesses. To reflect its geographic focus, the remaining portions of the Retail/Commercial Banking segment now represent the new Regional Banking segment. All prior period information has been revised to conform to the current segment structure.

Total revenue, expense and asset levels reflect those which are specifically identifiable or which are allocated based on an internal allocation method. Because the allocations are based on internally developed assignments and allocations, they are to an extent subjective. This assignment and allocation has been consistently applied for all periods presented. The following table reflects the amounts of consolidated revenue, expense, tax, and assets for each segment for the three and six months ended June 30:

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2008	2007	2008	2007
Total Consolidated				
Net interest income	\$ 238,895	\$ 239,432	\$ 466,987	\$ 476,851
Provision for loan losses	220,000	44,408	460,000	72,894
Noninterest income	399,046	280,299	848,122	563,487
Noninterest expense	465,843	457,240	904,120	860,252
Pre-tax (loss)/income	(47,902)	18,083	(49,011)	107,192
(Benefit)/provision for income taxes	(28,821)	(3,861)	(36,967)	14,941
(Loss)/income from continuing operations	(19,081)	21,944	(12,044)	92,251
Income from discontinued operations, net of tax	-	179	883	419
Net (loss)/income	\$ (19,081)	\$ 22,123	\$ (11,161)	\$ 92,670
Average assets	\$ 36,146,101	\$ 39,070,144	\$ 36,654,243	\$ 38,859,763
Regional Banking				
Net interest income	\$ 120,384	\$ 137,672	\$ 240,949	\$ 276,599

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Provision for loan losses	89,371	14,071	164,549	28,275
Noninterest income	92,536	91,629	179,607	180,258
Noninterest expense	150,294	161,336	300,817	317,655
Pre-tax (loss)/income	(26,745)	53,894	(44,810)	110,927
(Benefit)/provision for income taxes	(19,799)	11,826	(33,307)	26,446
(Loss)/income from continuing operations	(6,946)	42,068	(11,503)	84,481
Income from discontinued operations, net of tax	-	179	883	419
Net (loss)/income	\$ (6,946)	\$ 42,247	\$ (10,620)	\$ 84,900
Average assets	\$ 12,092,608	\$ 12,345,139	\$ 12,161,732	\$ 12,307,934

Certain previously reported amounts have been reclassified to agree with current presentation.

## Note 10 – Business Segment Information (continued)

(Dollars in thousands)	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2008	2007	2008	2007
<b>Capital Markets</b>				
Net interest income	\$ 18,493	\$ 13,693	\$ 38,142	\$ 24,422
Provision for loan losses	18,522	3,673	33,553	4,835
Noninterest income	124,657	92,997	258,587	184,305
Noninterest expense	100,559	80,480	216,287	167,099
Pre-tax income	24,069	22,537	46,889	36,793
Provision for income taxes	8,960	8,411	17,397	13,698
Net income	\$ 15,109	\$ 14,126	\$ 29,492	\$ 23,095
Average assets	\$ 5,379,946	\$ 6,182,294	\$ 5,602,709	\$ 6,127,691
<b>National Specialty Lending</b>				
Net interest income	\$ 53,555	\$ 59,438	\$ 107,944	\$ 123,994
Provision for loan losses	108,106	19,104	257,675	32,231
Noninterest income	\$ (14,503)	12,448	\$ (13,852)	24,447
Noninterest expense	26,675	38,212	51,821	73,391
Pre-tax (loss)/income	(95,729)	14,570	(215,404)	42,819
(Benefit)/provision for income taxes	(33,567)	5,987	(79,959)	15,869
Net (loss)/income	\$ (62,162)	\$ 8,583	\$ (135,445)	\$ 26,950
Average assets	\$ 8,823,976	\$ 9,730,084	\$ 9,075,058	\$ 9,703,643
<b>Mortgage Banking</b>				
Net interest income	\$ 31,835	\$ 28,382	\$ 61,887	\$ 48,978
Provision for loan losses	4,001	(112)	4,223	(119)
Noninterest income	190,462	74,945	358,476	151,654
Noninterest expense	149,062	115,461	296,605	220,701
Pre-tax income/(loss)	69,234	(12,022)	119,535	(19,950)
(Benefit)/provision for income taxes	22,960	(6,854)	41,089	(17,287)
Net (loss)/income	\$ 46,274	\$ (5,168)	\$ 78,446	\$ (2,663)
Average assets	\$ 6,233,993	\$ 6,784,982	\$ 6,176,396	\$ 6,501,498
<b>Corporate</b>				
Net interest income	\$ 14,628	\$ 247	\$ 18,065	\$ 2,858
Provision for loan losses	-	7,672	-	7,672
Noninterest income	5,894	8,280	65,304	22,823
Noninterest expense	39,253	61,751	38,590	81,406
Pre-tax (loss)/income	(18,731)	(60,896)	44,779	(63,397)
(Benefit)/provision for income taxes	(7,375)	(23,231)	17,813	(23,785)
Net (loss)/income	\$ (11,356)	\$ (37,665)	\$ 26,966	\$ (39,612)
Average assets	\$ 3,615,578	\$ 4,027,645	\$ 3,638,348	\$ 4,218,997

Certain previously reported amounts have been reclassified to agree with current presentation.

## Note 11 – Derivatives

In the normal course of business, FHN utilizes various financial instruments, through its mortgage banking, capital markets and risk management operations, which include derivative contracts and credit-related arrangements, as part of its risk management strategy and as a means to meet customers' needs. These instruments are subject to credit and market risks in excess of the amount recorded on the balance sheet in accordance with generally accepted accounting principles. The contractual or notional amounts of these financial instruments do not necessarily represent credit or market risk. However, they can be used to measure the extent of involvement in various types of financial instruments. Controls and monitoring procedures for these instruments have been established and are routinely reevaluated. The Asset/Liability Committee (ALCO) monitors the usage and effectiveness of these financial instruments.

Credit risk represents the potential loss that may occur because a party to a transaction fails to perform according to the terms of the contract. The measure of credit exposure is the replacement cost of contracts with a positive fair value. FHN manages credit risk by entering into financial instrument transactions through national exchanges, primary dealers or approved counterparties, and using mutual margining agreements whenever possible to limit potential exposure. With exchange-traded contracts, the credit risk is limited to the clearinghouse used. For non-exchange traded instruments, credit risk may occur when there is a gain in the fair value of the financial instrument and the counterparty fails to perform according to the terms of the contract and/or when the collateral proves to be of insufficient value. Market risk represents the potential loss due to the decrease in the value of a financial instrument caused primarily by changes in interest rates, mortgage loan prepayment speeds or the prices of debt instruments. FHN manages market risk by establishing and monitoring limits on the types and degree of risk that may be undertaken. FHN continually measures this risk through the use of models that measure value-at-risk and earnings-at-risk.

Derivative Instruments. FHN enters into various derivative contracts both in a dealer capacity, to facilitate customer transactions, and also as a risk management tool. Where contracts have been created for customers, FHN enters into transactions with dealers to offset its risk exposure. Derivatives are also used as a risk management tool to hedge FHN's exposure to changes in interest rates or other defined market risks.

Derivative instruments are recorded on the Consolidated Condensed Statements of Condition as other assets or other liabilities measured at fair value. Fair value is defined as the price that would be received to sell a derivative asset or paid to transfer a derivative liability in an orderly transaction between market participants on the transaction date. Fair value is determined using available market information and appropriate valuation methodologies. For a fair value hedge, changes in the fair value of the derivative instrument and changes in the fair value of the hedged asset or liability are recognized currently in earnings. For a cash flow hedge, changes in the fair value of the derivative instrument, to the extent that it is effective, are recorded in accumulated other comprehensive income and subsequently reclassified to earnings as the hedged transaction impacts net income. Any ineffective portion of a cash flow hedge is recognized currently in earnings. For freestanding derivative instruments, changes in fair value are recognized currently in earnings. Cash flows from derivative contracts are reported as operating activities on the Consolidated Condensed Statements of Cash Flows.

Interest rate forward contracts are over-the-counter contracts where two parties agree to purchase and sell a specific quantity of a financial instrument at a specified price, with delivery or settlement at a specified date. Futures contracts are exchange-traded contracts where two parties agree to purchase and sell a specific quantity of a financial instrument at a specified price, with delivery or settlement at a specified date. Interest rate option contracts give the purchaser the right, but not the obligation, to buy or sell a specified quantity of a financial instrument, at a specified price, during a specified period of time. Caps and floors are options that are linked to a notional principal amount and an underlying indexed interest rate. Interest rate swaps involve the exchange of interest payments at specified intervals between two parties without the exchange of any underlying principal. Swaptions are options on interest rate swaps that give the purchaser the right, but not the obligation, to enter into an interest rate swap agreement during a specified period of

time.

On June 30, 2008, FHN had approximately \$25.2 million of cash receivables and \$30.3 million of cash payables related to collateral posting under master netting arrangements with derivative counterparties.

#### Mortgage Banking

Mortgage banking interest rate lock commitments are short-term commitments to fund mortgage loan applications in process (the pipeline) for a fixed term at a fixed price. During the term of an interest rate lock commitment, First Horizon Home Loans has the risk that interest rates will change from the rate quoted to the borrower. First Horizon Home Loans enters into forward sales and futures contracts as economic hedges designed to protect the value of the interest rate lock commitments from changes in value due to changes in interest rates. Under SFAS No. 133, interest rate lock commitments qualify as derivative financial instruments and as such do not qualify for hedge accounting treatment. As a result,

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## Note 11 – Derivatives (continued)

the interest rate lock commitments are recorded at fair value with changes in fair value recorded in current earnings as gain or loss on the sale of loans in mortgage banking noninterest income. Prior to adoption of SAB No.109 fair value excluded the value of associated servicing rights. Additionally, on January 1, 2008, FHN adopted SFAS No. 157 which affected the valuation of interest rate lock commitments previously measured under the guidance of the EITF 02-03 by requiring recognition of concessions upon entry into the lock. Changes in the fair value of the derivatives that serve as economic hedges of interest rate lock commitments are also included in current earnings as a component of gain or loss on the sale of loans in mortgage banking noninterest income.

First Horizon Home Loans' warehouse (mortgage loans held for sale) is subject to changes in fair value, due to fluctuations in interest rates from the loan closing date through the date of sale of the loan into the secondary market. Typically, the fair value of the warehouse declines in value when interest rates increase and rises in value when interest rates decrease. To mitigate this risk, First Horizon Home Loans enters into forward sales contracts and futures contracts to provide an economic hedge against those changes in fair value on a significant portion of the warehouse. These derivatives are recorded at fair value with changes in fair value recorded in current earnings as a component of the gain or loss on the sale of loans in mortgage banking noninterest income.

FHN adopted SFAS No. 159 on January 1, 2008. As discussed below, prior to adoption of SFAS No. 159, all warehouse loans were carried at the lower of cost or market, where carrying value was adjusted for successful hedging under SFAS No. 133 and the comparison of carrying value to market was performed for aggregate loan pools. To the extent that these interest rate derivatives were designated to hedge specific similar assets in the warehouse and prospective analyses indicate that high correlation was expected, the hedged loans were considered for hedge accounting under SFAS No. 133. Anticipated correlation was determined by projecting a dollar offset relationship for each tranche based on anticipated changes in the fair value of the hedged mortgage loans and the related derivatives, in response to various interest rate shock scenarios. Hedges were reset daily and the statistical correlation was calculated using these daily data points. Retrospective hedge effectiveness was measured using the regression correlation results. First Horizon Home Loans generally maintained a coverage ratio (the ratio of expected change in the fair value of derivatives to expected change in the fair value of hedged assets) of approximately 100 percent on warehouse loans hedged under SFAS No. 133. Effective SFAS No. 133 hedging resulted in adjustments to the recorded value of the hedged loans. These basis adjustments, as well as the change in fair value of derivatives attributable to effective hedging, were included as a component of the gain or loss on the sale of loans in mortgage banking noninterest income. Warehouse loans qualifying for SFAS No. 133 hedge accounting treatment totaled \$2.6 billion on June 30, 2007. There were no warehouse loans qualifying for SFAS No. 133 hedge accounting treatment at June 30, 2008. The balance sheet impact of the related derivatives was net assets of \$20.0 million on June 30, 2007. Net losses of \$1.6 million representing the ineffective portion of these fair value hedges were recognized as a component of gain or loss on sale of loans for the six months ended June 30, 2007.

Upon adoption of SFAS No. 159, FHN elected to prospectively account for substantially all of its mortgage loan warehouse products at fair value upon origination and correspondingly discontinued the application of SFAS No. 133 hedging relationships for all new originations. First Horizon Home Loans enters into forward sales and futures contracts to provide an economic hedge against changes in fair value on a significant portion of the warehouse.

In accordance with SFAS No. 156, First Horizon revalues MSR to current fair value each month. Changes in fair value are included in servicing income in mortgage banking noninterest income. First Horizon Home Loans also enters into economic hedges of the MSR to minimize the effects of loss in value of MSR associated with increased prepayment activity that generally results from declining interest rates. In a rising interest rate environment, the value of the MSR generally will increase while the value of the hedge instruments will decline. First Horizon Home Loans enters into interest rate contracts (including swaps, swaptions, and mortgage forward sales contracts) to hedge against the effects of changes in fair value of its MSR. Substantially all capitalized MSR are hedged for economic purposes.

First Horizon Home Loans utilizes derivatives (including swaps, swaptions, and mortgage forward sales contracts) that change in value inversely to the movement of interest rates to protect the value of its interest-only securities as an economic hedge. Changes in the fair value of these derivatives are recognized currently in earnings in mortgage banking noninterest income as a component of servicing income.

Interest-only securities are included in trading securities with changes in fair value recognized currently in earnings in mortgage banking noninterest income as a component of servicing income.

#### Capital Markets

Capital Markets trades U.S. Treasury, U.S. Agency, mortgage-backed, corporate and municipal fixed income securities, and other securities for distribution to customers. When these securities settle on a delayed basis, they are considered forward contracts. Capital Markets also

## Note 11 – Derivatives (continued)

enters into interest rate contracts, including options, caps, swaps, and floors for its customers. In addition, Capital Markets enters into futures contracts to economically hedge interest rate risk associated with a portion of its securities inventory. These transactions are measured at fair value, with changes in fair value recognized currently in capital markets noninterest income. Related assets and liabilities are recorded on the balance sheet as other assets and other liabilities. Credit risk related to these transactions is controlled through credit approvals, risk control limits and ongoing monitoring procedures through the Credit Risk Management Committee.

As of June 30, 2008, Capital Markets hedged \$244.6 million of held-to-maturity trust preferred securities, which have an initial fixed rate term of five years before conversion to a floating rate. Capital Markets has entered into pay fixed, receive floating interest rate swaps to hedge the interest rate risk associated with this initial five year term. The balance sheet impact of those swaps was \$6.8 million in other liabilities on June 30, 2008. Interest paid or received for these swaps was recognized as an adjustment of the interest income of the assets whose risk is being hedged.

## Interest Rate Risk Management

FHN's ALCO focuses on managing market risk by controlling and limiting earnings volatility attributable to changes in interest rates. Interest rate risk exists to the extent that interest-earning assets and liabilities have different maturity or repricing characteristics. FHN uses derivatives, including swaps, caps, options, and collars, that are designed to moderate the impact on earnings as interest rates change. FHN's interest rate risk management policy is to use derivatives not to speculate but to hedge interest rate risk or market value of assets or liabilities. In addition, FHN has entered into certain interest rate swaps and caps as a part of a product offering to commercial customers with customer derivatives paired with offsetting market instruments that, when completed, are designed to eliminate market risk. These contracts do not qualify for hedge accounting and are measured at fair value with gains or losses included in current earnings in noninterest income.

FHN had entered into pay floating, receive fixed interest rate swaps to hedge the interest rate risk of certain large institutional certificates of deposit, totaling \$61.9 million on June 30, 2007. These swaps matured in first quarter 2008 and had been accounted for as fair value hedges under the shortcut method. The balance sheet impact of these swaps was \$.6 million in other liabilities on June 30, 2007. Interest paid or received for these swaps was recognized as an adjustment of the interest expense of the liabilities whose risk was being managed.

FHN has entered into pay floating, receive fixed interest rate swaps to hedge the interest rate risk of certain long-term debt obligations, totaling \$1.2 billion and \$1.1 billion on June 30, 2008 and 2007, respectively. These swaps have been accounted for as fair value hedges under the shortcut method. The balance sheet impact of these swaps was \$29.1 million in other assets on June 30, 2008, and \$41.5 million in other liabilities on June 30, 2007. Interest paid or received for these swaps was recognized as an adjustment of the interest expense of the liabilities whose risk was being managed.

FHN designates derivative transactions in hedging strategies to manage interest rate risk on subordinated debt related to its trust preferred securities. These qualify for hedge accounting under SFAS No. 133 using the long haul method. FHN has entered into pay floating, receive fixed interest rate swaps to hedge the interest rate risk of certain subordinated debt totaling \$.3 billion on June 30, 2008 and 2007. The balance sheet impact of these swaps was \$14.3 million and \$29.7 million in other liabilities on June 30, 2008 and 2007, respectively. There was no ineffectiveness related to these hedges. Interest paid or received for these swaps was recognized as an adjustment of the interest expense of the liabilities whose risk is being managed.

FHN had utilized an interest rate swap as a cash flow hedge of the interest payment on floating-rate bank notes with a fair value of \$100.5 million on June 30, 2007, and a maturity in first quarter 2009, which in first quarter 2008 was called early. The balance sheet impact of this swap was \$.5 million in other assets and \$.3 million, net of tax, in other



comprehensive income on June 30, 2007. There was no ineffectiveness related to this hedge.

Note 12 - Restructuring, Repositioning, and Efficiency Charges

Throughout 2007, FHN conducted a company-wide review of business practices with the goal of improving its overall profitability and productivity. In addition, during 2007 management announced its intention to sell 34 full-service First Horizon Bank branches in its national banking markets. These sales were completed in second quarter 2008. In the second half of 2007, FHN also took actions to right size First Horizon Home Loans' mortgage banking operations and to downsize FHN's national lending operations, in order to redeploy capital to higher-return businesses. As part of its strategy to reduce its national real estate portfolio, FHN announced in January 2008 that it was discontinuing national homebuilder and commercial real estate lending through its First Horizon Construction Lending offices. Additionally, FHN initiated the repositioning of First Horizon Home Loans' mortgage banking operations, which included sales of MSR in fourth quarter 2007 and the first and second quarters of 2008.

In June 2008, FHN announced that it had reached a definitive agreement with MetLife for the sale of more than 230 retail and wholesale mortgage origination offices nationwide as well as its loan origination and servicing platform. FHN also agreed with MetLife for the sale of servicing assets, and related hedges, on approximately \$20 billion of first lien mortgage loans and related custodial deposits. The transaction is expected to close in third quarter 2008. MetLife will pay book value for the assets and liabilities it is acquiring, subject to an adjustment of up to \$10.0 million.

Net costs recognized by FHN in the six months ended June 30, 2008 related to restructuring, repositioning, and efficiency activities were \$47.2 million. Of this amount, \$25.5 million represents exit costs that have been accounted for in accordance with Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS No. 146).

Significant expenses year to date for 2008 resulted from the following actions:

- Expense of \$25.5 million associated with organizational and compensation changes due to right sizing operating segments, the divestiture of certain First Horizon Bank branches, the pending divestiture of certain mortgage banking operations and consolidating functional areas.
  - Losses of approximately \$1.4 million from the sales of certain First Horizon Bank branches.