ZWEIG TOTAL RETURN FUND INC
Form N-CSR
March 10, 2008

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

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-05620

The Zweig Total Return Fund, Inc.
(Exact name of registrant as specified in charter)

900 Third Ave, 31st Floor
New York, NY 10022-4728
(Address of principal executive offices) (Zip code)

Kevin J. Carr, Esq.	
Chief Legal Officer and Secretary for Registrant	John H. Beers, Esq.
	Vice President and Counsel
Phoenix Life Insurance Company	Phoenix Life Insurance Company
One American Row	One American Row
Hartford, CT 06103-2899	Hartford, CT 06103-2899

(Name and address of agent for service)

Registrant's telephone number, including area code: 800-272-2700

Date of fiscal year end: December 31

Date of reporting period: December 31, 2007

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. (S) 3507.

Item 1. Reports to Stockholders.

The Report to Shareholders is attached herewith.

February 1, 2008

Dear Fellow ZTR Shareholder:

The Zweig Total Return Fund's net asset value increased 2.56% for the quarter ended December 31, 2007, including $0.126 in reinvested distributions. During the same period, the Fund's Composite Index gained 0.20%, including reinvested dividends. The Fund's overall exposure to the bond and equity markets for the quarter was approximately 88%. As previously announced, the Fund's distribution for the quarter was $0.041, payable on January 10, 2008 to shareholders of record on December 31, 2007.

For the year ended December 31, 2007, the Fund's net asset value increased 7.93%, including $0.503 in reinvested distributions. Year-to-date taxable distributions represent 28.1% from net investment income, 31.3% from ordinary gains, and 40.6% from return of capital. During the same period, the Fund's Composite Index gained 6.49%, including reinvested dividends. The Fund's overall exposure to the bond and equity markets for the year was approximately 92%.

Sincerely,

/s/ George R. Aylward
George R. Aylward
President, Chairman and
Chief Executive Officer
The Zweig Total Return
Fund, Inc.

MARKET OVERVIEW AND OUTLOOK

The Fund's bond exposure on December 31, 2007 was 47%, with average duration (a measure of interest rate sensitivity) of 5.0 years. This compares with bond exposure of 48%, with average duration of 5.5 years, on September 30, 2007. If we were fully invested, 50% of our portfolio would be in bonds and 50% in stocks. Consequently, at 47%, we are at about 94% of a full position (47%/50%).

The U.S. Treasury bond market marched in different directions during the first and second six months of 2007. The first half generally saw higher yields and poor bond market performance (bond prices move in an opposite direction from yields). Reversing course, the bond market staged a significant second-half rally generated by the housing implosion, the subprime mortgage meltdown and concerns about a possible recession.

With the exception of inflation data, bond-friendly economic news helped Treasuries surge, with the benchmark 10-year Treasury note falling from a high of 5.30% in mid-June to finish the year at 4.02%. The bond market's volatile year reflected the weakness in jobs, retail sales, housing starts and other economically-sensitive data. On balance, yields on Treasury bonds seemed to be driven mostly by the softening economic outlook rather than by worries about inflation. By the year-end, the Fed had cut the federal funds rate to 4.25%. Anticipating further easing, Treasury bonds are reacting with lower rates.

During 2007, we made several adjustments in our bond portfolio, moving at times from a high duration to a more neutral stance. Overall, our results were favorable. Considering only the bond performance of the Fund, we outperformed the Lipper Government Fund benchmark. Our current

Managed Distribution Plan: The Fund has a policy to distribute 10% of its net asset value annually. Please see the inside back cover for more details.

bond model is slightly positive. However, given the recent volatility endured by bond investors, we remain cautious and flexible, as always.

Our exposure to U.S. common stock was 40% on December 31, 2007 compared with 48% on September 30, 2007. At this level, we are at about 80% of a full position (40%/50%).

Featuring wild swings in stock prices, the fourth quarter of 2007 was one for the financial history books. On November 16, 2007, the Dow Jones Industrial Average plummeted 237.44 points, taking it 10% below its October 9, 2007, record high close of 14,164.53, a traditional definition of a correction. It was a very short correction. Three days later, on November 28, the Dow soared 331.01 points, its biggest percentage gain in more than four years. That day also marked the fifth straight day of 100-point- plus moves, up or down, for the Dow.

Earlier, three days of losses culminating on November 9 together represented the worst percentage decline in five years. After this whipsaw quarter, all the major indexes lost ground for the final three months of the year. The Dow was off 4.5%/1/, the S&P 500 Index was down 3.8%/1/ and the NASDAQ Composite Index fell 3.0%/1/. However, when the roller-coaster finally came to a halt on December 31, the Dow closed 6.4% higher for the year. The S&P 500 gained 3.5%/1/ and the NASDAQ climbed 9.8%/1/, its best annual showing since 2003.

For the fifth consecutive year, the world stock markets outperformed the U.S. Excluding the U.S., the Dow Jones World Stock Index rose nearly 12%/1/ in 2007, with the gains mostly in the emerging and developing nations. China soared 97% and Brazil, India, Indonesia and Turkey all scored over 40%. In England, the FTSE increased only 3.8%/1/ while Japan's NIKKEI dropped 11%/1/.

Most of the domestic market troubles centered around the widening housing slump and the slipover of its problematic subprime mortgage-backed securities into the broader financial markets, creating a credit crunch. That one-two punch had a huge impact. Its repercussions spread to the credit card companies, retailers and other sectors of the economy. It hit earnings hard and caused stocks to tumble.

The housing situation remains a mess. Marking the eighth consecutive monthly decline, construction of new homes dropped 3.7% in November, to a seasonally adjusted annual rate of 1.19 million units the lowest since 1991, according to the Commerce Department. Indicating a further decline, new building permits fell 1.5% in November, down 25% from a year earlier.

Because foreclosures are spreading in the housing market, large financial institutions have taken multi-billion dollar writedowns on their portfolios of subprime mortgages and their various derivatives. To balance their books, financial companies have cut back on their lending practices and received huge cash transfusions from foreign sources. The tightness in the credit markets is damaging the overall economy. At this writing, it is hard to see any light in the housing and credit tunnels.

With the economy wielding down and inflation heating up, the Fed is between a rock and a hard place. If it continues to cut rates, it will only help the banks and the economy at the margin in the short term. If it cuts too much, it can weaken the dollar and exacerbate inflation.

Citing the "deterioration in financial world markets," the Fed cut its benchmark short-term interest rate in December by 25 basis points to 4.25%. Since the credit crunch erupted in August, the Fed has reduced the federal funds rate by a full percentage point. Explaining its action, the Fed pointed to "the intensification of the housing correction and some softening in business and consumer spending." The Fed also noted that "elevated energy and commodity prices among other factors may put upward pressure on inflation." Stating that it would continue to monitor inflation developments carefully, the Fed

promised that it "will act as needed to foster price stability and sustainable economic growth."

Reflecting the weaker economy, the Institute for Supply Management reported that its index of manufacturing activity fell to 47.7 in December from 50.8 in November, its lowest reading since April 2003. A score below 50 indicates industrial contraction. Stoking the fear of inflation, consumer prices rose 0.8% in November, the biggest monthly gain in two years and 4.3% above a year ago. Producer prices jumped 3.2% in November, bringing the increase for the past 12 months to 7.7%. These parallel moves have given investors concern about stagflation, characterized by a slowing economy and rising inflation, bringing worries about a possible recession.

A bright spot in the economy is the rise in U.S. exports. Helped by the weak dollar, exports in October rose for the eighth consecutive month to a record $141.7 billion, the Commerce Department reported. From August through October, U.S. exports spurted 9.6% while imports inched up only 1.1%. Meanwhile, the dollar ended the year 9.6% lower against the euro and 6.4% below the Japanese yen, according to the Fed. Calculated against a group of 20 currencies, the dollar lost 7.5% for the year.

There are negatives as well as positive factors in the climbing exports. On the positive side, the export rise is keeping a lot of people at work in this country. At the same time, the soft dollar is responsible for raising prices of imported goods, fueling inflation. Overall, the increased exports are a plus for the economy but we don't believe it's healthy for the dollar to continue to decline.

When credit markets tightened, mergers and acquisitions world-wide declined. Deals came to 10,027 in the fourth quarter against 11,082 in the third period, according to Thomson Financial. Despite the sharp fall-off from August through December, transactions in 2007 increased to $4.5 trillion, a jump of 24% from 2006. Total European volume of $1.8 trillion topped the U.S. for the first time and beat the record of $1.7 trillion set by the U.S. in 2000. Last year the M&A volume in the U.S. came to $1.6 trillion.

We don't expect a quick pickup in mergers and acquisitions. While we will see some corporate takeovers of companies whose stock seems cheap, there will be far fewer leveraged buyouts because of the difficulty in obtaining debt financing. The credit crunch would have to ease a great deal before M&A

activity flourishes again.

With the emerging markets taking the lead, initial public offerings worldwide were slightly more active in the second half of 2007, accounting for 54% of the year's offerings, according to Dealogic. Last year saw 1,317 deals that raised $291.3 billion against 1,097 deals raising $241.6 billion in 2006. While we have been getting IPO's, it will become harder to underwrite them if the market declines. Nobody wants to buy IPO's in a really weak market.

Reflecting the blowouts in the housing and financial markets, earnings of companies in the S&P 500 Index presented a mixed picture. Operating earnings for the entire index in the fourth quarter are expected to fall 7.7% from the 2006 period, according to S&P. Excluding the financial sector, earnings of companies in the index are expected to rise 11.6%. Following are the strongest areas and their estimated gains: telecommunications 33%, healthcare 24%, and information technology 23%.

As far as dividends are concerned, S&P reported that companies in its 500-Index paid a total of $246.6 billion last year, up 11.5% from 2006. The per-share average reached a record $27.73 in 2007 and S&P forecast a further increase of 9.3% in 2008. Eleven companies initiated a dividend payment in 2007, bringing the dividend paying total to 389 companies, a seven-year high. Our guess is that dividend increases will slow down simply because earnings will not be there to support them.

At the year-end, companies in the S&P 500 were trading at 19.0 times earnings, according to

Barron's. This compares with 17.9 times earnings on September 30, 2007, and 18.2 times earnings on December 31, 2006. When the bull market began in October 2002, the P/E ratio was 27. Since World War II, the average P/E ratio is 16.1. P/E ratios are higher because company earnings fell more than the prices of their shares. While the year-end valuations may not be expensive, we don't see many bargains out there at these levels.

Surprisingly, with all the market turmoil and talk of a possible recession, advisors' sentiment remains bullish by a wide margin. As of December 31, 2007, the Investor Intelligence survey of market advisors found 55% bullish and only 23% bearish. This compares with a reading of 56% bulls and 27% bears at the end of the third quarter and 56% bulls and 20% bears at the close of 2006.

This excessive optimism by advisors certainly was not helpful for the market. More realistic views were expressed by members of the American Association of Individual Investors, who at the year-end stood at 25.7%, bulls 55.2% bears and 19.7% neutral. Since these readings, pessimism has definitely gone up.

Sincerely,

/s/Martin E. Zweig, Ph.D.

Martin E. Zweig, Ph.D.
President
Zweig Consulting LLC

PORTFOLIO COMPOSITION

All of our bonds are U.S. Government and Agency obligations. These bonds are highly liquid and provide the flexibility to respond quickly to changing conditions.

As of December 31, 2007, the Fund's leading equity sectors included information technology, energy, industrials, consumer staples, and financials. With the exception of financials, which replaced materials, all of the above were in our previous listing. During the quarter we trimmed our positions in information technology and consumer discretionary.

The Fund's top individual equity positions on December 31, 2007, included Allstate, Altria Group, AT&T, ConocoPhillips, Freeport McMoRan, McDonalds, Merck, Occidental Petroleum,
PepsiCo, and Verizon. New to this listing are Allstate, where we added to our position; AT&T, where there was no change in shares held, and Occidental Petroleum, where we reduced our holdings.

No longer in our top positions are Dow Chemical and Foster Wheeler, where we trimmed our holdings, and PowerShares QQQ, which we eliminated.

Sincerely,

[SIGNATURE]

/s/ Carlton Neel
Carlton Neel
Executive Vice President
Phoenix/Zweig Advisers LLC

/1/ Return excludes reinvested dividends

The preceding information is the opinion of portfolio management. Past performance is no guarantee of future results, and there is no guarantee that market forecasts will be realized.
For definitions of indexes cited and certain investment terms used in this report see the glossary on page 5.
As interest rates rise, bond prices fall. As such, this Fund's share value may decline substantially and it is possible to lose a significant portion of your principal when interest rates rise.

Glossary

American Depositary Receipt (ADR): Represents shares of foreign companies traded in U.S. dollars on U.S. exchanges that are held by a bank or a trust. Foreign companies use ADRs in order to make it easier for Americans to buy their shares.

Benchmark Index for The Zweig Total Return Fund: A composite index consisting of 62.5% Lehman Brothers Government Bond Index and 37.5% S&P 500(R) Index.

Dow Jones Industrial Average/SM/: A price-weighted average of 30 blue chip stocks. The index is calculated on a total return basis with dividends

reinvested.

Duration: A measure of a fixed income fund's sensitivity to interest rate changes. For example, if a fund's duration is 5 years, a 1% increase in interest rates would result in a 5% decline in the fund's price. Similarly, a 1% decline in interest rates would result in a 5% gain in the fund's price.

Federal funds rate: The interest rate charged on overnight loans of reserves by one financial institution to another in the United States. The federal funds rate is the most sensitive indicator of the direction of interest rates since it is set daily by the market.

Federal Reserve (the "Fed"): The central bank of the United States, responsible for controlling the money supply, interest rates and credit with the goal of keeping the U.S. economy and currency stable. Governed by a seven-member board, the system includes 12 regional Federal Reserve Banks, 25 branches and all national and state banks that are part of the system.

Initial public offering (IPO): A company's first sale of stock to the public.

Investors Intelligence Survey: A weekly survey published by Chartcraft, an investment services company, of the current sentiment of approximately 150 market newsletter writers. Participants are classified into three categories: bullish, bearish or waiting for a correction.

NASDAQ Composite(R) Index: A market capitalization-weighted index of all issues listed in the NASDAQ (National Association Of Securities Dealers Automated Quotation System) Stock Market, except for closed-end funds, convertible debentures, exchange traded funds, preferred stocks, rights, warrants, units and other derivative securities. The index is calculated on a total return basis with dividends reinvested.

S&P 500(R) Index: A free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested.

Yield curve: A line chart that shows interest rates at a specific point in time for securities of equivalent quality but with different maturities. A "normal or positive" yield curve indicates that short-term securities have a lower interest rate than long-term securities; an "inverted or negative" yield curve indicates short-term rates are exceeding long-term rates; and a "flat yield curve" means short- and long-term rates are about the same.

Indexes cited are unmanaged and not available for direct investment; therefore their performance does not reflect the expenses associated with the active management of an actual portfolio.

THE ZWEIG TOTAL RETURN FUND, INC.

[CHART]

Sector Weightings 12/31/07
(as a percentage of total investments)

U.S. Government Securities	40%
Domestic Common Stocks	37%
Agency Non-Mortgage Backed Securities	4%
Foreign Common Stocks	1%

Exchange Traded Funds	1%
Other (includes short-term investments)	17%

SCHEDULE OF INVESTMENTS AND SECURITIES SOLD SHORT

December 31, 2007

		Par (000's)	Value
INVESTMENTS			
U.S. GOVERNMENT SECURITIES	42.51%		
U.S. TREASURY BONDS -- 23.64%			
U.S. Treasury Bond 9.25%, 2/15/16..................		$20,000	$ 27,304,680
U.S. Treasury Bond 7.50%, 11/15/16/(d)/............		20,000	25,104,680
U.S. Treasury Bond 8.75%, 5/15/17/(d)/.............		22,000	29,930,318
U.S. Treasury Bond 8.875%, 2/15/19.................		15,000	21,094,920
U.S. Treasury Bond 6.125%, 11/15/27/(d)/...........		17,500	21,192,780
U.S. Treasury Bond 4.50%, 2/15/36/(d)/.............		10,000	10,050,780
			134,678,158
U.S. TREASURY NOTES -- 18.87%			
U.S. Treasury Inflation Indexed Note 1.625%, 1/15/15/(d)(h)/.................................		27,000	29,659,474
U.S. Treasury Note 4%, 11/15/12/(d)(e)/............		18,500	18,998,631
U.S. Treasury Note 3%, 2/15/08.....................		38,000	37,985,142
U.S. Treasury Note 4.50%, 2/15/16/(d)/.............		20,000	20,817,180
			107,460,427
Total U.S. Government Securities (Identified Cost $234,718,190)......................			242,138,585
AGENCY NON-MORTGAGE-BACKED SECURITIES	4.64%		
FNMA 3.15%, 5/28/08................................		26,570	26,418,338
Total Agency Non-Mortgage-Backed Securities (Identified Cost $26,581,157).			26,418,338

		Number of Shares	Value
DOMESTIC COMMON STOCKS	39.21%		
CONSUMER DISCRETIONARY -- 1.93%			
McDonald's Corp.............................		97,000	$ 5,714,270

NIKE, Inc. Class B..........................	82,000	5,267,680
		10,981,950
CONSUMER STAPLES -- 4.07%		
Altria Group, Inc...........................	94,000	7,104,520
Bunge Ltd...................................	40,000	4,656,400
Costco Wholesale Corp.......................	71,000	4,952,960
PepsiCo, Inc................................	85,000	6,451,500
		23,165,380
ENERGY -- 6.13%		
Chesapeake Energy Corp......................	109,000	4,272,800
ConocoPhillips..............................	73,000	6,445,900
Halliburton Co..............................	127,000	4,814,570
Massey Energy Co............................	138,000	4,933,500
Occidental Petroleum Corp...................	74,000	5,697,260
St. Mary Land & Exploration Co..............	109,000	4,208,490
Valero Energy Corp..........................	65,000	4,551,950
		34,924,470
FINANCIALS -- 3.77%		
Allstate Corp. (The)........................	118,000	6,163,140
American International Group, Inc...........	85,000	4,955,500
Citigroup, Inc..............................	143,000	4,209,920
Goldman Sachs Group, Inc. (The)..............	12,000	2,580,600
Reinsurance Group of America, Inc............	68,000	3,568,640
		21,477,800
HEALTH CARE -- 3.54%		
Bristol-Myers Squibb Co.....................	196,000	5,197,920
Gilead Sciences, Inc./(b)/..................	86,000	3,956,860
Merck & Co., Inc............................	106,000	6,159,660
UnitedHealth Group, Inc.....................	83,000	4,830,600
		20,145,040
INDUSTRIALS -- 6.47%		
3M Co.......................................	17,000	$ 1,433,440
AMR Corp./(b)/..............................	171,000	2,399,130
Boeing Co. (The)............................	61,000	5,335,060
Caterpillar, Inc............................	75,000	5,442,000
Continental Airlines, Inc. Class B/(b)(d)/....	141,000	3,137,250
Foster Wheeler Ltd./(b)/....................	27,000	4,185,540
General Electric Co.........................	145,000	5,375,150

See notes to financial statements

	Number of Shares	Value

INDUSTRIALS (CONTINUED)		
L-3 Communications Holdings, Inc.	43,000	$ 4,555,420
Union Pacific Corp.	40,000	5,024,800
		36,887,790
INFORMATION TECHNOLOGY -- 7.80%		
Ciena Corp./(b)(d)/	112,000	3,820,320
Cisco Systems, Inc./(b)/	160,000	4,331,200
Corning, Inc.	192,000	4,606,080
Dell, Inc./(b)(d)/	144,000	3,529,440
EMC Corp./(b)/	208,000	3,854,240
Hewlett-Packard Co.	98,000	4,947,040
International Business Machines Corp.	51,000	5,513,100
Microsoft Corp.	143,000	5,090,800
National Semiconductor Corp.	166,000	3,758,240
QUALCOMM, Inc.	127,000	4,997,450
		44,447,910
MATERIALS -- 3.35%		
Alcoa, Inc.	151,000	5,519,050
Dow Chemical Co. (The)	75,000	2,956,500
Freeport-McMoRan Copper & Gold, Inc. (Indonesia)	55,000	5,634,200
NuCor Corp.	84,000	4,974,480
		19,084,230
TELECOMMUNICATION SERVICES -- 2.15%		
AT&T, Inc./(e)/	146,000	6,067,760
Verizon Communications, Inc./(e)/	142,000	6,203,980
		12,271,740
Total Domestic Common Stocks (Identified Cost $193,381,700)		223,386,310
FOREIGN COMMON STOCKS/(c)/ 1.46%		
ENERGY -- 0.65%		
Nabors Industries Ltd. (United States)/(b)(d)/.	136,000	3,725,040
		3,725,040
INFORMATION TECHNOLOGY -- 0.81%		
Nokia Oyj Sponsored ADR (Finland)	120,000	4,606,800
		4,606,800
Total Foreign Common Stocks (Identified Cost $6,545,878)		8,331,840

See notes to financial statements

		Number of Shares	Value
EXCHANGE TRADED FUNDS	0.23%		
PowerShares Deutsche Bank Agriculture Fund/(b)/...		40,000	$ 1,319,600
Total Exchange Traded Funds (Identified Cost $1,283,206)			1,319,600
Total Long Term Investments -- 88.05% (Identified Cost $462,510,131)......................................			501,594,673
SHORT-TERM INVESTMENTS	17.61%		
MONEY MARKET MUTUAL FUNDS -- 6.17%			
State Street Navigator Prime Plus (4.88% seven-day effective yield)/(f)/...........		35,123,438	35,123,438
			35,123,438

	Par (000's)	Value
COMMERCIAL PAPER/(g)/ -- 11.44%		
7-Eleven, Inc. 4.20%, 1/9/08.....................	$ 10,100	10,090,573
Nestle S.A. 4.15%, 1/25/08.......................	3,100	3,091,423
Northern Illinois Gas Co. 4%, 1/2/08.............	27,000	26,997,000
NSTAR Electric Co. 4.22%, 1/4/08.................	25,000	24,991,209
		65,170,205
Total Short-Term Investments (Identified Cost $100,293,643)......................................		100,293,643
Total Investments (Identified Cost $562,803,774) -- 105.66%...		601,888,316/(a)/
Other Assets and Liabilities, net -- (4.91)%...........		(27,941,524)
Securities Sold Short (Proceeds $6,690,525) -- (0.75)%.		(4,291,220)
Net Assets -- 100.00%.................................		$569,655,572

(a) Federal Income Tax Information: Net unrealized appreciation of investment securities is comprised of gross appreciation of $40,473,953 and gross depreciation of $6,892,281 for federal income tax purposes. At December 31, 2007, the aggregate cost of securities for federal income tax purposes was $568,306,644.
(b) Non-income producing.
(c) A security is considered to be foreign if the security is issued in a foreign country. The country of risk, noted parenthetically, is determined based on criteria described in Note 2F "Foreign security country determination" in the Notes to Financial Statements.
(d) All or a portion of security is on loan.
(e) Position, or a portion thereof, has been segregated as collateral for securities sold short.
(f) Represents security purchased with cash collateral received for securities on loan.
(g) The rate shown is the discount rate.
(h) Principal amount is adjusted daily pursuant to the change in the Consumer

Price Index.

See notes to financial statements

		Number of Shares	Value
DOMESTIC COMMON STOCKS SOLD SHORT	0.75%		
CONSUMER DISCRETIONARY -- 0.49%			
Starbucks Corp.		137,000	$2,804,390
INDUSTRIALS -- 0.26%			
YRC Worldwide, Inc.		87,000	1,486,830
Total Domestic Common Stocks Sold Short (Proceeds $6,690,525)			$4,291,220/(i)/

(i) Federal Tax Information: Net unrealized appreciation of securities sold short is comprised of gross appreciation of $2,399,305, and gross depreciation of $0 for federal income tax purposes. At December 31, 2007, the aggregate proceeds of securities sold short for federal income tax purposes was $6,690,525.

See notes to financial statements

THE ZWEIG TOTAL RETURN FUND, INC.

STATEMENT OF ASSETS AND LIABILITIES

December 31, 2007

ASSETS	
Investment securities at value, including $36,427,667 of securities on loan (Identified cost $562,803,774)	$601,
Cash	
Deposits with broker for securities sold short	4,
Receivables	
Dividends and interest	3,
Prepaid expenses	
Total Assets	609,
LIABILITIES	

Payables	
Securities sold short at value, (Proceeds $6,690,525)........	4,
Upon return of securities loaned........	35,
Investment advisory fee........	
Printing fee........	
Transfer agent fee........	
Professional fee........	
Administration fee........	
Trustees' fee........	
Rights offering expense........	
Custodian fee........	
Other accrued expenses........	
Total Liabilities........	40,
NET ASSETS	$569,
NET ASSET VALUE PER SHARE ($569,655,572 / 114,594,744)........	$
Net Assets Consist of:	
Capital paid in on shares of beneficial interest........	$531,
Undistributed net investment income........	1,
Accumulated net realized loss........	(5,
Net unrealized appreciation on investments........	39,
Net unrealized appreciation on short sales........	2,
Net Assets	$569,

See notes to financial statements

11

THE ZWEIG TOTAL RETURN FUND, INC.

STATEMENT OF OPERATIONS

Year Ended December 31, 2007

INVESTMENT INCOME	
Income	
Interest........	$14,092,542
Dividends (net of foreign taxes withheld of $62,459)........	3,859,957
Security lending........	183,647
Total Investment Income........	18,136,146
Expenses	
Investment advisory fees........	3,711,846
Transfer agent fees........	222,312
Administration fees........	344,672
Printing and postage fees........	168,960
Registration fees........	153,424
Directors' fees and expenses........	144,432

Professional fees	114,362
Custodian fees	53,924
Miscellaneous	214,306
Total Expenses	5,128,238
Less custodian fees paid indirectly	(16,119)
Net Expenses	5,112,119
Net Investment Income	13,024,027
NET REALIZED AND UNREALIZED GAIN (LOSS)	
Net realized gain (loss) on:	
Investments	15,702,500
Short Sales	1,182,877
Net change in unrealized appreciation (depreciation) on:	
Investments	8,169,539
Short Sales	2,399,305
Net realized and unrealized gain (loss)	27,454,221
Net increase (decrease) in net assets resulting from operations	$40,478,248

See notes to financial statements

THE ZWEIG TOTAL RETURN FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	Year Ended December 31, 2007	Year December
INCREASE (DECREASE) IN NET ASSETS		
Operations		
Net investment income (loss)	$ 13,024,027	$ 11,7
Net realized gain (loss)	16,885,377	7,9
Net change in unrealized appreciation (depreciation)	10,568,844	12,7
Net increase (decrease) in net assets resulting from operations	40,478,248	32,5
Dividends and distributions to shareholders from		
Net investment income	(15,001,480)	(13,9
Net realized short-term gains	(15,864,004)	(6,7
Tax return of capital	(22,280,924)	(27,2
Total dividends and distributions to shareholders	(53,146,408)	(47,8
Capital share transactions		
Net asset value of shares issued to shareholders in reinvestment of distributions resulting in issuance of common stock	2,892,063	2,1

Net proceeds from the sales of shares during rights offering (net of expenses of $650,000)......................	102,586,107	
Net increase in net assets derived from capital share transactions......................................	105,478,170	2,1
Net increase (decrease) in net assets......................	92,810,010	(13,1
NET ASSETS		
Beginning of period...	476,845,562	490,0
End of period (including undistributed net investment income of $1,322,246 and $1,093,308, respectively)...............	$569,655,572	$476,8

See notes to financial statements

13

THE ZWEIG TOTAL RETURN FUND, INC.

FINANCIAL HIGHLIGHTS

(Selected data for a share outstanding throughout each year)

	Year Ended Dec		
	2007	2006	20
Per Share Data			
Net asset value, beginning of period...........................	$ 5.11	$ 5.28	$ 5
Income from Investment Operations			
Net investment income (loss)/(3)/..............................	0.12	0.13	0
Net realized and unrealized gains (losses)......................	0.26	0.22	0
Total from investment operations...............................	0.38	0.35	0
Dividends and Distributions			
Dividends from net investment income...........................	(0.14)	(0.15)	(0
Distributions from net realized gains..........................	(0.15)	(0.07)	(0
Tax return of capital..	(0.21)	(0.30)	(0
Dilutive effect of common stock distributions..................	--	--	
Total dividends and distributions..............................	(0.50)	(0.52)	(0
Dilutive effect on net assets as a result of rights offering/(4)/	(0.02)	--	
Change in net asset value......................................	(0.14)	(0.17)	(0
Net asset value, end of period.............................	$ 4.97	$ 5.11	$ 5
Market value, end of period/(1)/...........................	$ 4.53	$ 5.89	$ 4
Total investment return/(2)/...................................	(14.99)%/(5)/	39.23%	(2

Ratios/Supplemental Data:

Net assets, end of period (in thousands)........................	$569,656	$476,846	$490,
Ratio of expenses to average net assets (excluding dividends on short sales)..	0.96%	1.00%	1
Ratio of expenses to average net assets (including dividends on short sales)..	0.96%	1.01%	1
Ratio of net investment income to average net assets............	2.46%	2.47%	2
Portfolio turnover rate...	36.0%	21.7%	7

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(1) Closing Price -- New York Stock Exchange.

(2) Total investment return is calculated assuming a purchase of a share of the Fund's common stock at the opening NYSE share price on the first business day and a sale at the closing NYSE share price on the last business day of each period reported. Dividends and distributions, if any, are assumed for the purpose of this calculation, to be reinvested at prices obtained under the Fund's Automatic Reinvestment and Cash Purchase Plan. Generally, total investment return based on net asset value will be higher than total investment return based on market value in periods where there is an increase in the discount or a decrease in the premium of the market value to the net assets from the beginning to the end of such years. Conversely, total investment return based on net asset value will be lower than total investment return based on market value in periods where there is a decrease in the discount or an increase in the premium of the market value to the net asset value from the beginning to the end of such periods.

(3) Computed using average shares outstanding.

(4) Shares were sold at a 5% discount from a 5-day average market price from 5/14/07 to 5/18/07.

(5) Total investment return includes the dilutive effect of the rights offering. Without this effect, the total investment return would have been (13.82)%.

See notes to financial statements

THE ZWEIG TOTAL RETURN FUND, INC.

NOTES TO FINANCIAL STATEMENTS

December 31, 2007

NOTE 1 -- ORGANIZATION

The Zweig Total Return Fund, Inc. (the "Fund") is a closed-end, diversified management investment company registered under the Investment Company Act of 1940 (the "Act"). The Fund was incorporated under the laws of the State of Maryland on July 21, 1988. The Fund's objective is to seek the highest total return, consisting of capital appreciation and current income, consistent with the preservation of capital.

NOTE 2 -- SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of increases and decreases in

net assets from operations during the reporting period. Actual results could differ from those estimates.

A. Security Valuation:

Equity securities are valued at the official closing price (typically last sale) on the exchange on which the securities are primarily traded, or if no closing price is available, at the last bid price.

Debt securities are valued on the basis of broker quotations or valuations provided by a pricing service, which utilizes information with respect to recent sales, market transactions in comparable securities, quotations from dealers, and various relationships between securities in determining value.

As required, some securities and other assets may be valued at fair value as determined in good faith by or under the direction of the Directors.

Certain foreign common stocks may be fair valued in cases where closing prices are not readily available or are deemed not reflective of readily available market prices. For example, significant events (such as movement in the U.S. securities market, or other regional and local developments) may occur between the time that foreign markets close (where the security is principally traded) and the time that the Fund calculates its net asset value (generally, the close of the NYSE) that may impact the value of securities traded in these foreign markets. In these cases, information from an external vendor may be utilized to adjust closing market prices of certain foreign common stocks to reflect their fair value. Because the frequency of significant events is not predictable, fair valuation of certain foreign common stocks may occur on a frequent basis.

Short-term investments having a remaining maturity of 60 days or less are valued at amortized cost, which approximates market.

In September 2006, Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"), was issued and is effective for fiscal years beginning after November 15, 2007. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. Management is currently evaluating the impact the adoption of SFAS 157 will have on the Fund's financial statement disclosures. The Fund will be adopting SFAS 157 effective with the 3/31/08 reporting of the financial statements.

B. Security Transactions and Related Income:

Security transactions are recorded on the trade date. Dividend income is recorded on the ex-dividend date, or in the case of certain foreign securities, as soon as the Fund is notified. Interest income is recorded on the accrual basis. The Fund amortizes premiums and accretes discounts using the effective interest method. Realized gains and losses are determined on the identified cost basis.

C. Income Taxes:

It is the policy of the Fund to comply with the requirements of the Internal Revenue Code and to distribute substantially all of its taxable income to its shareholders. Therefore, no provision for federal income taxes or excise taxes

has been made.

The Fund may be subject to foreign taxes on income, gains on investments or currency repatriation, a portion of which may be recoverable. The Fund will accrue such taxes and recoveries as applicable based upon current interpretations of the tax rules and regulations that exist in the markets in which it invests.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." This standard defines the threshold for recognizing the benefits of tax-return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority and requires measurement of a tax position meeting the more-likely-than-not criterion, based on the largest benefit that is more than 50 percent likely to be realized. Management has analyzed the fund's tax positions taken on federal income tax returns for all open tax years (tax years ended December 31, 2004-2007) for purposes of implementing FIN 48, and has concluded that no provision for income tax is required in the Fund's financial statements. Management is not aware of any events that are reasonably possible to occur in the next twelve months that would result in the amount of any unrecognized tax benefits significantly increasing or decreasing for the Fund.

D. Dividends and Distributions to Shareholders:

Distributions are recorded by the Fund on the ex-dividend date. Income and capital gain distributions are determined in accordance with income tax regulations, which may differ from accounting principles generally accepted in the United States of America. These differences may include the treatment of non-taxable dividends, market premium and discount, non-deductible expenses, expiring capital loss carryovers, foreign currency gain or loss, operating losses and losses deferred due to wash sales. Permanent book and tax basis differences relating to shareholder distributions will result in reclassifications to capital paid in on shares of beneficial interest. As of December 31, 2007, the Fund increased undistributed net investment income by $24,406,695, decreased the accumulated net realized loss by $15,782,474, and decreased capital paid in on shares of beneficial interest by $40,189,170.

The components of distributable earnings on a tax basis (excluding unrealized appreciation (depreciation) which is disclosed in the Schedules of Investments and Securities Sold Short) consist of undistributed ordinary income of $0 and undistributed long-term capital gains of $0.

The Fund has $4,861,360 of capital loss carryovers, $86,434 expiring in 2010 and $4,774,926 expiring in 2011, which may be used to offset future capital gains. The Fund may not realize the benefit of these losses to the extent it does not realize gains on investments prior to the expiration of the capital loss carryovers. For the fiscal year (the "period") ended December 31, 2007, the Fund utilized losses deferred in prior years of $16,820,078.

In addition, under certain conditions, the Fund may lose the benefit of these losses to the extent that distributions to shareholders exceed required distribution amounts as defined under the Internal Revenue Code. Shareholders may also pay additional taxes on these excess distributions.

E. Foreign Currency Translation:

Foreign securities and other assets and liabilities are valued using the foreign currency exchange rate effective at the end of the reporting period. Cost of investments is translated at the currency exchange rate effective at the trade date. The gain or loss resulting from a change in currency exchange rates between the trade and settlement dates of a portfolio transaction is treated as a gain or loss on foreign currency. Likewise, the gain or loss resulting from a change in currency exchange rates between the date income is accrued and paid is treated as a gain or loss on foreign currency. The Fund does not isolate that portion of the results of operations arising from changes in exchange rates and that portion arising from changes in the market prices of securities.

F. Foreign Security Country Determination:

A combination of the following criteria is used to assign the countries of risk listed in the Schedule of Investments and Securities Sold Short: country of incorporation, actual building address, primary exchange on which the security is traded and country in which the greatest percentage of company revenue is generated.

G. Short Sales:

A short sale is a transaction in which the Fund sells a security it does not own in anticipation of a decline in market price. To sell a security short, the Fund must borrow the security. The Fund's obligation to replace the security borrowed and sold short will be fully collateralized at all times by the proceeds from the short sale retained by the broker and by cash and securities deposited in a segregated account with the Fund's custodian. If the price of the security sold short increases between the time of the short sale and the time the Fund replaces the borrowed security, the Fund will realize a loss, and if the price declines during the period, the Fund will realize a gain. Any realized gain will be decreased, and any realized loss increased, by the amount of transaction costs. On ex-dividend date, dividends on short sales are recorded as an expense to the Fund. At December 31, 2007, the value of securities sold short amounted to $4,291,220 against which collateral of $24,064,700 was held. The collateral includes the deposits with the broker for securities held short and the value of the segregated investments held long, as shown in the Schedule of Investments and Securities Sold Short. Short selling used in the management of the Fund may accelerate the velocity of potential losses if the prices of securities sold short appreciate quickly. Stocks purchased may decline in value at the same time stocks sold short may appreciate in value, thereby increasing potential losses.

H. Security Lending:

The Fund may loan securities to qualified brokers through an agreement with State Street Bank and Trust Company (the "Custodian"). Under the terms of agreement, the Fund is required to maintain

collateral with a market value not less than 100% of the market value of loaned securities. Collateral is adjusted daily in connection with changes in the market value of securities on loan. Collateral may consist of cash, securities issued or guaranteed by the U.S. Government or its agencies, sovereign debt of foreign countries and/or irrevocable letters of credit issued by banks. Cash collateral is invested in a short-term money market fund. Dividends earned on the collateral and premiums paid by the broker are recorded an income by the Fund net of fees and rebates charged by the Custodian for its services in

connection with this securities lending program. Lending portfolio securities involves a risk of delay in the recovery of the loaned securities or in the foreclosure on collateral.

At December 31, 2007, the Fund had securities valued at $36,427,667 on loan. For collateral the Fund received cash collateral of $35,123,438 and non-cash collateral of $2,193,126.

NOTE 3 -- PURCHASES AND SALES OF SECURITIES:

Purchases and sales of securities (excluding U.S. Government and agency securities and short-term securities) for the period ended December 31, 2007, were as follows:

Purchases.....................	$198,096,333
Sales.........................	155,568,696
Short sales...................	5,586,581
Purchases to cover short sales.	6,769,458

Purchases and sales of long-term U.S. Government and agency securities for the period ended December 31, 2007, were as follows:

Purchases.....................	$ --
Sales.........................	23,022,188

NOTE 4 -- INVESTMENT ADVISORY FEES AND OTHER TRANSACTIONS WITH AFFILIATES

a) Investment Advisory Fee: The Investment Advisory Agreement (the "Agreement") between Phoenix/Zweig Advisers LLC (the "Adviser"), the Fund's investment adviser, and the Fund provides that, subject to the direction of the Board of Directors of the Fund and the applicable provisions of the Act, the adviser is responsible for the actual management of the Fund's portfolio. The Adviser is a wholly-owned subsidiary of Phoenix Investment Partners, Ltd. ("PXP"). PXP is an indirect, wholly-owned subsidiary of The Phoenix Companies, Inc. ("PNX"). The responsibility for making decisions to buy, sell or hold a particular investment rests with the Adviser, subject to review by the Board of Directors and the applicable provisions of the Act. For the services provided by the Adviser under the Agreement, the Fund pays the Adviser a monthly fee equal, on an annual basis to 0.70% of the Fund's average daily net assets. During the period ended December 31, 2007, the Fund incurred advisory fees of $3,711,846.

Zweig Consulting LLC (the "Sub-Adviser"), which serves as the Sub-Adviser for the Fund, performs certain asset allocation research and analysis and provides such advice to the Adviser. The Sub-Adviser's fees are paid by the Adviser.

18

b) Administration Fee: Phoenix Equity Planning Corporation ("PEPCO"), an indirect wholly owned subsidiary of PNX, serves as the Fund's Administrator (the "Administrator") pursuant to an Administration Agreement. The

Administrator receives a fee for financial reporting, tax services, and oversight of the subagent's performance at a rate of 0.065% of the Fund's average daily net assets. During the period ended December 31, 2007, the Fund incurred Administration fees of $344,672.

c) Directors Fee: The Fund pays each Director who is not an interested person of the Fund or the Adviser a fee of $10,000 per year plus $1,500 per Directors' or committee meeting attended, together with the out-of-pocket costs relating to attendance at such meetings. Any Director of the Fund who is an interested person of the Fund or the Adviser receives no remuneration from the Fund.

NOTE 5 -- INDEMNIFICATIONS

Under the Fund's organizational documents, its directors and officers are indemnified against certain liabilities arising out of the performance of their duties to the Fund. In addition, the Fund enters into contracts that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these arrangements.

NOTE 6 -- CAPITAL STOCK AND REINVESTMENT PLAN

At December 31, 2007, the Fund had one class of common stock, par value $0.001 per share, of which 500,000,000 shares are authorized and 114,594,744 shares are outstanding.

Registered shareholders may elect to have all distributions paid by check mailed directly to the shareholder by Computershare as dividend paying agent. Pursuant to the Automatic Reinvestment and Cash Purchase Plan (the "Plan"), shareholders not making such election will have all such amounts automatically reinvested by Computershare, as the Plan agent, in whole or fractional shares of the Fund, as the case may be. During the year ended December 31, 2007 and the year ended December 31, 2006, 552,046 and 421,068 shares, respectively, were issued pursuant to the Plan.

In a non-transferable rights offering ended May 18, 2007, shareholders exercised rights to purchase 20,730,142 shares of common stock at an offering price of $4.98 per share for proceeds, net of expenses of $102,586,107.

On December 17, 2007, the Fund announced a distribution of $0.41 per share to shareholders of record on December 31, 2007. This distribution has an ex-dividend date of January 3, 2008, and is payable on January 10, 2008.

NOTE 7 -- CREDIT RISK AND ASSET CONCENTRATIONS

In countries with limited or developing markets, investments may present greater risks than in more developed markets and the prices of such investments may be volatile. The consequences of political, social or economic changes in these markets may have disruptive effects on the market prices of these investments and the income they generate, as well as the Fund's ability to repatriate such amounts.

The Fund may invest a high percentage of its assets in specific sectors of the market in its pursuit of a greater investment return. Fluctuations in these

sectors of concentration may have a greater impact on the Fund, positive or negative, than if the Fund did not concentrate its investments in such sectors.

NOTE 8 -- REGULATORY EXAMS

In February 2005, the NASD notified PNX that it was asserting violations of trade reporting rules by a subsidiary. PNX responded to the NASD allegations in May 2005. Thereafter, in January 2007, the NASD notified PNX that the matter is being referred for potential violations and possible action. On May 3, 2007, the NASD accepted a letter of acceptance, waiver and consent submitted by the PXP subsidiary to resolve this matter. Without admitting or denying the NASD's findings, in accordance with the terms of the letter the PXP subsidiary agreed to a censure, to pay a fine of $8,000 and to revise its supervisory procedures.

The Company does not believe that the outcome of these matters will be material to these financial statements.

NOTE 9 -- THE ZWEIG TOTAL RETURN FUND YEAR END RESULTS

	Total Return on Net Asset Value	Net Asset Value	NYSE Share Price	Premium (Discount)
Year ended 12/31/2007.........	7.9%*	$4.97	$ 4.5300	(8.9%)
Year ended 12/31/2006.........	7.3%	5.11	5.8900	15.3%
Year ended 12/31/2005.........	4.5%	5.28	4.7000	(11.0%)
Year ended 12/31/2004.........	6.1%	5.62	5.3500	(4.8%)
Year ended 12/31/2003.........	7.1%	5.70	5.0100	(12.1%)
Year ended 12/31/2002.........	(3.3%)	5.81	5.4900	(5.5%)
Year ended 12/31/2001.........	(1.9%)	6.63	7.0500	6.3%
Year ended 12/31/2000.........	5.7%	7.48	6.5700	(12.2%)
Year ended 12/31/1999.........	3.9%	7.89	6.5000	(17.6%)
Year ended 12/31/1998.........	8.8%	8.43	8.8750	5.3%
Year ended 12/31/1997.........	14.6%	8.61	9.4375	9.6%
Year ended 12/31/1996.........	6.3%	8.29	8.0000	(3.5%)
Year ended 12/31/1995.........	17.7%	8.63	8.6250	(0.1%)
Year ended 12/31/1994.........	(1.9%)	8.11	8.0000	(1.4%)
Year ended 12/31/1993.........	10.7%	9.11	10.7500	18.0%
Year ended 12/31/1992.........	2.1%	9.06	10.0000	10.4%
Year ended 12/31/1991.........	20.1%	9.79	10.6250	8.5%
Year ended 12/31/1990.........	4.2%	9.02	8.6250	(4.4%)
Year ended 12/31/1989.........	14.9%	9.59	9.7500	1.7%
Inception 9/30/1988-12/31/1988	1.1%	9.24	9.1250	(1.2%)

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* Total return on net asset value includes the dilutive effect of the rights offering.

NOTE 10 -- SUBSEQUENT EVENT

On February 7, 2008, Phoenix Companies, Inc. ("PNX") announced that it intends to spin off its asset management subsidiary, Phoenix Investment Partners, Ltd. (PXP), to PNX's shareholders. As direct subsidiaries of PXP, Phoenix/Zweig Advisers LLC, the Adviser to the Fund and Phoenix Equity Planning Corporation, the Fund's Administrator, are also intended to be a part of the spin-off.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of The Zweig Total Return Fund, Inc.

In our opinion, the accompanying statement of assets and liabilities, including the schedule of investments and securities sold short, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of The Zweig Total Return Fund, Inc (the "Fund") at December 31, 2007, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at December 31, 2007 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

/s/ PricewaterhouseCooper LLP
PricewaterhouseCoopers LLP
Boston, Massachusetts
February 15, 2008

21

CERTIFICATION (Unaudited)

In accordance with the requirements of the Sarbanes-Oxley Act, the Fund's CEO (the President of the Fund) and CFO (the Treasurer of the Fund) have filed the required "Section 302" certifications with the SEC on Form N-CSR.

In accordance with Section 303A of the NYSE listed company manual, the CEO certification has been filed with the NYSE.

TAX INFORMATION (Unaudited)

For the fiscal year ended December 31, 2007, for federal income tax purposes, 10.3% of the ordinary income dividends earned by the Fund qualify for the dividends received deduction for corporate shareholders.

For the fiscal year ended December 31, 2007, the Fund hereby designates 10.7%, or the maximum amount allowable, of its ordinary income dividends to qualify for the lower tax rates applicable to individual shareholders.

The actual percentage for the calendar year will be designated in the year-end tax statements.

22

FUND MANAGEMENT

Information pertaining to the Directors and officers of the Fund as of December 31, 2007 is set forth below. The address of each individual, unless otherwise noted, is c/o Phoenix/Zweig Advisers LLC, 900 Third Avenue, New York, NY 10022.

DISINTERESTED DIRECTORS

Name (Age) Address and Position(s) with Fund	Term of Office and Length of Time Served	Number of Portfolios in Fund Complex Overseen by Director	Principal Occupation(s) During Past 5 Years and Other Direc
Charles H. Brunie.......... Brunie Associates 600 Third Avenue, 17th Floor New York, NY 10016 YOB: 1930 Director	Term: Until 2009. Served since: 1988.	2	Director, The Zweig Fund, Inc. (since Chairman, Brunie Associates (investmen April 2001); Oppenheimer Capital (1969 Chairman (1980-1990), Chairman Emeritu 2000). Chairman Emeritus, Board of Tru Manhattan Institute (since 1990); Trus Rose D. Friedman Foundation for Vouche 1999); Trustee, Hudson Institute (sinc Chairman of the Board, American Specta 2002); Chartered Financial Analyst (si
Wendy Luscombe............. 480 Churchtown Rd. Craryville, NY 12521 YOB: 1951 Director	Term: Until 2008. Served since: 2002.	2	Director of The Zweig Fund, Inc. (sinc Independent Director of the Zweig Tota Inc. and of The Zweig Fund, Inc. (sinc Principal, WKL Associates, Inc. (Priva Consultant) (since 1994); Fellow, Roya Chartered Surveyors; Member, Chartered Arbitrators; Director, Endeavour Real Securities, Ltd. REIT Mutual Fund (200 Director, PXRE, Group (reinsurance) (1 Member and Chairman of Management Over Committee, Deutsche Bank Real Estate O Fund 1A and 1B (since 2003); Trustee A Trust (since 2004); Member of National Corporate Directors Teachers Facility
Alden C. Olson............. 2711 Ramparte Path Holt, MI 48842 YOB: 1928 Director	Term: Until 2010. Served since: 1996.	2	Director of The Zweig Fund, Inc. (sinc Currently retired; Chartered Financial 1964); Professor of Financial Manageme Investments at Michigan State Universi (1959 to 1990).
James B. Rogers, Jr........ 352 Riverside Dr. New York, NY 10025 YOB: 1942 Director	Term: Until 2009. Served since: 1988.	2	Director of The Zweig Fund, Inc. (sinc investor (since 1980); Chairman, Beela (Media and Investments) (since 1980); Commentator on Fox News (since 2002); "Investment Biker: On the Road with Ji

(1994), "Adventure Capitalist" (2003)
Commodities" (2004); Director, Emergin
Brewery Fund (1993-2002); Director, Le
Trust.

DISINTERESTED DIRECTORS

Name (Age) Address and Position(s) with Fund	Term of Office and Length of Time Served	Number of Portfolios in Fund Complex Overseen by Director	Principal Occupation(s) During Past 5 Years and Other Directorsh
R. Keith Walton...... 15 Claremont Avenue New York, NY 10027 YOB: 1964 Director	Term: Until 2008. Served since: 2004.	2	Director of The Zweig Fund, Inc. (since 2004 Independent Director of the Zweig Total Retu Inc. and of The Zweig Fund, Inc. (since 2006 and Chief Administrative Officer, Global Inf Partners (since 2007); Director, Blue Crest Management Funds (since 2006); Executive Vic President and the Secretary (1996-2007) of t University at Columbia University; Director 2002), Member, Executive Committee (since 20 Chair, Audit Committee (since 2003), Apollo Foundation, Inc.; Director, Orchestra of St. (since 2000); Vice President and Trustee, Th Episcopal School Corporation (since 2003); M (since 1997), Nominating and Governance Comm Board of Directors (since 2004), Council on Relations.

INTERESTED DIRECTOR

Name (Age) Address and Position(s) with Fund	Term of Office and Length of Time Served	Number of Portfolios in Fund Complex Overseen by Director	Principal Occupation(s) During Past 5 Years and Other Directorsh
George R. Aylward........... 56 Prospect Street Hartford, CT 06115 YOB: 1964 President, Chairman and Chief Executive Officer	Term: Until 2010. Chairman of the Board and President since December 2006.	2	Senior Executive Vice President and President Management (since 2007), Senior Vice Presiden Chief Operating Officer, Asset Management (2004-2007), Vice President (2001-2004), The Companies, Inc. Director and President (2006- Chief Operating Officer (2004-present), Execu President (2004-2006), Vice President, Financ 2002), Phoenix Investment Partners, Ltd. Vari officer and directorship positions with Phoen affiliates. President (2006-present), Executi President (2004-2006), the Phoenix Funds Fami Chairman, President and Chief Executive Offic Zweig Fund Inc. and The Zweig Total Return Fu (2006-present).

OFFICERS WHO ARE NOT DIRECTORS

Name, Address and Date of Birth	Position with the Fund and Length of Time Served	Principal Occupation(s) During Past 5 Years and Other Directorships Held
Carlton Neel...... 900 Third Avenue New York, NY 10022 YOB: 1967	Executive Vice President since: 2003. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Executive Vice President of The Zweig Fund, Inc. (since 2003); Senior Vice President and Portfolio Manager, Phoenix/Zweig Advisers LLC (since 2003); Managing Director and Co-Founder, Shelter Rock Capital Partners, LP (2002-2003); Senior Vice President and Portfolio Manager, Phoenix/Zweig Advisers LLC (1995-2002); Vice President, JP Morgan & Co. (1990-1995).
David Dickerson... 900 Third Avenue New York, NY 10022 YOB: 1967	Senior Vice President since: 2003. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Senior Vice President of The Zweig Fund, Inc. (since 2003); Senior Vice President and Portfolio Manager, Phoenix/Zweig Advisers LLC (since 2003); Managing Director and Co-Founder, Shelter Rock Capital Partners, LP (2002-2003); Vice President and Portfolio Manager, Phoenix/Zweig Advisers LLC (1993-2002).
Marc Baltuch...... 900 Third Avenue New York, NY 10022 YOB: 1945	Vice President and Chief Compliance Officer since: 2004. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Vice President and Chief Compliance Officer of The Zweig Fund, Inc. (since 2004); Chief Compliance Officer of Phoenix/Zweig Advisers LLC (since 2004); President and Director of Watermark Securities, Inc. (since 1991); Secretary of Phoenix-Zweig Trust (1989-2003); Secretary of Phoenix-Euclid Market Neutral Fund (1998-2002); Assistant Secretary of Gotham Advisors, Inc. (1990-2005); Chief Compliance Officer of the Zweig Companies (since 1989) and of the Phoenix Funds Complex (since 2004).
Kevin J. Carr..... One American Row Hartford, CT 06102 YOB: 1954	Secretary and Chief Legal Officer since: 2005. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Secretary and Chief Legal Officer of The Zweig Fund, Inc. (since 2005); Vice President and Counsel, Phoenix Life Insurance Company (since 2005); Vice President, Counsel, Chief Legal Officer and Secretary, certain Funds within Phoenix Fund Complex (since 2005); Compliance Officer of Investments and Counsel, Travelers Life and Annuity Company (January 2005-May 2005); Assistant General Counsel, The Hartford Financial Services Group (1999-2005).
Moshe Luchins..... 900 Third Avenue New York, NY 10022 YOB: 1971	Vice President since: 2004. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Vice President of The Zweig Fund, Inc. (since 2004); Associate Counsel (1996-2005), Associate General Counsel (since 2006) of the Zweig Companies.
Nancy Curtiss..... 56 Prospect Street Hartford, CT 06115 YOB: 1952	Treasurer since: 2003. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Treasurer of The Zweig Fund, Inc. (since 2003); Vice President, Head of Operations, Phoenix Investment Partners (since 2007); Vice President, Operations (2003-2007); Vice President, Fund Accounting (1994-2003) and Treasurer (1996-2003). Phoenix Equity Planning Corporation. Treasurer, multiple funds in the Phoenix

		Fund Complex (1994-2006).
Jacqueline Porter. 56 Prospect Street Hartford, CT 06115 YOB: 1958	Vice President and Assistant Treasurer since: 2006. Expires: Immediately following the 2008 Annual Meeting of Shareholders.	Vice President and Assistant Treasurer of The Zweig Fund, Inc. (since 2006); Assistant Vice President, Fund Administration and Tax (since 1995), Phoenix Equity Planning Corporation. Assistant Treasurer and Vice President, multiple funds in Phoenix Fund Complex (since 1995).

KEY INFORMATION

Zweig Shareholder Relations: 1-800-272-2700
For general information and literature, as well as updates on net asset value, share price, major industry groups and other key information

REINVESTMENT PLAN

Many of you have questions about our reinvestment plan. We urge shareholders who want to take advantage of this plan and whose shares are held in "Street Name," to consult your broker as soon as possible to determine if you must change registration into your own name to participate.

REPURCHASE OF SECURITIES

Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940 that the Fund may from time to time purchase its shares of common stock in the open market when Fund shares are trading at a discount from their net asset value.

PROXY VOTING INFORMATION (FORM N-PX)

The Adviser and Sub-Adviser vote proxies relating to portfolio securities in accordance with procedures that have been approved by the Fund's Board of Directors. You may obtain a description of these procedures, along with information regarding how the Fund voted proxies during the most recent 12-month period ended June 30, 2007, free of charge, by calling toll-free 1-800-243-1574. This information is also available through the Securities and Exchange Commission's website at http://www.sec.gov.

FORM N-Q INFORMATION

The Fund files a complete schedule of portfolio holdings with the Securities and Exchange Commission (the "SEC") for the first and third quarters of each fiscal year on Form N-Q. Form N-Q is available on the SEC's website at http://www.sec.gov. Form N-Q may be reviewed and copied at the SEC's Public Reference Room. Information on the operation of the SEC's Public Reference Room can be obtained by calling toll-free 1-800-SEC-0330.

FUND DISTRIBUTIONS AND MANAGED DISTRIBUTION PLAN

The Fund has a Managed Distribution Plan to pay 10% of the Fund's net asset value on an annualized basis. Distributions may represent earnings from net investment income, realized capital gains, or, if necessary, return of capital. The board believes that regular, fixed quarterly cash payouts will enhance shareholder value and serve the long-term interests of shareholders. You should not draw any conclusions about the Fund's investment performance from the amount of the distributions or from the terms of the Fund's Managed Distribution Plan.

The Fund estimates that it has distributed more than its income and net realized capital gains in the fiscal year to date; therefore, a portion of your distributions may be a return of capital. A return of capital may occur when some or all of the money that you invested in the Fund is paid back to you. A return of capital does not necessarily reflect the Fund's investment performance and should not be confused with "yield" or "income".

Please note that the characterization of Fund distributions for federal income tax purposes is different from book accounting generally accepted accounting principles ("GAAP"). The amounts and sources of distributions reported in Section 19(a) notices of the 1940 Act are only estimates and are not being provided for tax reporting purposes. The actual amounts and sources of the amounts for tax reporting purposes will depend upon the Fund's investment experience during the remainder of its fiscal year and may be subject to changes based on tax regulations. It is only after December 31 that we will know the exact source of our distributions. Shareholders should use only the Form 1099-DIV that will be mailed by January 31, 2008 to determine the taxability of our distributions.

The Board may amend, suspend or terminate the Managed Distribution Plan without prior notice to shareholders if it deems such action to be in the best interest of the Fund and its shareholders.

Information on the Zweig funds is available at http://www.PhoenixFunds.com. Section 19(a) notices are posted on the website at: http://www.phoenixinvestments.com/phxinv/PublicSite.jsp?Target=/Individual/Products/Closed_End_Funds/Zweig/ZTR_Fund.html.

OFFICERS AND DIRECTORS
George R. Aylward
President, Chairman and Chief Executive Officer

Carlton Neel
Executive Vice President

David Dickerson
Senior Vice President

Marc Baltuch
Chief Compliance Officer and Vice President

Moshe Luchins
Vice President

Kevin J. Carr
Chief Legal Officer and Secretary

Nancy Curtiss

Treasurer

Jacqueline Porter
Vice President and Assistant Treasurer

Charles H. Brunie
Director

Wendy Luscombe
Director

Alden C. Olson, Ph.D.
Director

James B. Rogers, Jr.
Director

R. Keith Walton
Director

Investment Adviser
Phoenix/Zweig Advisers LLC
900 Third Avenue
New York, NY 10022-4793

Fund Administrator
Phoenix Equity Planning Corporation
One American Row
Hartford, CT 06103-2899

Custodian
State Street Bank and Trust Company
P.O. Box 5501
Boston, MA 02206-5501

Independent Registered Public Accounting Firm
PricewaterhouseCoopers LLP
125 High Street
Boston, MA 02110

Legal Counsel
Katten Muchin Rosenman LLP
575 Madison Avenue
New York, NY 10022-2585

Transfer Agent
Computershare Trust Company, NA
P.O. Box 43010
Providence, RI 02940-3010

This report is transmitted to the shareholders of The Zweig Total Return Fund, Inc. for their information. This is not a prospectus, circular or representation intended for use in the purchase of shares of the Fund or any securities mentioned in this report.

PXP4133 Q4-07

Annual Report

Zweig

The Zweig Total
Return Fund, Inc.

December 31, 2007

[LOGO]

Item 2. Code of Ethics.

(a) The registrant, as of the end of the period covered by this report, has adopted a code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party.

(c) There have been no amendments, during the period covered by this report, to a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, and that relates to any element of the code of ethics described in Item 2(b) of the instructions for completion of Form N-CSR.

(d) The registrant has not granted any waivers, during the period covered by this report, including an implicit waiver, from a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, that relates to one or more of the items set forth in paragraph (b) of the instructions for completion of this Item.

Item 3. Audit Committee Financial Expert.

(a)(1) The Registrant's Board of Trustees has determined that the Registrant has an "audit committee financial expert" serving on its Audit Committee.

(a)(2) Wendy Luscombe has been determined by the Registrant to possess the technical attributes identified in Instruction 2(b) of Item 3 to Form N-CSR to qualify as an "audit committee financial expert" effective December 12, 2007. Ms. Luscombe is an "independent" trustee pursuant to paragraph (a)(2) of Item 3 to Form N-CSR.

(a)(3) Not applicable.

Item 4. Principal Accountant Fees and Services.

Audit Fees

(a) The aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements or services

that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years are $32,600 for 2007 and $32,000 for 2006.

Audit-Related Fees

(b) The aggregate fees billed in each of the last two fiscal years for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item are $1,000 for 2007 and $1,000 for 2006. This represents the review of the semi-annual financial statements.

Tax Fees

(c) The aggregate fees billed in each of the last two fiscal years for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning are $4,600 for 2007 and $6,350 for 2006.

"Tax Fees" are those primarily associated with review of the Trust's tax provision and qualification as a regulated investment company (RIC) in connection with audits of the Trust's financial statement, review of year-end distributions by the Fund to avoid excise tax for the Trust, periodic discussion with management on tax issues affecting the Trust, and reviewing and signing the Fund's federal income tax returns.

All Other Fees

(d) The aggregate fees billed in each of the last two fiscal years for products and services provided by the principal accountant, other than the services reported in paragraphs (a) through (c) of this Item are $5,000 for 2007 and $0 for 2006.

(e)(1) Disclose the audit committee's pre-approval policies and procedures described in paragraph (c)(7) of Rule 2-01 of Regulation S-X.

The Zweig Total Return Fund, Inc. (the "Fund") Board has adopted policies and procedures with regard to the pre-approval of services provided by PwC. The Audit Committee pre-approves: (i) all audit and non-audit services to be rendered to the Fund by PwC; and (ii) all non-audit services to be rendered to the Fund, financial reporting of the Fund provided by PwC to the Adviser or any affiliate thereof that provides ongoing services to the Fund (collectively, "Covered Services"). The Audit Committee has adopted pre-approval procedures authorizing a member of the Audit Committee to pre-approve from time to time, on behalf of the Audit Committee, all Covered Services to be provided by PwC which are not otherwise pre-approved at a meeting of the Audit committee, provided that such delegate reports to the full Audit Committee at its next meeting. The pre-approval procedures do not include delegation of the Audit committee's responsibilities to management. Pre-approval has not been waived with respect to any of the services described above since the date on which the Audit Committee adopted its current pre-approval procedures.

(e)(2) The percentage of services described in each of paragraphs (b) through (d) of this Item that were approved by the audit committee pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X are as follows:

(b) 100% for 2007 and 100% for 2006

(c) 100% for 2007 and 100% for 2006

(d) Not applicable for 2007 and not applicable for 2006

(f) The percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees was less than fifty percent.

(g) The aggregate non-audit fees billed by the registrant's accountant for services rendered to the registrant, and rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the registrant for each of the last two fiscal years of the registrant was $961,830 for 2007 and $892,561 for 2006.

(h) The registrant's audit committee of the board of directors has considered whether the provision of non-audit services that were rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registrant that were not pre-approved pursuant to paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X is compatible with maintaining the principal accountant's independence.

Item 5. Audit Committee of Listed registrants.

The registrant has a separately designated audit committee consisting of all the independent directors of the registrant. Audit Committee Members are: Charles H. Brunie, Wendy Luscombe, Prof. Alden C. Olson, James B. Rogers and R. Keith Walton.

Item 6. Schedule of Investments.

Schedule of Investments in securities of unaffiliated issuers as of the close of the reporting period is included as part of the report to shareholders filed under Item 1 of this form.

Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.

The Proxy Voting Policies are attached herewith.

THE ZWEIG FUND, INC

THE ZWEIG TOTAL RETURN FUND, INC

STATEMENT OF POLICY WITH RESPECT TO PROXY VOTING

I Definitions. As used in this Statement of Policy, the following terms shall have the meanings ascribed below:

A. "Adviser" refers to Phoenix/Zweig Advisers LLC.

B. "Corporate Governance Matters" refers to changes involving the corporate ownership or structure of an issuer whose securities are within a Portfolio Holding, including changes in the state of incorporation, changes in capital structure, including increases and decreases of capital and preferred stock issuance, mergers and other corporate restructurings, and anti-takeover provisions such as staggered boards, poison pills, and supermajority voting provisions.

C. "Delegate" refers to the Adviser or Subadviser to whom responsibility has been delegated to vote proxies for the applicable Portfolio Holding, including any qualified, independent organization engaged by the Adviser to vote proxies on behalf of such delegated entity.

D. "Fund" shall individually and collectively mean and refer to The Zweig Fund, Inc. and The Zweig Total Return Fund, Inc., and each of them.

E. "Management Matters" refers to stock option plans and other management compensation issues.

F. "Portfolio Holding" refers to any company or entity whose securities is held within the investment portfolio(s) of one or more of the Fund as of the date a proxy is solicited.

G. "Proxy Contests" refer to any meeting of shareholders of an issuer for which there are at least two sets of proxy statements and proxy cards, one solicited by management and the others by a dissident or group of dissidents.

H. "Social Issues" refers to social and environmental issues.

I. "Takeover" refers to "hostile" or "friendly" efforts to effect radical change in the voting control of the board of directors of a company.

II. General Policy. It is the intention of the Fund to exercise stock ownership rights in Portfolio Holdings in a manner that is reasonably anticipated to further the best economic interests of shareholders of the Fund. Accordingly, the Fund or its Delegate(s) shall endeavor to analyze and vote all proxies that are considered likely to have financial implications, and, where appropriate, to participate in corporate governance, shareholder proposals, management communications and legal proceedings. The Fund and its Delegate(s) must also identify potential or actual conflicts of interests in voting proxies and address any such conflict of interest in accordance with this Statement of Policy.

III. Factors to consider when voting.

A. A Delegate may abstain from voting when it concludes that the effect on shareholders' economic interests or the value of the Portfolio Holding is indeterminable or insignificant.

B. In analyzing anti-takeover measures, the Delegate shall vote on a case-by-case basis taking into consideration such factors as overall long-term financial performance of the target company relative to its industry competition. Key measures which shall be considered include, without limitation, five-year annual compound growth rates for sales, operating income, net income, and

total shareholder returns (share price appreciation plus dividends). Other financial indicators that will be considered include margin

analysis, cash flow, and debit levels.

C. In analyzing contested elections, the Delegate shall vote on a case-by-case basis taking into consideration such factors as the qualifications of all director nominees. The Delegate shall also consider the independence and attendance record of board and key committee members. A review of the corporate governance profile shall be completed highlighting entrenchment devices that may reduce accountability.

D. In analyzing corporate governance matters, the Delegate shall vote on a case-by-case basis taking into consideration such factors as tax and economic benefits associated with amending an issuer's state of incorporation, dilution or improved accountability associated with changes in capital structure, management proposals to require a supermajority shareholder vote to amend charters and bylaws and bundled or "conditioned" proxy proposals.

E. In analyzing executive compensation proposals and management matters, the Adviser shall vote on a case-by-case basis taking into consideration such factors as executive pay and spending on perquisites, particularly in conjunction with sub-par performance and employee layoffs.

F. In analyzing proxy contests for control, the Delegate shall vote on a case-by-case basis taking into consideration such factors as long-term financial performance of the target company relative to its industry; management's track record; background to the proxy contest; qualifications of director nominees (both slates); evaluation of what each side is offering shareholders as well as the likelihood that the proposed objectives and goals can be met; and stock ownership positions.

G. A Delegate shall generally vote against shareholder social matters proposals.

IV Delegation.

A. In the absence of a specific direction to the contrary from the Board of Trustees of the Fund, the Adviser will be responsible for voting proxies for all Portfolio Holdings in accordance with this Statement of Policy, or for delegating such responsibility as described below.

B. The Adviser delegated with authority to vote proxies for Portfolio Holdings shall be deemed to assume a duty of care to safeguard the best interests of the Fund and its shareholders. No Delegate shall accept direction or inappropriate influence from any other client, director or employee of any affiliated company and shall not cast any vote inconsistent with this Statement of Policy without obtaining the prior approval of the Fund or its duly authorized representative(s).

C. With regard to each Series for which there is a duly appointed Subadviser acting pursuant to an investment advisory agreement satisfying the requirements of Section 15(a) of the Investment Company Act of 1940, as amended, and the rules thereunder, the Subadviser may, pursuant to delegated authority from the Adviser, vote proxies for Portfolio Holdings with regard to the Series or portion of the assets thereof for which the Subadviser is responsible. In such case, the Subadviser shall vote proxies for the Portfolio Holdings in accordance with Sections II, III and V of this Statement of Policy, provided, however, that the Subadviser may vote proxies in accordance with its own proxy voting policy/procedures ("Subadviser Procedures") if the

following two conditions are satisfied: (1) the Adviser must have approved the Subadviser Procedures based upon the Adviser's determination that the Subadviser Procedures are reasonably designed to further the best economic interests of the affected Fund shareholders, and (2) the Subadviser Procedures are reviewed and approved annually by the Board of Trustees. The Subadviser will promptly notify the Adviser of any material changes to the Subadviser Procedures. The Adviser will periodically review the votes by the Subadviser for consistency with this Statement of Policy.

V. Conflicts of Interest

A. The Fund and its Delegate(s) seek to avoid actual or perceived conflicts of interest in the voting of proxies for Portfolio Holdings between the interests of Fund shareholders, on one hand, and those of the Adviser, Delegate, principal underwriter, or any affiliated person of the Fund, on the other hand. The Board of Trustees may take into account a wide array of factors in determining whether such a conflict exists, whether such conflict is material in nature, and how to properly address or resolve the same.

B. While each conflict situation varies based on the particular facts presented and the requirements of governing law, the Board of Trustees or its delegate(s) may take the following actions, among others, or otherwise give weight to the following factors, in addressing material conflicts of interest in voting (or directing Delegates to vote) proxies pertaining to Portfolio Holdings: (i) rely on the recommendations of an established, independent third party with qualifications to vote proxies such as Institutional Shareholder Services; (ii) vote pursuant to the recommendation of the proposing Delegate; (iii) abstaining; or (iv) where two or more Delegates provide conflicting requests, vote shares in proportion to the assets under management of the each proposing Delegate.

C. The Adviser shall promptly notify the President of the Fund once any actual or potential conflict of interest exists and their recommendations for protecting the best interests of Fund's shareholders. No Adviser shall waive any conflict of interest or vote any conflicted proxies without the prior written approval of the Board of Trustees or the President of the Fund pursuant to section D of this Article.

D. In the event that a determination, authorization or waiver under this Statement of Policy is requested at a time other than a regularly scheduled meeting of the Board of Trustees, the President of the Fund shall be empowered with the power and responsibility to interpret and apply this Statement of Policy and provide a report of his or her determinations at the next following meeting of the Board of Trustees.

VI. Miscellaneous.

A. A copy of the current Statement of Policy with Respect to Proxy Voting and the voting records for the Fund reconciling proxies with Portfolio Holdings and recording proxy voting guideline compliance and justification, shall be kept in an easily accessible place and available upon request.

B. The Adviser shall present a report of any material deviations from this Statement of Policy at every regularly scheduled meeting of the Board of Trustees and shall provide such other reports as the Board of

Trustees may request from time to time. The Adviser shall provide to the Fund or any shareholder a record of its effectuation of proxy voting pursuant to this Statement of Policy at such times and in such format or medium as the Fund shall reasonably request. The Adviser shall be solely responsible for complying with the disclosure and reporting requirements under applicable laws and regulations, including, without limitation, Rule 206(4)-6 under the Investment Advisers Act of 1940. The Adviser shall gather, collate and present information relating to the its proxy voting activities of those of each Delegate in such format and medium as the Fund shall determine from time to time in order for the Fund to discharge its disclosure and reporting obligations pursuant to Rule 30b1-4 under the Investment Company Act of 1940, as amended.

C. The Adviser shall pay all costs associated with proxy voting for Portfolio Holdings pursuant to this Statement of Policy and assisting the Fund in providing public notice of the manner in which such proxies were voted.

D. The Adviser may delegate its responsibilities hereunder to a proxy committee established from time to time by the Adviser, as the case may be. In performing its duties hereunder, the Adviser, or any duly authorized committee, may engage the services of a research and/or voting adviser or agent, the cost of which shall be borne by such entity.

This Statement of Policy shall be presented to the Board of Trustees annually for their amendment and/or approval.

Item 8. Portfolio Managers of Closed-End Management Investment Companies.

(a)(1) Identification of Portfolio Manager(s) or Management Team Members and Description of Role of Portfolio Manager(s) or Management Team Members

Following are the names, titles and length of service of the person or persons employed by or associated with the registrant or an investment adviser of the registrant who are primarily responsible for the day-to-day management of the registrant's portfolio ("Portfolio Manager") and each Portfolio Manager's business experience during the past 5 years as of March 10, 2008: Carlton Neel and David Dickerson have served as Co-Portfolio Managers of The Zweig Total Return Fund, Inc., a closed-end fund managed by Phoenix/Zweig Advisers LLC (the "Fund") since April 1, 2003. Mr. Neel and Mr. Dickerson are Senior Vice Presidents of Phoenix/Zweig Advisers LLC ("PZA") and Euclid Advisors, LLC ("Euclid"), a subsidiary of PZA. Mr. Neel and Mr. Dickerson were previously employed by PZA and managed the Phoenix Market Neutral Fund from April 2000 through June 2002. Since April 1, 2003, they have served as Portfolio Managers for The Zweig Fund, Inc., a closed-end fund managed by PZA, and as Portfolio Managers for the Phoenix Small-Cap Value Fund and Phoenix Market Neutral Fund, two funds a Fund managed by Euclid. From April 1, 2003 to January 9, 2008, Messrs. Neil and Dickerson were portfolio managers of the Phoenix Market Neutral Fund, a fund also managed by Euclid. For the period from July 2002 until returning to PZA on April 1, 2003, Mr. Neel and Mr. Dickerson co-founded and managed a hedge fund.

Mr. Neel previously served as Senior Portfolio Manager for a number of the former Phoenix-Zweig mutual funds from 1995 until July 2002.

Mr. Dickerson began his investment career at the Zweig Companies in 1993.

(a)(2) Other Accounts Managed by Portfolio Manager(s) or Management Team Member and Potential Conflicts of Interest

Other Accounts Managed by Portfolio Manager(s) or Management Team Member

The following information is provided as of the fiscal year ended December 31, 2007.

Mr. Neel and Mr. Dickerson are responsible for the day-to-day management of other portfolios of other accounts, namely The Zweig Fund, Inc. and the Phoenix Small-Cap Value Fund and Phoenix Market Neutral Fund. For both Mr. Neel and Mr. Dickerson, the following are tables which provide the number of other accounts managed within the Type of Accounts and the Total Assets for each Type of Account. Also provided for each Type of Account is the number of accounts and the total assets in the accounts with respect to which the advisory fee is based on the performance of the account.

Name of Portfolio Manager or Team Member	Type of Accounts	Total No. of Accounts Managed	Total Assets	No. of Accounts where Advisory Fee is Based on Performance	Total Assets in Accounts where Advisory Fee is Based on Performance
David Dickerson	Registered Investment Companies:	3	732.5 mil	None	None
	Other Pooled Investment Vehicles:	None	None	None	None
	Other Accounts:	None	None	None	None
Carlton Neel	Registered Investment Companies:	3	732.5 mil	None	None
	Other Pooled Investment Vehicles:	None	None	None	None
	Other Accounts:	None	None	None	None

Potential Conflicts of Interests

There may be certain inherent conflicts of interest that arise in connection with the Mr. Neel's and Mr. Dickerson's management of each Fund's investments and the investments of any other accounts he manages. Such conflicts could arise from the aggregation of orders for all accounts managed by a particular portfolio manager, the allocation of purchases across all such accounts, the allocation of IPOs and any soft dollar arrangements that the Adviser may have in place that could benefit the Funds and/or such other accounts. The Board of Trustees/Directors has adopted on behalf of the Funds policies and procedures designed to address any such conflicts of interest to ensure that all transactions are executed in the best interest of the Funds' shareholders. The Advisers and Subadviser are required to certify their compliance with these procedures to the Board of Trustees on a quarterly basis. There have been no material compliance issues with respect to any of these policies and procedures during the Funds' most recent fiscal year ended December 31, 2007. Additionally, there are no material conflicts of interest between the

investment strategy of a Fund and the investment strategy of other accounts managed by Mr. Neel and Mr. Dickerson since portfolio managers generally manage funds and other accounts having similar investment strategies.

(a)(3)Compensation Structure of Portfolio Manager(s) or Management Team Members

For the most recently completed fiscal year ended December 31, 2007, following is a description of Mr. Neel's and Mr. Dickerson's compensation structure as portfolio managers of PZA and Euclid.

Phoenix Investment Partners, Ltd. and its affiliated investment management firms (collectively, "PXP"), believe that the firm's compensation program is adequate and competitive to attract and retain high-caliber investment professionals. Investment professionals at PXP receive a competitive base salary, an incentive bonus opportunity and a benefits package. Managing Directors and portfolio investment professionals who supervise and manage others also participate in a management incentive program reflecting their personal contribution and team performance. Highly compensated individuals can also take advantage of a long-term Incentive Compensation program to defer their compensation and reduce tax implications.

The bonus package for portfolio managers is based upon how well the individual manager meets or exceeds assigned goals and subjective assessment of contribution to the team effort. Their incentive bonus

also reflects a performance component for achieving and/or exceeding performance competitive with peers managing similar strategies. Such component is further adjusted to reward investment personnel for managing within the stated framework and for not taking unnecessary risks. This ensures that investment personnel will remain focused on managing and acquiring securities that correspond to a fund's mandate and risk profile. It also avoids the temptation for portfolio managers to take on more risk and unnecessary exposure to chase performance for personal gain.

Finally, Portfolio Managers and investment professionals may also receive The Phoenix Companies, Inc. ("PNX") stock options and/or be granted PNX restricted stock at the direction of the parent's Board of Directors.

Following is a more detailed description of the compensation structure of the Fund's portfolio managers.

Base Salary. Each Portfolio Manager is paid a fixed base salary, which is determined by PXP and is designed to be competitive in light of the individual's experience and responsibilities. PXP management uses compensation survey results of investment industry compensation conducted by an independent third party in evaluating competitive market compensation for its investment management professionals.

Incentive Bonus. Generally, the current Performance Incentive Plan for portfolio managers at PXP is made up of three components:

(1) Seventy percent of the target incentive is based on achieving investment area investment goals and individual performance. The Investment Incentive pool will be established based on actual pre-tax investment performance compared with specific peer group or index measures established at the beginning of each calendar year. Performance of the funds managed is measured over one, three and five-year periods against specified benchmarks and/or peer groups for each fund managed. Performance of the PNX general account and growth

of revenue, if applicable to a particular portfolio manager, is measured on a one-year basis. Generally, individual manager's participation is based on the performance of each fund/account managed as weighted roughly by total assets in each of those funds/accounts.

(2) Fifteen percent of the target incentive is based on the profitability of the investment management division with which the portfolio manager is associated. This component of the plan is paid in restricted stock units of The Phoenix Companies, Inc., which vest over three years.

(3) Fifteen percent of the target incentive is based on the portfolio manager's investment area's competencies and on individual performance. This pool is funded based on The Phoenix Companies, Inc.'s return on equity.

The Performance Incentive Plan applicable to some portfolio managers may vary from the description above. For instance, plans applicable to certain portfolio managers (i) may specify different percentages of target incentive that is based on investment goals and individual performance and on The Phoenix Companies, Inc. return on equity, (ii) may not contain the component that is based on the profitability of the management division with which the portfolio manager is associated, or (iii) may contain a guarantee payout percentage of certain portions of the Performance Incentive Plan.

Long-Term Incentive Bonus. Certain portfolio managers are eligible for a long-term incentive plan that is paid in restricted stock units of The Phoenix Companies, Inc. which vest over three years. Awards under this plan are contingent upon PNX achieving its cash return on equity objective, generally over a three-year period. Target award opportunities for eligible participants are determined by PNX's Compensation Committee.

Other Benefits. Portfolio managers are also eligible to participate in broad-based plans offered generally to the firm's employees, including broad-based retirement, 401(k), health and other employee benefit plans.

(a)(4)Disclosure of Securities Ownership

For the most recently completed fiscal year ended December 31, 2007, beneficial ownership of shares of the Fund by Messrs. Dickerson and Neel are as follows. Beneficial ownership was determined in accordance with rule 16a-1(a)(2) under the Securities Exchange Act of 1934 (17 CFR 240.161-1(a)(2)).

Name of Portfolio Manager or Team Member	Dollar ($) Range of Fund Shares Beneficially Owned
David Dickerson	$ 10,001 - $50,000
Carlton Neel	$50,001 - $100,000

(b) Not applicable.

Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.

Not applicable.

Item 10.Submission of Matters to a Vote of Security Holders.

There have been no material changes to the procedures by which the shareholders

may recommend nominees to the registrant's board of trustees, where those changes were implemented after the registrant last provided disclosure in response to the requirements of Item 407(c)(2)(iv) of Regulation S-K (17 CFR 229.407) (as required by Item 22(b)(15) of Schedule 14A (17 CFR 240.14a-101)), or this Item.

Item 11.Controls and Procedures.

(a) The registrant's principal executive and principal financial officers, or persons performing similar functions, have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the "1940 Act") (17 CFR 270.30a-3(c))) are effective, as of a date within 90 days of the filing date of the report that includes the disclosure required by this paragraph, based on their evaluation of these controls and procedures required by Rule 30a-3(b) under the 1940 Act (17 CFR 270.30a-3(b)) and Rules 13a-15(b) or 15d-15(b) under the Securities Exchange Act of 1934, as amended (17 CFR 240.13a-15(b) or 240.15d-15(b)).

(b) There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act (17 CFR 270.30a-3(d)) that occurred during the registrant's

second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

Item 12. Exhibits.

(a)(1) Code of ethics, or any amendment thereto, that is the subject of disclosure required by Item 2 is attached hereto.

(a)(2) Certifications pursuant to Rule 30a-2(a) under the 1940 Act and Section 302 of the Sarbanes-Oxley Act of 2002 are attached hereto.

(a)(3) Not applicable.

(b) Certifications pursuant to Rule 30a-2(b) under the 1940 Act and Section 906 of the Sarbanes-Oxley Act of 2002 are attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(registrant) The Zweig Total Return Fund, Inc.

By (Signature and Title)* /s/ George R. Aylward

George R. Aylward, President
(principal executive officer)

Date March 7, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the

following persons on behalf of the registrant and in the capacities and on the dates indicated.

By (Signature and Title)* /s/ George R. Aylward

George R. Aylward, President
(principal executive officer)

Date March 7, 2008

By (Signature and Title)* /s/ Nancy G. Curtiss

Nancy G. Curtiss, Treasurer
(principal financial officer)

Date March 7, 2008

* Print the name and title of each signing officer under his or her signature.

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Other interest income

129

106

465

383

Total interest income	
	126,704
	138,194
	401,098
	423,785

Interest expense:

Savings deposits	
	2,563
	6,807
	8,182
	22,609
Time deposits	
	14,757
	24,093
	48,650
	85,360
Securities sold under repurchase agreements	
	11,110

12,486

33,622

38,612

Other borrowings

732

7,133

9,041

24,546

Junior subordinated interest deferrable debentures

3,095

3,461

9,483

10,586

Other interest expense

	96
	184
Total interest expense	
	32,257
	54,076
	108,978
	181,897

Net interest income	
	94,447
	84,118
	292,120
	241,888

Provision for probable loan losses	
	10,346
	7,037
	45,429
	12,690
Net interest income after provision for probable loan losses	
	84,101
	77,081

246,691

229,198

Non-interest income:

Service charges on deposit accounts

25,425

25,354

73,753

74,596

Other service charges, commissions and fees

Banking

10,513

10,437

31,781

30,599

Non-banking

5,485

2,267

9,203

5,412

Gain on investment securities transactions, net

174

11,880

6,410

Other investments, net

3,374

5,785

10,609

13,895

Other income	
	5,904
	6,980
	11,853
	17,222
Total non-interest income	
	50,875
	50,823
	149,079

148,134

3

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Non-interest expense:				
Employee compensation and benefits	$ 35,316	$ 32,854	$ 99,796	$ 95,314
Occupancy	8,723	9,955	25,899	27,053
Depreciation of bank premises and equipment	8,965	9,481	26,979	27,119
Professional fees	4,958	2,557	16,735	8,442
Stationery and supplies	1,109	1,540	2,925	4,134
Amortization of identified intangible assets	1,320	1,299	3,950	3,897
Advertising	2,647	3,667	7,887	10,329
Other	15,708	15,238	49,982	47,682
Total non-interest expense	78,746	76,591	234,153	223,970
Income before income taxes	56,230	51,313	161,617	153,362
Provision for income taxes	19,257	17,433	55,983	52,953
Net income	$ 36,973	$ 33,880	$ 105,634	$ 100,409
Preferred Stock Dividends	3,250		9,725	
Net income available to common shareholders	$ 33,723	$ 33,880	$ 95,909	$ 100,409
Basic earnings per common share:				
Weighted average number of shares outstanding:	68,192,647	68,571,661	68,437,023	68,573,318
Net income	$ .49	$ .49	$ 1.40	$ 1.46
Fully diluted earnings per common share:				
Weighted average number of shares outstanding:	68,207,682	68,727,949	68,447,067	68,715,082
Net income	$ .49	$ .49	$ 1.40	$ 1.46

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Net income	$ 36,973	$ 33,880	$ 105,634	$ 100,409
Other comprehensive income, net of tax				
Net unrealized holding (losses) gains on securities available for sale arising during period (tax effects of $(431), $(3,270), $25,293 and $4,322)	(801)	(6,073)	46,972	8,027
Reclassification adjustment for gains on securities available for sale included in net income (tax effects of $(61), $-, $(4,158) and $(2,243))	(113)		(7,722)	(4,167)
Comprehensive income	$ 36,059	$ 27,807	$ 144,884	$ 104,269

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30,	
	2009	**2008**
Operating activities:		
Net income	$ 105,634	$ 100,409
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for probable loan losses	45,429	12,690
Amortization of loan premiums		134
Accretion of time deposits with banks		1
Accretion of time deposit discounts	(10)	(28)
Depreciation of bank premises and equipment	26,979	27,119
Gain on sale of bank premises and equipment	(133)	(44)
Depreciation and amortization of leased assets	300	760
Accretion of investment securities discounts	(1,463)	(858)
Amortization of investment securities premiums	4,768	4,787
Investment securities transactions, net	(11,880)	(6,410)
Amortization of junior subordinated debenture discounts	26	110
Amortization of identified intangible assets	3,951	3,897
Stock based compensation expense	502	550
Earnings from affiliates and other investments	(9,778)	(9,773)
Deferred tax benefit	(7,811)	(7,727)
Decrease in accrued interest receivable	7,631	7,857
Net increase in other assets	(24,854)	(4,226)
Net (decrease) increase in other liabilities	(72,973)	1,046
Net cash provided by operating activities	66,318	130,294
Investing activities:		
Proceeds from maturities of securities	1,637	16,261
Proceeds from sales of available for sale securities	571,814	8,359
Purchases of available for sale securities	(419,614)	(1,002,839)
Principal collected on mortgage-backed securities	944,989	981,679
Maturities of time deposits with banks	396	4,457
Net decrease (increase) in loans	101,911	(209,873)
Purchases of other investments	(10,425)	(8,315)
Distributions of other investments	53,295	33
Purchases of bank premises and equipment	(52,485)	(47,415)
Proceeds from sale of bank premises and equipment	628	800
Net cash provided by (used in) investing activities	1,192,146	(256,853)

6

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Financing activities:		
Net decrease in non-interest bearing demand deposits	$ (11,190)	$ (52,063)
Net increase (decrease) in savings and interest bearing demand deposits	48,465	(64,633)
Net increase (decrease) in time deposits	16,183	(39,526)
Net increase in securities sold under repurchase agreements	59,099	139,023
Net (decrease) increase in other borrowed funds	(1,394,411)	167,814
Purchase of treasury stock	(6,722)	(958)
Proceeds from stock transactions	2,359	560
Payment of dividends on common stock	(11,662)	(22,623)
Payments of dividends on preferred stock	(6,960)	
Net cash (used in) provided by financing activities	(1,304,839)	127,594
(Decrease) increase in cash and cash equivalents	(46,375)	1,035
Cash and cash equivalents at beginning of period	298,720	346,052
Cash and cash equivalents at end of period	$ 252,345	$ 347,087
Supplemental cash flow information:		
Interest paid	$ 114,805	$ 191,610
Income taxes paid	56,918	51,711
Accrued dividends, preferred shares	1,350	
Dividends declared, not yet paid		22,630
Sales of available-for-sale securities not yet settled	1,282	
Purchases of available-for-sale securities not yet settled	464,760	149,351

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 - Basis of Presentation

The accounting and reporting policies of International Bancshares Corporation (Corporation) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the Company) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries, International Bank of Commerce, Laredo (IBC), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville and the Corporation s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, IBC Capital Corporation and Premier Tierra Holdings, Inc. All significant inter-company balances and transactions have been eliminated in consolidation. The consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. It is suggested that these financial statements be read in conjunction with the financial statements and the notes thereto in the Company s latest Annual Report on Form 10-K. The consolidated statement of condition at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications have been made to make prior periods comparable.

The Company operates as one segment. The operating information used by the Company s chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville. The Company applies the provisions of Financial Accounting Standards Board (FASB) Accounting Statement Codification (ASC), FASB ASC 280, Segment Reporting, in determining its reportable segments and related disclosures.

On July 1, 2009, the Financial Accounting Standards Board officially launched the FASB Accounting Standards Codification, (Codification), which is now the single official source of authoritative, non-governmental U.S. GAAP, in addition to guidance issued by the Securities and Exchange Commission (SEC). The Codification supersedes all prior accounting literature. With the launch of the Codification, U.S. GAAP now consists of two levels authoritative (Codification) and non-authoritative (anything not in the Codification). The Codification is effective for interim and annual periods ending after September 15, 2009, and is organized into approximately 90 accounting topics. The FASB will no longer be issuing accounting standards in the form of Statements, Staff Positions or Emerging Issues Task Force Abstracts. The FASB will instead amend the Codification by issuing Accounting Standards Updates. The adoption of the Codification did not have a significant impact to the Company s consolidated financial statements.

Effective June 30, 2009, the Company adopted Statement of Financial Accounting Standards No. 165 (SFAS No. 165), Subsequent Events. SFAS No. 165 is currently included in the Codification under ASC Topic 855, Subsequent Events (ASC 855). ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855 defines (i) the period after the balance sheet date during which a reporting entity s management should evaluate events or

transactions that may occur for potential recognition or disclosure in the financial statements (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The adoption of the accounting standard did not have an impact on the Company s consolidated financial statements. The Company has evaluated all events or transactions that occurred after September 30, 2009 through November 2, 2009, the date the Company issued these financial statements. During this period, the Company did not have any material recognizable or non-recognizable subsequent events.

Note 2 Fair Value Measurements

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157 (SFAS No. 157), Fair Value Measurements for financial assets and liabilities. Additionally, in accordance with Financial Accounting Standards Board Staff Position No. 157-2, (FSP No 157-2), Effective date of FASB Statement No. 157, the Company delayed application of SFAS No. 157 for non-financial assets and non-financial liabilities until January 1, 2009, except for those that are recognized or disclosed at fair value on a recurring basis. SFAS No. 157 and FSP No. 157-2 are now included in the Accounting Standards Codification (ASC) in Topic 820, Fair Value Measurements and Disclosures (ASC 820). ASC 820 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; it also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs Unadjusted quoted prices in active markets for identical assets or liabilities.

- Level 2 Inputs Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 Inputs Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy is set forth below.

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value as of September 30, 2009 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in thousands)		
	Assets/Liabilities Measured at Fair Value September 30, 2009	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Measured on a recurring basis:				
Assets:				
U.S. Treasury securities Available-for-sale	$ 1,327	$	$ 1,327	$
Mortgage-backed securities Available-for-sale	4,361,946		4,283,391	78,555
States and political subdivisions Available-for-sale	128,472		128,472	

Other Available-for-sale	14,164	664	13,500	
Measured on a non-recurring basis:				
Assets:				
Impaired Loans	88,407			88,407

Investment securities available-for-sale are classified within level 2 and level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within level 1. For investments classified as level 2 in the fair value hierarchy, the Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. Investment securities classified as level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in in-active markets and markets that have experienced significant decreases in volume and level of activity, as exhibited by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company evaluated the performance of the securities since the time of purchase and determined that the securities have performed as expected or better than expected. Therefore, the Company applied the spread from the time of purchase against the current yield curve to determine the fair value represented in the consolidated financial statements since that spread represented an orderly, active market.

The following table presents a reconciliation of activity for such mortgage-backed securities on a net basis (Dollars in thousands):

Balance at December 31, 2008	$	
Principal paydowns, net of discount amortization		(4,010)
Total unrealized gains included in:		
Other comprehensive income		(6)
Transfers into level 3		82,571
Balance at September 30, 2009	$	78,555

As of September 30, 2009, the Company s financial instruments measured at fair value on a non-recurring basis are limited to impaired loans. Impaired loans are classified within level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, Receivables . The fair value of impaired loans is based on the fair value of the collateral, as determined through an external appraisal process, discounted based on internal criteria. Impaired loans are primarily comprised of collateral-dependent commercial loans.

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis. The instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The fair value estimates, methods, and assumptions for the Company s financial instruments at September 30, 2009 and December 31, 2008 are outlined below.

Cash and Due From Banks and Federal Funds Sold

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Time Deposits with Banks

The carrying amounts of time deposits with banks approximate fair value.

10

Investment securities held-to-maturity

The carrying amounts of investments held-to-maturity approximate fair value.

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate and consumer loans as outlined by regulatory reporting guidelines. Each category is segmented into fixed and variable interest rate terms and by performing and non-performing categories.

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. At September 30, 2009, and December 31, 2008, the carrying amount of fixed rate performing loans was $1,272,210,000 and $1,272,370,000 respectively, and the estimated fair value was $1,255,047,000 and $1,253,496,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of September 30, 2009 and December 31, 2008. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. At September 30, 2009 and December 31, 2008, the carrying amount of time deposits was $3,333,685,000 and $3,317,512,000, respectively, and the estimated fair value was $3,350,874,000 and $3,343,150,000, respectively.

Securities Sold Under Repurchase Agreements and Other Borrowed Funds

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at September 30, 2009 and December 31, 2008. The fair value of the long-term instruments is based on established market spreads. At September 30, 2009 and December 31, 2008, the carrying amount of long-term repurchase agreements was $1,000,000,000 and the estimated fair value was $1,114,056,000 and $1,158,873,000, respectively. Other borrowed funds are short-term Federal Home Loan Bank borrowings. Due to the contractual terms of these financial instruments, the carrying amounts approximated fair value at September 30, 2009 and December 31, 2008.

Junior Subordinated Deferrable Interest Debentures

The Company currently has fixed and floating junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at September 30, 2009 and December 31, 2008. The fair value of the fixed junior subordinated deferrable interest debentures is based on established market spreads to the debentures. At September 30, 2009 and December 31, 2008, the carrying amount of fixed junior subordinated deferrable interest debentures was $139,216,000 and $139,190,000, respectively, and the estimated fair value was $58,795,000 and $44,704,000, respectively.

Commitments to Extend Credit and Letters of Credit

Commitments to extend credit and fund letters of credit are principally at current interest rates and therefore the carrying amount approximates fair value.

Limitations

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on-and off-statement of condition financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include the bank premises and equipment and core deposit value. In addition, the tax ramifications related to the effect of fair value estimates have not been considered in the above estimates.

Note 3 Loans

A summary of net loans, by loan type at September 30, 2009 and December 31, 2008 is as follows:

	September 30, 2009	December 31, 2008
	(Dollars in Thousands)	
Commercial, financial and agricultural	$ 2,705,704	$ 2,574,247
Real estate mortgage	953,978	888,095
Real estate construction	1,657,685	1,911,954
Consumer	154,726	169,589
Foreign	270,263	328,948
Total loans	$ 5,742,356	$ 5,872,833

Note 4 - Allowance for Probable Loan Losses

A summary of the transactions in the allowance for probable loan losses is as follows:

	September 30, 2009	September 30, 2008
	(Dollars in Thousands)	
Balance at December 31,	$ 73,461	$ 61,726
Losses charged to allowance	(29,864)	(6,345)

Recoveries credited to allowance		1,296		892
Net losses charged to allowance		(28,568)		(5,453)
Provision charged to operations		45,429		12,690
Balance at September 30,	$	90,322	$	68,963

The losses charged to the allowance increased by $23,519,000 for the nine months ended September 30, 2009 versus the same period of 2008. The nationwide recession and its consequences are being felt in the Company s markets, but not to the extent being seen in the nation as a whole. These factors, as well as other economic issues, have elevated the Company s provisions as well as charge-offs.

12

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. The Company has identified these loans through its normal loan review procedures. Impaired loans are measured based on (1) the present value of expected future cash flows discounted at the loan s effective interest rate; (2) the loan s observable market price; or (3) the fair value of the collateral if the loan is collateral dependent. Substantially all of the Company s impaired loans are measured at the fair value of the collateral. In limited cases, the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

The following table details key information regarding the Company s impaired loans:

	September 30, 2009		December 31, 2008	
	(Dollars in Thousands)			
Balance of impaired loans where there is a related allowance for loan loss	$	118,407	$	137,153
Balance of impaired loans where there is no related allowance for loan loss		12,314		27,786
Total impaired loans	$	130,721	$	164,939
Allowance allocated to impaired loans	$	30,000	$	20,671

The impaired loans included in the table above are primarily comprised of collateral dependent commercial loans, which have not been fully charged off. The average recorded investment in impaired loans was $161,194,000 and $93,654,000 for the nine months and year ended September 30, 2009 and December 31, 2008, respectively. The interest recognized on impaired loans was not significant. The increase in the balance of impaired loans over historical levels can be partially attributed to certain loans that filed for bankruptcy protection and a few loan relationships that deteriorated during 2008 and 2009. A substantial amount of the impaired loans have adequate collateral and credit enhancements not requiring a related allowance for loan loss. The level of impaired loans is reflective of the economic weakness that has been created by the financial crisis and the subsequent economic downturn. While impaired loans have increased compared to historical levels, they have decreased for the period ended September 30, 2009, compared to the period ending December 31, 2008. Management is confident the Company s loss exposure regarding these credits will be significantly reduced due to the Company s long-standing practices that emphasize secured lending with strong collateral positions and guarantor support. Management is likewise confident the reserve for probable loan losses is adequate. The Company has no direct exposure to sub-prime loans in its loan portfolio, but the sub-prime crisis has affected the credit markets on a national level, and as a result, the Company has experienced an increasing amount of impaired loans; however, management s decision to place loans in this category does not necessarily mean that the Company will experience significant losses from these loans or significant increases in impaired loans from these levels.

Management of the Company recognizes the risks associated with these impaired loans. However, management s decision to place loans in this category does not necessarily mean that losses will occur. In the current environment, troubled loan management can be protracted because of the legal and process problems that delay the collection of an otherwise collectable loan. Additionally, management believes that the collateral related to these impaired loans and/or the secondary support from guarantors mitigates the potential for losses from impaired loans. It is also important to note that even though the economic conditions in Texas and Oklahoma are softening, we believe these markets are stronger and better positioned to recover than many other areas of the country.

The bank subsidiaries charge off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a loss by bank examiners. Commercial and industrial or real estate loans are generally considered by management to represent a loss, in whole or part, when an exposure beyond any collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower s financial condition and general economic conditions in the borrower s industry. Generally, unsecured consumer loans are charged-off when 90 days past due.

While management of the Company considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. It is the judgment of the Company s management that the allowance for probable loan losses at September 30, 2009 was adequate to absorb probable losses from loans in the portfolio at that date.

Note 5 Stock Options

On April 1, 2005, the Board of Directors adopted the 2005 International Bancshares Corporation Stock Option Plan (the 2005 Plan). Effective May 19, 2008, the 2005 Plan was amended to increase the number of shares available for stock option grants under the 2005 Plan by 300,000 shares. The 2005 Plan replaced the 1996 International Bancshares Corporation Key Contributor Stock Option Plan (the 1996 Plan). Under the 2005 Plan both qualified incentive stock options (ISOs) and non-qualified stock options (NQSOs) may be granted. Options granted may be exercisable for a period of up to 10 years from the date of grant, excluding ISOs granted to 10% shareholders, which may be exercisable for a period of up to only five years. As of September 30, 2009, 138,297 shares were available for future grants under the 2005 Plan.

A summary of option activity under the stock option plans for the nine months ended September 30, 2009 is as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value ($) (Dollars in Thousands)
Options outstanding at December 31, 2008	833,597	$ 21.43		
Plus: Options granted	247,250	10.42		
Less:				
Options exercised	186,395	12.66		
Options expired	15,052	12.66		
Options forfeited	24,088	17.26		
Options outstanding at September 30, 2009	855,312	$ 20.35	4.93	$ 1,499
Options fully vested and exercisable at September 30, 2009	275,032	$ 22.47	2.81	$ 70

Stock-based compensation expense included in the consolidated statements of income for the three and nine months ended September 30, 2009 was approximately $185,400 and $502,000, respectively. As of September 30, 2009, there was approximately $1,342,000 of total unrecognized stock-based compensation cost related to non-vested options granted under the Company plans that will be recognized over a weighted average period of 1.7 years.

Note 6 - Investment Securities

The Company classifies debt and equity securities into one of three categories: held-to maturity, available-for-sale, or trading. Such securities are reassessed for appropriate classification at each reporting date. Securities classified as held-to-maturity are carried at amortized cost for financial statement reporting, while securities classified as available-for-sale and trading are carried at their fair value. Unrealized holding gains and losses are included in net income for those securities classified as trading , while unrealized holding gains and losses related to those securities classified as available-for-sale are excluded from net income and reported net of tax as other comprehensive income (loss) and accumulated other comprehensive income (loss) until realized, or in the case of losses, when deemed other than temporary.

The amortized cost and estimated fair value by type of investment security at September 30, 2009 are as follows:

	Held to Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	$ 2,450	$	$	$ 2,450	$ 2,450
Total investment securities	$ 2,450	$	$	$ 2,450	$ 2,450

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value (1)
	(Dollars in Thousands)				
U.S. Treasury securities	$ 1,327	$	$	$ 1,327	$ 1,327
Mortgage-backed securities	4,275,422	86,821	(297)	4,361,946	4,361,946
Obligations of states and political subdivisions	126,205	2,429	(162)	128,472	128,472
Equity securities	13,825	368	(29)	14,164	14,164
Total investment securities	$ 4,416,779	$ 89,618	$ (488)	$ 4,505,909	$ 4,505,909

(1) Included in the carrying value of mortgage-backed securities are $1,616,728 of mortgage-backed securities issued by Ginnie Mae, $2,666,663 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and $78,555 issued by non-government entities

The amortized cost and estimated fair value by type of investment security at December 31, 2008 are as follows:

	Held to Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	$ 2,300	$	$	$ 2,300	$ 2,300
Total investment securities	$ 2,300	$	$	$ 2,300	$ 2,300

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value (1)
	(Dollars in Thousands)				
U.S. Treasury securities	$ 1,319	$	$	$ 1,319	$ 1,319
Mortgage-backed securities	4,947,351	59,915	(32,949)	4,974,317	4,974,317
Obligations of states and political subdivisions	81,208	1,346	(340)	82,214	82,214
Equity securities	13,825	205		14,030	14,030
Total investment securities	$ 5,043,703	$ 61,466	$ (33,289)	$ 5,071,880	$ 5,071,880

(1) Included in the carrying value of mortgage-backed securities are $1,820,988 of mortgage-backed securities issued by Ginnie Mae, $3,087,038 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and $66,291 issued by non-government entities

The amortized cost and estimated fair value of investment securities at September 30, 2009, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated fair value	Amortized Cost	Estimated fair value
	(Dollars in Thousands)			
Due in one year or less	$ 625	$ 625	$ 1,327	$ 1,327
Due after one year through five years	1,825	1,825		
Due after five years through ten years			11,225	11,303
Due after ten years			114,980	117,169
Mortgage-backed securities			4,275,422	4,361,946
Equity securities			13,825	14,164
Total investment securities	$ 2,450	$ 2,450	$ 4,416,779	$ 4,505,909

Mortgage-backed securities are securities issued by the Freddie Mac, Fannie Mae, Ginnie Mae or non-government entities. Investments in mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U.S. Government. Investments in mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. Government, but carry an implied AAA rating with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008.

Proceeds from the sale of securities available-for-sale were $35,135,000 and $571,814,000 for the three and nine months ended September 30, 2009, respectively, which included $29,946,000 and $555,674,000 of mortgage-backed securities. Gross gains of $179,000 and $11,894,000 and gross losses of $(5,000) and $(14,000) were realized on the sales for the quarter and nine months ended September 30, 2009, respectively.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2009 were as follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in Thousands)					
Available for sale:						
Mortgage-backed securities	$ 82,539	$ (214)	$ 63,621	$ (83)	$ 146,160	$ (297)
Obligations of states and political subdivisions	17,851	(158)	271	(4)	18,122	(162)
Other equity securities	47	(29)			47	(29)
	$ 100,437	$ (401)	$ 63,892	$ (87)	$ 164,329	$ (488)

The unrealized losses on investments in mortgage-backed securities are primarily caused by changes in market interest rates. Mortgage-backed securities are primarily securities issued by the Freddie Mac, Fannie Mae and Ginnie Mae. The contractual cash obligations of the securities issued by Ginnie Mae are fully guaranteed by the U.S. Government. The contractual cash obligations of the securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. Government; however, the securities carry an implied AAA rating with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008. The decrease in fair value on mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae is due to market interest rates. The Company has the ability and intent to hold these investments until a market price recovery or maturity of the securities; therefore, it is the conclusion of the Company that the investments in mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae are not considered other-than-temporarily impaired. In addition, the Company has a small investment in non-agency mortgage-backed securities that have strong credit backgrounds and include additional credit enhancements to protect the Company from losses arising from high foreclosure rates. These securities have additional market volatility beyond economically induced interest rate events. The Company has received principal and interest payments in line with expected cash flows at the time of purchase. The Company has no intent to sell and will not more likely than not be required to sell before recovery of amortized cost, the non-agency mortgage-backed securities until a market price recovery or maturity and has continued to receive cash as expected; therefore, it is the conclusion of the Company that the investments in non-agency mortgage-backed securities are not other-than-temporarily impaired.

The unrealized losses on investments in other securities are caused by fluctuations in market interest rates. The underlying cash obligations of the securities are guaranteed by the entity underwriting the debt instrument. It is the belief of the Company that the entity issuing the debt will honor its interest payment schedule, as well as the full debt at maturity. The securities are purchased by the Company for their economic value. The decrease in fair value is primarily due to market interest rates and not other factors, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity of the securities, it is the conclusion of the Company that the investments are not considered other-than-temporarily impaired.

Note 7 Other Borrowed Funds

Other borrowed funds include Federal Home Loan Bank borrowings, which are short-term, variable-rate borrowings issued by the Federal Home Loan Bank of Dallas at the market price offered at the time of funding. These borrowings are secured by mortgage-backed investment securities and a portion of the Company s loan portfolio. At September 30, 2009, other borrowed funds totaled $1,128,575,000, a decrease of 55.3% from $2,522,986,000 at December 31, 2008.

Note 8 Junior Subordinated Interest Deferrable Debentures

The Company has formed twelve statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. As part of the Local Financial Corporation (LFIN) acquisition, the Company acquired three additional statutory business trusts previously formed by LFIN for the purpose of issuing trust preferred securities. The twelve statutory business trusts formed by the Company and the three business trusts acquired in the LFIN transaction (the Trusts) have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the Debentures) issued by the Company or LFIN, as appropriate. As of September 30, 2009, the Debentures issued by four of the trusts formed by the Company and the Debentures issued by all three of the trusts formed by LFIN have been redeemed by the Company. As of September 30, 2009, the principal amount of debentures outstanding totaled $201,074,000. As a result of the participation in the TARP Capital Purchase Program, the Company may not, without the consent of the Treasury Department, redeem any of the Debentures until the earlier to occur of December 23, 2011, or the date on which the Company has redeemed all of the Series A Preferred Stock issued under the Capital Purchase Program or the date on which the Treasury has transferred all of the Series A Preferred Stock to third parties not affiliated with the Treasury.

The Debentures are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the respective indentures) of the Company, and are *pari passu* with one another. The interest rate payable on, and the payment terms of the Debentures are the same as the distribution rate and payment terms of the respective issues of Capital and Common Securities issued by the Trusts. The Company has fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. The Company has the right, unless an Event of Default (as defined in the Indentures) has occurred and is continuing, to defer payment of interest on the Debentures for up to ten consecutive semi-annual periods on Trust I and for up to twenty consecutive quarterly periods on Trusts VI, VII, VIII, IX, X, XI and XII. If interest payments on any of the Debentures are deferred, distributions on both the Capital and Common Securities related to that Debenture would also be deferred. The redemption prior to maturity of any of the Debentures may require the prior approval of the Federal Reserve and/or other regulatory bodies.

For financial reporting purposes, the Trusts are treated as investments of the Company and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. For September 30, 2009, the total $201,074,000, of the Capital Securities outstanding qualified as Tier 1 capital.

In March 2005, the Federal Reserve Board issued a final rule that allowed the inclusion of trust preferred securities in Tier 1 capital, but placed stricter quantitative limits. Under the final rule, after a transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. On March 16, 2009, the Federal Reserve Board extended for two years the transition period. The Company believes that substantially all of the current trust preferred securities will be included in Tier 1 capital after the transition period ending on March 31, 2011.

The following table illustrates key information about each of the Capital and Common Securities and their interest rate at September 30, 2009:

		Junior Subordinated Deferrable Interest Debentures (In Thousands)	Repricing Frequency	Interest Rate	Interest Rate Index	Maturity Date	Optional Redemption Date
Trust I	$	10,348	Fixed	10.18%	Fixed	June 2031	June 2011
Trust VI	$	25,774	Quarterly	3.89%	LIBOR + 3.45	November 2032	February 2010
Trust VII	$	10,310	Quarterly	3.73%	LIBOR + 3.25	April 2033	January 2010
Trust VIII	$	25,774	Quarterly	3.56%	LIBOR + 3.05	October 2033	January 2010
Trust IX	$	41,238	Fixed	7.10%	Fixed	October 2036	October 2011
Trust X	$	34,021	Fixed	6.66%	Fixed	February 2037	February 2012
Trust XI	$	32,990	Fixed	6.82%	Fixed	July 2037	July 2012
Trust XII	$	20,619	Fixed	6.85%	Fixed	September 2037	September 2012
	$	201,074					

(1) Trust IX, X, XI and XII accrue interest at a fixed rate for the first five years, then floating at LIBOR + 1.62%, 1.65%, 1.62% and 1.45% thereafter, respectively.

18

Note 9 Preferred Stock, Common Stock and Dividends

The Company has outstanding 216,000 shares of Series A cumulative perpetual preferred stock, issued to the US Treasury under the Company s participation in the Troubled Asset Relief Program Capital Purchase Program (the TARP Capital Purchase Program). The Series A shares have a par value of $.01 per share (the Senior Preferred Stock), and a liquidation preference of $1,000 per share, for a total price of $216,000,000. The Senior Preferred Stock will pay dividends at a rate of 5% per year for the first five years and 9% per year thereafter. The Senior Preferred Stock has no maturity date and ranks senior to the Company s common stock with respect to the payment of dividends and distributions and amounts payable upon liquidation, dissolution and winding up of the Company. In conjunction with the purchase of the Senior Preferred Stock, the US Treasury received a warrant (the Warrant) to purchase 1,326,238 shares of the Company s common stock (the Warrant Shares) at $24.43 per share, which would represent an aggregate common stock investment in the Company on exercise of the warrant in full equal to 15% of the Senior Preferred Stock investment. The term of the Warrant is ten years and was immediately exercisable. The number of shares issuable upon exercise of the Warrant is also subject to reduction in certain limited events that involve the Company conducting Qualified Equity Offerings on or prior to December 31, 2009. Both the Senior Preferred Stock and Warrant are included as components of Tier 1 capital. As of September 30, 2009, none of the Warrants had been exercised. The Company paid dividends on the Senior Preferred Stock on February 16, May 15, and August 2009, in the amounts of $1,560,000, $2,700,000, and $2,700,000, respectively, and will pay a dividend on the Senior Preferred Stock on November 15, 2009, in the amount of $2,700,000.

Upon issuance, the fair value of the Series A shares and the associated warrants were computed as if the instruments were issued on a stand-alone basis. The fair value of the Series A shares were estimated based on discounted cash flows, resulting in a stand-alone fair value of approximately $130.9 million. The Company used the Black-Sholes-Merton option pricing model to estimate the fair value of the warrants, resulting in a stand-alone fair value of approximately $8.0 million. The fair values of both were then used to record the Series A shares and Warrants on a relative fair value basis, with the warrants being recorded in Surplus as permanent equity and the Series A shares being recorded at a discount of approximately $12.4 million. Accretion of the discount associated with the preferred stock is recognized as an increase to preferred stock dividends in determining net income available to common shareholders. The discount is being amortized over a five year period from the respective issuance date using the effective-yield method and totaled $550,000 and $1,625,000 for the three and nine months ended September 30, 2009.

The Company paid cash dividends to the common shareholders of $.17 per share on May 11, 2009 to all holders of record on April 27, 2009. The Company will pay cash dividends to the common shareholders of $.17 per share on November 2, 2009 to all holders of record on October 19, 2009. Cash dividends to common shareholders were paid on April 18, and October 15, 2008 to all holders of record on March 31, 2008 and September 30, 2008, respectively.

The Company terminated its stock repurchase program on December 19, 2008, in connection with participating in the TARP Capital Purchase Program, which program prohibited stock repurchases, except for repurchases made in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices. On April 7, 2009, the Company obtained consent from the Treasury to repurchase shares of the Company s common stock; provided, however, that in no event will the aggregate amount of cash dividends and common stock repurchases for a given semi-annual period exceed the aggregate amount that would be used to pay the originally permitted semi-annual cash dividend of $.33 per share. The Company also received consent from the Treasury to pay quarterly dividends. The Company will determine on an ongoing basis the best use of the funds and whether a more frequent dividend program and expanded repurchase program are warranted and beneficial to its shareholders. Under the new stock repurchase program, the Company is authorized to repurchase up to $40,000,000 of its common stock within twelve months from the adoption of the repurchase program on April 9, 2009. Stock repurchases may be made from time to time, on the open market or through private transactions. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of October 28, 2009, a total of 6,754,098 shares had been repurchased under all programs at a cost of $219,811,000.

Note 10 - Commitments and Contingent Liabilities and Other Tax Matters

The Company is involved in various legal proceedings that are in various stages of litigation. Some of these actions allege lender liability claims on a variety of theories and claim substantial actual and punitive damages. The Company has determined, based on discussions with its counsel that any material loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to the consolidated financial position or results of operations of the Company. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

The Company s lead bank subsidiary has invested in partnerships, which have entered into several lease-financing transactions. The Internal Revenue Service issued a Notice of Final Partnership Administrative Adjustments (FPAA) on two of the partnerships. In both partnerships, the lead bank subsidiary was the owner of a ninety-nine percent (99%) limited partnership interest. In connection with the two partnerships through the first quarter of 2006, the Company expensed approximately $25.7 million, which amount represents the total of the tax adjustments due and the interest due on such adjustments for both FPAAs. Management will continue to evaluate the correspondence with the IRS on the FPAAs and make any appropriate revisions to the amounts as deemed necessary.

Note 11 Capital Ratios

The Company had a Tier 1 capital to average total asset (leverage) ratio of 11.22% and 9.97%, risk-weighted Tier 1 capital ratio of 17.19% and 15.30% and risk-weighted total capital ratio of 18.44% and 16.35% at September 30, 2009 and December 31, 2008, respectively. The identified intangibles and goodwill of $305,966,000 as of September 30, 2009, recorded in connection with the acquisitions made by the Company, are deducted from the sum of core capital elements when determining the capital ratios of the Company. Under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold qualifies as Tier 2 capital. As of September 30, 2009, the total of $201,074,000 of the Capital Securities outstanding qualified as Tier 1 capital. The Company actively monitors the regulatory capital ratios to ensure that the Company s bank subsidiaries are well capitalized under the regulatory framework.

In March 2005, the Federal Reserve Board issued a final rule that allowed the inclusion of trust preferred securities in Tier 1 capital, but placed stricter quantitative limits. Under the final rule, after a transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Tier 2 capital, subject to restrictions. On March 16, 2009, the Federal Reserve Board extended for two years the transition period. The Company believes that substantially all of the current trust preferred securities will be included in Tier 1 capital after the transition period ending on March 31, 2011.

Item 2 - Management s Discussion and Analysis of Financial Condition and Results of Operations

Special Cautionary Notice Regarding Forward Looking Information

Certain matters discussed in this report, excluding historical information, include forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by these sections. Although the Company believes such forward-looking statements are based on reasonable assumptions, no assurance can be given that every objective will be reached. The words estimate, expect, intend, believe and project, as wel other words or expressions of a similar meaning are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this report. Such statements are based on current expectations, are inherently uncertain, are subject to risks and should be viewed with caution. Actual results and experience may differ materially from the forward-looking statements as a result of many factors.

Risk factors that could cause actual results to differ materially from any results that are projected, forecasted, estimated or budgeted by the Company in forward-looking statements include, among others, the following possibilities:

- Local, regional, national and international economic business conditions and the impact they may have on the Company, the Company s customers, and such customers ability to transact profitable business with the Company, including the ability of its borrowers to repay their loans according to their terms or a change in the value of the related collateral.

- Volatility and disruption in national and international financial markets.

- Government intervention in the U.S. financial system.

- Changes in consumer spending, borrowings and savings habits.

- Changes in interest rates and market prices, which could reduce the Company s net interest margins, asset valuations and expense expectations.

- Changes in the capital markets utilized by the Company and its subsidiaries, including changes in the interest rate environment that may reduce margins.

- Changes in state and/or federal laws and regulations to which the Company and its subsidiaries, as well as their customers, competitors and potential competitors, are subject, including, without limitation, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance and employment laws and regulations.

- Changes in U.S. Mexico trade, including, without limitation, reductions in border crossings and commerce resulting from the Homeland Security Programs called US-VISIT, which is derived from Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.

- The loss of senior management or operating personnel.

- Increased competition from both within and outside the banking industry.

- The timing, impact and other uncertainties of the Company s potential future acquisitions including the Company s ability to identify suitable potential future acquisition candidates, the success or failure in the integration of their operations and the Company s ability to maintain its current branch network and to enter new markets successfully and capitalize on growth opportunities.

- Changes in the Company s ability to pay dividends on its Preferred Stock or Common Stock.

- The effects of the proceedings pending with the Internal Revenue Service regarding the Company s lease financing transactions.

- Additions to the Company s loan loss allowance as a result of changes in local, national or international conditions which adversely affect the Company s customers.

- Greater than expected costs or difficulties related to the development and integration of new products and lines of business.

- Changes in the soundness of other financial institutions with which the Company interacts.

- Political instability in the United States and Mexico.

- Technological changes.

- Acts of war or terrorism.

- Natural disasters.

- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale portfolio following a determination that the securities are other-than-temporarily impaired.

- The effect of changes in accounting policies and practices as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.

- The costs and effects of regulatory developments, including the resolution of regulatory or other governmental inquiries and the results of regulatory examinations or reviews.

- The Company s success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. It is not probable to foresee or identify all such factors. The Company makes no commitment to update any forward-looking statement, or to disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement, unless required by law.

Recent Developments

On July 1, 2009, the Financial Accounting Standards Board officially launched the FASB Accounting Standards Codification, (Codification), which is now the single official source of authoritative, non-governmental U.S. GAAP, in addition to guidance issued by the Securities and Exchange Commission (SEC). The Codification supersedes all prior accounting literature. With the launch of the Codification, U.S. GAAP now consists of two levels authoritative (Codification) and non-authoritative (anything not in the Codification). The Codification is effective for interim and annual periods ending after September 15, 2009, and is organized into approximately 90 accounting topics. The FASB will no longer be issuing accounting standards in the form of Statements, Staff Positions or Emerging Issues Task Force Abstracts. The FASB will instead amend the Codification by issuing Accounting Standards Updates. The adoption of the Codification did not have a significant impact to the Company s consolidated financial statements.

Overview

The Company, which is headquartered in Laredo, Texas, with 280 facilities and more than 440 ATMs, provides banking services for commercial, consumer and international customers of South, Central and Southeast Texas and the State of Oklahoma. The Company is one of the largest independent commercial bank holding companies headquartered in Texas. The Company, through its bank subsidiaries, is in the business of gathering funds from various sources and investing those funds in order to earn a return. The Company either directly or through a bank subsidiary owns two insurance agencies, a liquidating subsidiary, a broker/dealer and a fifty percent interest in an investment banking unit that owns a broker/dealer. The Company s primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, the Company generates income from fees on products offered to commercial, consumer and international customers.

The Company is very active in facilitating trade along the United States border with Mexico. The Company does a large amount of business with customers domiciled in Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of the Company s bank subsidiaries. The Company also serves the growing Hispanic population through the Company s facilities located throughout South, Central and Southeast Texas and the State of Oklahoma.

Expense control is an essential element in the Company s long-term profitability. As a result, the Company monitors the efficiency ratio, which is a measure of non-interest expense to net interest income plus non-interest income closely. The Company s efficiency ratio has been negatively impacted over the last few years because of the Company s aggressive branch expansion which has added a total of 34 branches during 2008 and 2009. During rapid expansion periods, the Company s efficiency ratio will suffer but the long-term benefits of the expansion should be realized in future periods and the benefits should positively impact the efficiency ratio in future periods. The Company monitors this ratio over time to

assess the Company s efficiency relative to its peers taking into account the Company s branch expansion. The Company uses this measure as one factor in determining if the Company is accomplishing its long-term goals of providing superior returns to the Company s shareholders.

Results of Operations

Summary

Consolidated Statements of Condition Information

	September 30, 2009	December 31, 2008	Percent Increase (Decrease)
	(Dollars in Thousands)		
Assets	$ 11,685,584	$ 12,439,341	(6.1)%
Net loans	5,652,034	5,799,372	(2.5)
Deposits	6,912,232	6,858,784	.8
Other borrowed funds	1,128,575	2,522,986	(55.3)
Junior subordinated deferrable interest debentures	201,074	201,048	
Shareholders equity	1,378,348	1,257,297	9.6

Consolidated Statements of Income Information

	Three Months Ended September 30, (Dollars in Thousands)		Percent Increase (Decrease)	Nine Months Ended September 30, (Dollars in Thousands)		Percent Increase (Decrease)
	2009	2008		2009	2008	
Interest income	$ 126,704	$ 138,194	(8.3)%	$ 401,098	$ 423,785	(5.4)%
Interest expense	32,257	54,076	(40.3)	108,978	181,897	(40.1)
Net interest income	94,447	84,118	12.3	292,120	241,888	20.8
Provision for probable loan losses	10,346	7,037	47.0	45,429	12,690	258.0
Non-interest income	50,875	50,823	.1	149,079	148,134	.6
Non-interest expense	78,746	76,274	3.2	234,153	223,970	4.5
Net income	33,723	33,880	(.5)	95,909	100,409	(4.5)
Per common share (adjusted for stock dividends):						
Basic	$ .49	$ .49	%	$ 1.40	$ 1.46	(4.1)%
Diluted	.49	.49		1.40	1.46	(4.1)

Net Income

Net income for the third quarter of 2009 decreased by .5% compared to the same period in 2008 and decreased by 4.5% for the nine months ended September 30, 2009 as compared to the same period in 2008 despite the $21.3 million, after tax, increase in the provision for probable loan losses charged to expense during the first nine months of 2009. Additionally, an industry-wide FDIC special assessment negatively impacted the Company s earnings by $3.3 million, after tax in the second quarter.Net income for the first nine months of 2009 was positively affected by the increasing net interest margin of the Company. The increase in the provision was prompted by the analysis of management regarding the general weakness in the economy and the impact of that weakness on the Company s loan portfolio and the related allowance for probable loan losses. While the Texas and Oklahoma economies are doing better than other parts of the country, Texas and Oklahoma are not immune to the problems associated with the U.S. economy. The increase in the provision for probable loan losses is not necessarily an indicator that more credits will worsen to the point that the Company will have to continue to record provisions for probable loan losses at the same level in future periods.

23

Net Interest Income

	Three Months Ended September 30, (in Thousands)		Percent Increase (Decrease)	Nine Months Ended September 30, (in Thousands)		Percent Increase (Decrease)
	2009	2008		2009	2008	
Interest income:						
Loans, including fees	$ 84,263	$ 91,020	(7.4)%	$ 252,105	$ 281,569	(10.5)%
Federal funds sold		226	(100.0)		907	(100.0)
Investment securities:						
Taxable	40,937	45,996	(11.0)	145,074	138,246	4.9
Tax-exempt	1,375	846	62.5	3,454	2,680	28.9
Other interest income	129	106	21.7	465	383	21.4
Total interest income	126,704	138,194	(8.3)	401,098	423,785	(5.4)
Interest expense:						
Savings deposits	2,563	6,807	(62.3)	8,182	22,609	(63.8)
Time deposits	14,757	24,093	(38.7)	48,650	85,360	(43.0)
Securities sold under repurchase agreements	11,110	12,486	(11.0)	33,622	38,612	(12.9)
Other borrowings	732	7,133	(89.7)	9,041	24,546	(63.2)
Junior subordinated interest deferrable debentures	3,095	3,461	(10.6)	9,483	10,586	(10.4)
Other interest expense		96	(100.0)		184	(100.0)
Total interest expense	32,257	54,076	(40.3)	108,978	181,897	(40.1)
Net interest income	$ 94,447	$ 84,118	12.3%	$ 292,120	$ 241,888	20.8%

Net interest income is the spread between income on interest earning assets, such as loans and securities, and the interest expense on liabilities used to fund those assets, such as deposits, repurchase agreements and funds borrowed. Net interest income is the Company s largest source of revenue and increased substantially because of the reduction in the Federal Reserve prime interest rate. The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Company s loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate that loan rates are indexed from, ended 2007 at 7.25%. During 2008, the prime interest rate decreased 400 basis points to end the year at 3.25% where it has remained as of September 30, 2009. The Company s goal is to manage the net interest income in periods of rising and falling rates. Net interest income increased 20.8% for the first nine months of 2009 as compared to the same period in 2008 because of the lower cost of funding incurred by the Company.

As part of its strategy to manage interest rate risk, the Company strives to manage both assets and liabilities so that interest sensitivities match. One method of calculating interest rate sensitivity is through gap analysis. A gap is the difference between the amount of interest rate sensitive assets and interest rate sensitive liabilities that re-price or mature in a given time period. Positive gaps occur when interest rate sensitive assets exceed interest rate sensitive liabilities, and negative gaps occur when interest rate sensitive liabilities exceed interest rate sensitive assets. A positive gap position in a period of rising interest rates should have a positive effect on net interest income as assets will re-price faster than liabilities. Conversely, net interest income should contract somewhat in a period of falling interest rates. Management can quickly change the Company s interest rate position at any given point in time as market conditions dictate. Additionally, interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Analytical techniques employed by the Company to supplement gap analysis include simulation analysis to quantify interest rate risk exposure. The gap analysis prepared by management is reviewed by the Investment Committee of the Company twice a year (see table on page 29 for the September 30, 2009 gap analysis). Management currently believes that the Company is properly positioned for interest rate changes; however if management determines at any time that the Company is not properly positioned, it will strive to adjust the interest rate sensitive assets and liabilities in order to manage the effect of interest rate changes.

24

Non-Interest Income

	Three Months Ended September 30, (in Thousands)		Percent Increase (Decrease)	Nine Months Ended September 30, (in Thousands)		Percent Increase (Decrease)
	2009	2008		2009	2008	
Service charges on deposit accounts	$ 25,425	$ 25,354	.3%	$ 73,753	$ 74,596	(1.1)%
Other service charges, commissions and fees						
Banking	10,513	10,437	.7	31,781	30,599	3.9
Non-banking	5,485	2,267	141.9	9,203	5,412	70.0
Investment securities transactions, net	174		100.0	11,880	6,410	85.3
Other investments, net	3,374	5,785	(41.7)	10,609	13,895	(23.6)
Other income	5,904	6,980	(15.4)	11,853	17,222	(31.2)
Total non-interest income	$ 50,875	$ 50,823	.1%	$ 149,079	$ 148,134	.6%

The increase in investment securities transactions for the nine months ended September 30, 2009 can be attributed to the sale of investment securities. Non-banking service charges, commissions and fees for the three and nine-months ended September 30, 2009 was positively impacted by the results of a wholly owned insurance subsidiary of the Company s lead bank. Other income for the nine months ended September 30, 2008 was positively impacted by the sale of a portion of the Company s majority interest of its investment services unit, totaling $2.0 million, before tax. In connection with the sale, the Company recorded a charge, included in other expense of $841,000, before tax, to dispose of goodwill acquired as part of its initial investment in the unit.

Non-Interest Expense

	Three Months Ended September 30, (in Thousands)		Percent Increase (Decrease)	Nine Months Ended September 30, (in Thousands)		Percent Increase (Decrease)
	2009	2008		2009	2008	
Employee compensation and benefits	$ 35,316	$ 32,854	7.5%	$ 99,796	$ 95,314	4.7%
Occupancy	8,723	9,955	(12.4)	25,899	27,053	(4.3)
Depreciation of bank premises and equipment	8,965	9,481	(5.4)	26,979	27,119	(.5)
Professional fees	4,958	2,557	93.9	16,735	8,442	98.2
Stationery and supplies	1,109	1,540	(28.0)	2,925	4,134	(29.2)
Amortization of identified intangible assets	1,320	1,299	1.6	3,950	3,897	1.4
Advertising	2,647	3,667	(27.8)	7,887	10,329	(23.6)
Other	15,708	15,238	3.1	49,982	47,682	4.8
Total non-interest expense	$ 78,746	$ 76,591	2.8%	$ 234,153	$ 223,970	4.5%

Non-interest expense was affected by the aggressive de novo branching activity that has added 16 new branches in 2009 and 18 branches in 2008. As a result of the branch expansion, employee compensation increased due to staffing of these branches. Professional fee expense for the nine months ended September 30, 2009 was negatively impacted by the FDIC special assessment. In May 2009, the FDIC issued a final rule which levied a special assessment on all insured depository institutions totaling five basis points of each institution s total assets less Tier 1 capital as of June 30, 2009 that was collected on September 30, 2009. The special assessment is part of the FDIC s efforts to re-build the Deposit Insurance Fund (DIF). The Company accrued $5.1 million related to the special assessment. The FDIC has proposed that financial institutions prepay their quarterly assessments for the next three years in an effort to shore up the DIF. The proposal would require banks to prepay their quarterly risk-based assessments for the fourth quarter of 2009, and all of 2010, 2011 and 2012

on December 30, 2009.

Financial Condition

Allowance for Probable Loan Losses

The allowance for probable loan losses increased 23.0% to $90,322,000 at September 30, 2009 from $73,461,000 at December 31, 2008. The provision for probable loan losses charged to expense increased 258.0% to $45,429,000 for the nine months ended September 30, 2009 from $12,690,000 for the same period in 2008. The allowance for probable loan losses was 1.6% of total loans at September 30, 2009 and 1.3% at December 31, 2008, respectively. The increase in the provision was prompted by the analysis of management regarding the general weakness in the economy and the impact of that weakness on the Company s loan portfolio and the related allowance for probable loan losses. The increase is not necessarily an indicator that more credits will worsen to the point that the Company will have to continue to record provisions for probable loan losses at the same level in future periods.

Investment Securities

Mortgage-backed securities are securities primarily issued by the Federal Home Loan Mortgage Corporation (Freddie Mac), Federal National Mortgage Association (Fannie Mae), and the Government National Mortgage Association (Ginnie Mae). Investments in mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U.S. Government. Investments in mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. Government, but carry an implied AAA rating with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008.

Loans

Loans decreased 2.2% to $5,742,356,000 at September 30, 2009, from $5,872,833,000 at December 31, 2008. The decrease in loans can be attributed to the lack of demand for loans that the Company is experiencing as the result of the negative economic conditions.

Deposits

Deposits increased by an insignificant amount to $6,912,232,000 at September 30, 2009, from $6,858,784,000 at December 31, 2008. The slight increase in deposits is the result of the increased demand for deposits and the aggregate pricing that is occurring in the market for deposits. Even though the Company increased its deposits, the Company is still experiencing a substantial amount of demand for deposits at higher than market rates. As a result, the Company has attempted to maintain certain deposit relationships but has allowed certain deposits to leave as the result of aggressive pricing.

Foreign Operations

On September 30, 2009, the Company had $11,685,584,000 of consolidated assets, of which approximately $270,263,000, or 2.3%, was related to loans outstanding to borrowers domiciled in foreign countries, compared to $328,948,000, or 2.6%, at December 31, 2008. Of the $270,263,000, 79.2% is directly or indirectly secured by U.S. assets, certificates of deposits and real estate; 20.2% is secured by foreign real estate; and 0.6% is unsecured.

Critical Accounting Policies

The Company has established various accounting policies which govern the application of accounting principles in the preparation of the Company s consolidated financial statements. The significant accounting policies are described in the notes to the consolidated financial statements. Certain accounting policies involve significant subjective judgments and assumptions by management which have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies.

The Company considers its Allowance for Probable Loan Losses as a policy critical to the sound operations of the bank subsidiaries. The allowance for probable loan losses consists of the aggregate loan loss allowances of the bank subsidiaries. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each bank subsidiary is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance is derived from the following elements: (i) allowances established on specific loans and (ii) allowances based on historical loss experience on the Company s remaining loan portfolio, which includes general economic conditions and other qualitative risk factors both internal and external to the Company. See also discussion regarding the allowance for probable loan losses and provision for probable loan losses included in the results of operations and Provision and Allowance for Probable Loan Losses included in Notes 1 and 5 of the notes to Consolidated Financial Statements in the Company s latest Annual Report on Form 10-K for further information regarding the Company s provision and allowance for probable loan losses policy.

Liquidity and Capital Resources

The maintenance of adequate liquidity provides the Company s bank subsidiaries with the ability to meet potential depositor withdrawals, provide for customer credit needs, maintain adequate statutory reserve levels and take full advantage of high-yield investment opportunities as they arise. Liquidity is afforded by access to financial markets and by holding appropriate amounts of liquid assets. The Company s bank subsidiaries derive their liquidity largely from deposits of individuals and business entities. Deposits from persons and entities domiciled in Mexico comprise a stable portion of the deposit base of the Company s bank subsidiaries. Other important funding sources for the Company s bank subsidiaries during 2009 and 2008 were borrowings from FHLB, securities sold under repurchase agreements and large certificates of deposit, requiring management to closely monitor its asset/liability mix in terms of both rate sensitivity and maturity distribution. Primary liquidity of the Company and its subsidiaries has been maintained by means of increased investment in shorter-term securities, certificates of deposit and repurchase agreements. As in the past, the Company will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities and respond accordingly to anticipated fluctuations in interest rates over reasonable periods of time.

The Company maintains an adequate level of capital as a margin of safety for its depositors and shareholders. At September 30, 2009, shareholders equity was $1,378,348,000 compared to $1,257,297,000 at December 31, 2008, an increase of $121,051,000, or 9.6%. The increase is primarily due to the retention of earnings and an increase in comprehensive income, offset by dividends paid to the preferred and common shareholders.

The Company had a leverage ratio of 11.22% and 9.97%, risk-weighted Tier 1 capital ratio of 17.19% and 15.30% and risk-weighted total capital ratio of 18.44% and 16.35% at September 30, 2009 and December 31, 2008, respectively. The identified intangibles and goodwill of $305,966,000 as of September 30, 2009, recorded in connection with the Company s acquisitions, are deducted from the sum of core capital elements when determining the capital ratios of the Company.

As in the past, the Company will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities, and respond accordingly to anticipate fluctuations in interest rates by adjusting the balance between sources and uses of funds as deemed appropriate. The net-interest rate sensitivity as of September 30, 2009 is illustrated in the table on the following page. This information reflects the balances of assets and liabilities for which rates are subject to change. A mix of assets and liabilities that are roughly equal in volume and re-pricing characteristics represents a matched interest rate sensitivity position. Any excess of assets or liabilities results in an interest rate sensitivity gap.

The Company undertakes an interest rate sensitivity analysis to monitor the potential risk on future earnings resulting from the impact of possible future changes in interest rates on currently existing net asset or net liability positions. However, this type of analysis is as of a

point-in-time position, when in fact that position can quickly change as market conditions, customer needs, and management strategies change. Thus, interest rate changes do not affect all categories of asset and liabilities equally or at the same time. As indicated in the table, the Company is liability sensitive during the early time periods and asset sensitive in the longer periods. The Company s Asset and Liability Committee semi-annually reviews the consolidated position along with simulation and duration models, and makes adjustments as needed to control the Company s interest rate risk position. The Company uses modeling of future events as a primary tool for monitoring interest rate risk.

Interest Rate Sensitivity

(Dollars in Thousands)

September 30, 2009	3 Months or Less	Over 3 Months to 1 Year	Rate/Maturity Over 1 Year to 5 Years	Over 5 Years	Total
Rate sensitive assets					
Time deposits with banks	$	$	$	$	$
Investment securities	667,777	1,622,401	2,218,181		4,508,359
Loans, net of non-accruals	4,334,934	229,184	365,391	701,717	5,631,226
Total earning assets	$ 5,002,711	$ 1,851,585	$ 2,583,572	$ 701,717	$ 10,139,585
Cumulative earning assets	$ 5,002,711	$ 6,854,296	$ 9,437,868	$ 10,139,585	
Rate sensitive liabilities					
Time deposits	$ 1,459,128	$ 1,555,629	$ 318,639	$ 289	$ 3,333,685
Other interest bearing deposits	2,130,067				2,130,067
Securities sold under repurchase agreements	430,790	68,106	1,334	1,000,000	1,500,230
Other borrowed funds	1,128,575				1,128,575
Junior subordinated deferrable interest debentures	61,858		128,868	10,348	201,074
Total interest bearing liabilities	$ 5,210,418	$ 1,623,735	$ 448,841	$ 1,010,637	$ 8,293,631
Cumulative sensitive liabilities	$ 5,210,418	$ 6,834,153	$ 7,282,994	$ 8,293,631	
Repricing gap	$ (207,707)	$ 227,850	$ 2,134,731	$ (308,920)	$ 1,845,954
Cumulative repricing gap	(207,707)	20,143	2,154,874	1,845,954	
Ratio of interest-sensitive assets to liabilities	.96	1.14	5.76	.69	1.22
Ratio of cumulative, interest-sensitive assets to liabilities	.96	1.00	1.30	1.22	

Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>

During the first nine months of 2009, there were no material changes in market risk exposures that affected the quantitative and qualitative disclosures regarding market risk presented under the caption Liquidity and Capital Resources located on pages 18 through 22 of the Company s 2008 Annual Report as filed as an exhibit to the Company s Form 10-K for the year ended December 31, 2008.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within specified time periods. As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company s principal executive officer and principal financial officer evaluated, with the participation of the Company s management, the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act rules 13a-15(e) and 15d-15(e)). Based on the evaluation, which disclosed no material weaknesses, the Company s principal executive officer and principal financial officer concluded that the Company s disclosure controls and procedures were effective as of the end of the period covered by this report.

Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting that occurred during the Company s most recent fiscal quarter that have materially affected or are reasonably likely to materially affect the Company s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in various legal proceedings that are in various stages of litigation. Some of these actions allege lender liability claims on a variety of theories and claim substantial actual and punitive damages. The Company has determined, based on discussions with its counsel that any material loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to the consolidated financial position or results of operations of the Company. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

The Company s lead bank subsidiary has invested in partnerships, which have entered into several lease-financing transactions. The Internal Revenue Service issued a Notice of Final Partnership Administrative Adjustments (FPAA) on two of the partnerships. In both partnerships, the lead bank subsidiary was the owner of a ninety-nine percent (99%) limited partnership interest. In connection with the two partnerships through the first quarter of 2006, the Company expensed approximately $25.7 million, which amount represents the total of the tax adjustments due and the interest due on such adjustments for both FPAAs. Management will continue to evaluate the correspondence with the IRS on the FPAAs and make any appropriate revisions to the amounts as deemed necessary.

1A. Risk Factors

There were no material changes in the risk factors as previously disclosed in Item 1A to Part I of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

From time to time, the Company s Board of Directors has authorized stock repurchase plans. The Company terminated its stock repurchase program on December 19, 2008, in connection with participating in the TARP Capital Purchase Program, which program prohibited stock repurchases, except for repurchases made in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices. On April 7, 2009, the Company obtained consent from the Treasury to repurchase shares of the Company s common stock; provided, however, that in no event with the aggregate amount of cash dividends and common stock repurchases for a given semi-annual period exceed the aggregate amount that would be used to pay the originally permitted semi-annual cash dividend of $.33 per share. The Company also received consent from the Treasury to pay quarterly dividends. The Company will determine on an ongoing basis the best use of the funds and whether a more frequent dividend program and expanded repurchase program are warranted and beneficial to its shareholders. Under the new stock repurchase program, the Company is authorized to repurchase up to $40,000,000 of its common stock within twelve months from the adoption of the repurchase program on April 9, 2009. Stock repurchases may be made from time to time, on the open market or through private transactions. During the third quarter, the Company s Board of Directors adopted a Rule 10b5-1 trading plan and intends to adopt additional Rule 10b5-1 trading plans that will allow the Company to purchase its shares of common stock during certain trading blackout periods when the Company ordinarily would not be in the market due to trading restrictions in its internal trading policy. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of October 28, 2009, a total of 6,754,098 shares had been repurchased under all programs at a cost of $219,811,000. The Company is not obligated to repurchase shares under its stock purchase program or to enter into additional Rule 10b5-1 trading plans. The timing, actual number and value of shares purchased will depend on many factors, including the Company s cash flow and the liquidity and price performance of its shares of common stock.

Except for repurchases in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices, common stock repurchases are only conducted under publicly announced repurchase programs approved by the Board of Directors. The following table includes information about common stock share repurchases for the quarter ended September 30, 2009.

	Total Number of Shares Purchased	Average Price Paid Per Share	Shares Purchased as Part of a Publicly-Announced Program	Approximate Dollar Value of Shares Available for Repurchase (1)
July 1 July 31, 2009				$ 35,586,000
August 1 August 31, 2009	87,200	15.58	87,200	34,227,000
September 1 September 30, 2009	58,605	15.03	39,161	33,946,000
	145,805	$ 15.36	126,361	

(1) The formal stock repurchase program was initiated in 1999 and before it was terminated on December 19, 2008, it had been expanded periodically. The new repurchase program that was adopted on April 9, 2009 allows for the repurchase of up to $40,000,000 of treasury stock through April 9, 2010.

Item 6. Exhibits

The following exhibits are filed as a part of this Report:

31(a) Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31(b) Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32(a) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32(b) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTERNATIONAL BANCSHARES CORPORATION

Date:	November 2, 2009	/s/ Dennis E. Nixon Dennis E. Nixon President
Date:	November 2, 2009	/s/ Imelda Navarro Imelda Navarro Treasurer

33