CULLEN/FROST BANKERS, INC.
Form 10-Q
October 29, 2014
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United States
Securities and Exchange Commission
Washington, D.C. 20549
Form 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: September 30, 2014
Or

* Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from
to
Commission file number: 001-13221
Cullen/Frost Bankers, Inc.
(Exact name of registrant as specified in its charter)
Texas
(State or other jurisdiction of
incorporation or organization)

> 74-1751768
(I.R.S. Employer

Identification No.)
100 W. Houston Street, San Antonio, Texas
78205
(Address of principal executive offices)
(Zip code)
(210) 220-4011
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ý No *
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T
( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No *.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ý
Non-accelerated filer " (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the
Act). Yes " No ý
As of October 23, 2014 there were $63,058,493$ shares of the registrant's Common Stock, $\$ .01$ par value, outstanding.
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Quarterly Report on Form 10-Q
September 30, 2014
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Part I. Financial Information
Item 1. Financial Statements (Unaudited)
Cullen/Frost Bankers, Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share amounts)

Assets:

|  | September 30, <br> 2014 | December 31, <br> 2013 |
| :--- | :--- | :--- |
| Assets: |  |  |
| Cash and due from banks | $\$ 714,851$ | $\$ 885,121$ |
| Interest-bearing deposits | $4,577,004$ | $3,646,756$ |
| Federal funds sold and resell agreements | 8,598 | 24,248 |
| Total cash and cash equivalents | $5,300,453$ | $4,556,125$ |
| Securities held to maturity, at amortized cost | $2,942,012$ | $3,139,748$ |
| Securities available for sale, at estimated fair value | $6,911,652$ | $5,895,436$ |
| Trading account securities | 16,552 | 16,398 |
| Loans, net of unearned discounts | $10,746,784$ | $9,515,700$ |
| Less: Allowance for loan losses | $(98,312$ | $)(92,438$ |
| Net loans | $10,648,472$ | $9,423,262$ |
| Premises and equipment, net | 397,429 | 313,331 |
| Goodwill | 653,849 | 536,649 |
| Other intangible assets, net | 13,121 | 6,345 |
| Cash surrender value of life insurance policies | 171,142 | 141,108 |
| Accrued interest receivable and other assets | 315,951 | 284,537 |
| Total assets | $\$ 27,370,633$ | $\$ 24,312,939$ |

Liabilities:
Deposits:
Non-interest-bearing demand deposits $\quad \$ 10,162,415 \quad \$ 8,311,149$
$\begin{array}{lll}\text { Interest-bearing deposits } & 13,328,188 & 12,377,637\end{array}$
Total deposits
Federal funds purchased and repurchase agreements
23,490,603 20,688,786
Junior subordinated deferrable interest debentures
Other long-term borrowings
Accrued interest payable and other liabilities
Total liabilities
Shareholders' Equity:
Preferred stock, par value $\$ 0.01$ per share; $10,000,000$ shares authorized;
$6,000,000$ Series A shares ( $\$ 25$ liquidation preference) issued at September 30, 2014 144,486
144,486 and December 31, 2013
Common stock, par value $\$ 0.01$ per share; $210,000,000$ shares authorized; $63,632,464$
shares issued at September 30, 2014 and 61,632,464 shares issued at December 31, 637
617
2013
Additional paid-in capital
883,121 724,197
Retained earnings 1,672,527 1,575,282
Accumulated other comprehensive income, net of tax
155,276
140,434
Treasury stock, at cost; 574,346 shares at September 30, 2014 and 1,066,021 shares at
December 31, 2013
Total shareholders' equity
2,817,852 2,514,161

Total liabilities and shareholders' equity
See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Income
(Dollars in thousands, except per share amounts)

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 | 2013 | 2014 | 2013 |
| Interest income: |  |  |  |  |
| Loans, including fees | \$116,415 | \$104,349 | \$330,998 | \$309,721 |
| Securities: |  |  |  |  |
| Taxable | 22,855 | 23,007 | 66,372 | 75,869 |
| Tax-exempt | 39,635 | 31,402 | 113,168 | 88,046 |
| Interest-bearing deposits | 2,960 | 2,077 | 8,045 | 4,928 |
| Federal funds sold and resell agreements | 20 | 16 | 63 | 67 |
| Total interest income | 181,885 | 160,851 | 518,646 | 478,631 |
| Interest expense: |  |  |  |  |
| Deposits | 2,991 | 3,522 | 8,119 | 11,412 |
| Federal funds purchased and repurchase agreements | 35 | 30 | 96 | 89 |
| Junior subordinated deferrable interest debentures | 659 | 1,710 | 1,821 | 5,073 |
| Other long-term borrowings | 222 | 236 | 668 | 710 |
| Total interest expense | 3,907 | 5,498 | 10,704 | 17,284 |
| Net interest income | 177,978 | 155,353 | 507,942 | 461,347 |
| Provision for loan losses | 390 | 5,108 | 11,914 | 14,683 |
| Net interest income after provision for loan losses | 177,588 | 150,245 | 496,028 | 446,664 |
| Non-interest income: |  |  |  |  |
| Trust and investment management fees | 26,807 | 22,692 | 78,966 | 67,138 |
| Service charges on deposit accounts | 20,819 | 20,742 | 61,255 | 60,830 |
| Insurance commissions and fees | 11,348 | 10,371 | 34,297 | 32,707 |
| Interchange and debit card transaction fees | 4,719 | 4,376 | 13,589 | 12,655 |
| Other charges, commissions and fees | 9,804 | 9,266 | 26,561 | 25,599 |
| Net gain (loss) on securities transactions | 33 | (14 | ) 35 | (3 |
| Other | 7,332 | 6,558 | 22,799 | 25,354 |
| Total non-interest income | 80,862 | 73,991 | 237,502 | 224,280 |
| Non-interest expense: |  |  |  |  |
| Salaries and wages | 73,756 | 68,524 | 214,446 | 201,491 |
| Employee benefits | 14,639 | 14,989 | 46,833 | 47,609 |
| Net occupancy | 14,049 | 13,094 | 40,735 | 37,718 |
| Furniture and equipment | 16,078 | 14,629 | 46,238 | 43,800 |
| Deposit insurance | 3,421 | 2,921 | 9,683 | 8,645 |
| Intangible amortization | 1,029 | 780 | 2,524 | 2,388 |
| Other | 40,856 | 36,886 | 125,280 | 115,744 |
| Total non-interest expense | 163,828 | 151,823 | 485,739 | 457,395 |
| Income before income taxes | 94,622 | 72,413 | 247,791 | 213,549 |
| Income taxes | 17,007 | 11,969 | 42,518 | 38,254 |
| Net income | 77,615 | 60,444 | 205,273 | 175,295 |
| Preferred stock dividends | 2,016 | 2,015 | 6,047 | 4,703 |
| Net income available to common shareholders | \$75,599 | \$58,429 | \$199,226 | \$170,592 |
| Earnings per common share: |  |  |  |  |
| Basic | \$1.20 | \$0.96 | \$3.20 | \$2.82 |

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Diluted
1.19
0.96
3.18
2.81

See Notes to Consolidated Financial Statements.
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Cullen/Frost Bankers, Inc.
Consolidated Statements of Comprehensive Income
(Dollars in thousands)

|  | Three Months Ended |  | Nine Months Ended |  |
| :--- | :--- | :--- | :--- | :---: |
|  | September 30, | September 30, |  |  |
| Net income | 2014 | 2013 | 2014 |  |
| 2013 |  |  |  |  |
| 77,615 | $\$ 60,444$ | $\$ 205,273$ | $\$ 175,295$ |  |

Other comprehensive income (loss), before tax:
Securities available for sale and transferred securities:
$\left.\begin{array}{lllll}\text { Change in net unrealized gain/loss during the period } 9,464 & (551 & ) 76,007 & (95,920 \\ \begin{array}{l}\text { Change in net unrealized gain on securities } \\ \text { transferred to held to maturity }\end{array} & (8,746 & )(8,054 & )(27,119 & )(26,258\end{array}\right)$
cash flow hedge derivatives
Reclassification adjustments for (gains) losses
included in net income:
$\left.\begin{array}{lllllll}\text { Interest rate swaps on variable-rate loans } & (9,345 & )(9,345 & )(28,035 & )(28,035 & \\ \text { Interest rate swap on junior subordinated deferrable } & - & 1,120 & - & 3,308 \\ \text { interest debentures } & (9,345 & )(8,240 & )(28,035 & )(24,775 l l\end{array}\right)$

See Notes to Consolidated Financial Statements.
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Cullen/Frost Bankers, Inc.
Consolidated Statements of Changes in Shareholders' Equity
(Dollars in thousands, except per share amounts)


See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands)

|  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: |
| Operating Activities: |  |  |  |
| Net income | \$205,273 |  | \$175,295 |
| Adjustments to reconcile net income to net cash from operating activities: |  |  |  |
| Provision for loan losses | 11,914 |  | 14,683 |
| Deferred tax expense (benefit) | (7,324 | ) | 271 |
| Accretion of loan discounts | (10,561 | ) | (9,423 |
| Securities premium amortization (discount accretion), net | 43,965 |  | 30,054 |
| Net (gain) loss on securities transactions | (35 |  | 3 |
| Depreciation and amortization | 29,593 |  | 28,835 |
| Net (gain) loss on sale/write-down of assets/foreclosed assets | 863 |  | 2,958 |
| Stock-based compensation | 6,938 |  | 7,310 |
| Net tax benefit (deficiency) from stock-based compensation | 24 |  | (396 |
| Excess tax benefits from stock-based compensation | (2,262 | ) | (2,250 |
| Earnings on life insurance policies | (2,311 | ) | (2,399 |
| Net change in: |  |  |  |
| Trading account securities | 710 |  | 14,785 |
| Accrued interest receivable and other assets | (43,688 | ) | 11,556 |
| Accrued interest payable and other liabilities | (58,261 | ) | (170,982 |
| Net cash from operating activities | 174,838 |  | 100,300 |
| Investing Activities: |  |  |  |
| Securities held to maturity: |  |  |  |
| Purchases | - |  | (257,571 |
| Maturities, calls and principal repayments | 152,459 |  | 13,561 |
| Securities available for sale: |  |  |  |
| Purchases | (8,799,362 | ) | (9,128,340 |
| Sales | 3,651,982 |  | 8,497,061 |
| Maturities, calls and principal repayments | 4,396,491 |  | 1,192,979 |
| Net change in loans | (557,817 | ) | (102,195 |
| Net cash (paid) received in acquisitions | 830,656 |  | - |
| Proceeds from sales of premises and equipment | 35 |  | 16,312 |
| Purchases of premises and equipment | (80,557 | ) | (24,783 |
| Proceeds from sales of repossessed properties | 8,412 |  | 6,363 |
| Net cash from investing activities | (397,701 | ) | 213,387 |
| Financing Activities: |  |  |  |
| Net change in deposits | 1,177,774 |  | 481,528 |
| Net change in short-term borrowings | (137,477 | ) | 26,076 |
| Principal payments on long-term borrowings | - |  | (7 |
| Proceeds from stock option exercises | 25,573 |  | 65,026 |
| Excess tax benefits from stock-based compensation | 2,262 |  | 2,250 |
| Proceeds from issuance of preferred stock | - |  | 144,486 |
| Purchase of treasury stock | - |  | (144,000 |


| Cash dividends paid on preferred stock | $(6,047$ | $(4,703)$ |
| :--- | :--- | :--- |
| Cash dividends paid on common stock | $(94,894$ | $)(89,261)$ |
| Net cash from financing activities | 967,191 | 481,395 |
|  |  |  |
| Net change in cash and cash equivalents | 744,328 | 795,082 |
| Cash and equivalents at beginning of period | $4,556,125$ | $3,524,979$ |
| Cash and equivalents at end of period | $\$ 5,300,453$ | $\$ 4,320,061$ |

See Notes to Consolidated Financial Statements.

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Notes to Consolidated Financial Statements
(Table amounts in thousands, except for share and per share amounts)
Note 1 - Significant Accounting Policies
Nature of Operations. Cullen/Frost Bankers, Inc. (Cullen/Frost) is a financial holding company and a bank holding company headquartered in San Antonio, Texas that provides, through its subsidiaries, a broad array of products and services throughout numerous Texas markets. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, investment banking, insurance, brokerage, leasing, treasury management and item processing.
Basis of Presentation. The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of Cullen/Frost and all other entities in which Cullen/Frost has a controlling financial interest (collectively referred to as the "Corporation"). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies the Corporation follows conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry.
The consolidated financial statements in this Quarterly Report on Form 10-Q have not been audited by an independent registered public accounting firm, but in the opinion of management, reflect all adjustments necessary for a fair presentation of the Corporation's financial position and results of operations. All such adjustments were of a normal and recurring nature. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission ("SEC"). Accordingly, the financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements and should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2013, included in the Corporation's Annual Report on Form 10-K filed with the SEC on February 6, 2014 (the " 2013 Form 10-K"). Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year or any future period. Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Actual results could differ from those estimates. The allowance for loan losses, the fair value of stock-based compensation awards, the fair values of financial instruments and the status of contingencies are particularly subject to change. Cash Flow Reporting. Additional cash flow information was as follows:

|  | Nine Months Ended <br> September 30, |  |
| :--- | :--- | :--- |
| Cash paid for interest | 2014 | 2013 |
| Cash paid for income taxes | $\$ 10,519$ | $\$ 17,681$ |
| Significant non-cash transactions: | 45,186 | 42,944 |
| Securities purchased not yet settled | 61,974 | 36,301 |
| Loans foreclosed and transferred to other real estate owned and foreclosed assets | 1,993 | 3,251 |
| Premises and equipment transferred to other real estate owned and foreclosed assets | 1,799 | - |
| Loans to facilitate the sale of other real estate owned | 102 | 228 |
| Deferred gain on sale of building and parking garage | - | 922 |

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Note 2 - Mergers and Acquisitions
On May 30, 2014, the Corporation acquired WNB Bancshares, Inc. ("WNB"), including its subsidiary Western National Bank ("Western"), a privately-held bank holding company and bank located in the Permian Basin region of Texas. The Corporation purchased all of the outstanding shares of WNB for approximately $\$ 198.8$ million. The total purchase price included $\$ 149.7$ million of the Corporation's common stock ( 2 million shares) and $\$ 49.1$ million in cash. Western was integrated into Frost Bank as of the close of business on June 20, 2014.
The acquisition of WNB was accounted for using the acquisition method with all cash consideration funded through internal sources. The operating results of WNB are included with the Corporation's results of operations since the date of acquisition. The total purchase price paid for the acquisition of WNB was allocated based on the estimated fair values of the assets acquired and liabilities assumed as set forth below. The purchase price allocation is preliminary and is subject to final determination and valuation of the fair value of assets acquired and liabilities assumed.

Cash and cash equivalents
\$879,735
Securities available for sale 154,227

## Loans

670,637
$\begin{array}{ll}\text { Premises and equipment } & 22,912\end{array}$
Core deposit intangible asset
9,300
Goodwill
117,200
Other assets 33,621
Deposits
Other borrowings $\quad(63,592$
Other liabilities (63,592 )

The loans acquired in this transaction were recorded at fair value with no carryover of any existing allowance for loan losses. Loans that were not deemed to be credit impaired at acquisition were subsequently considered as a part of the Corporation's determination of the adequacy of the allowance for loan losses. Purchased credit-impaired loans, meaning those loans with evidence of credit quality deterioration at acquisition, were not significant. The core deposit intangible asset acquired in this transaction will be amortized using an accelerated method over a period of 10 years. Pro forma condensed consolidated results of operations assuming WNB had been acquired at the beginning of the reported periods are not presented because the effect of this acquisition was not considered significant based on the SEC significance tests.
Expenditures related to the acquisition of WNB totaled $\$ 1.1$ million and $\$ 7.1$ million during the three and nine months ended September 30, 2014, respectively, and are reported as a component of other non-interest expense in the accompanying consolidated income statements. During the third and fourth quarters of 2013, expenditures related to the acquisition of WNB totaled $\$ 1.4$ million.

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Note 3 - Securities
A summary of the amortized cost and estimated fair value of securities, excluding trading securities, is presented below.

|  | September 30, 2014 |  |  |  | December 31, 2013 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amortized <br> Cost | Gross <br> Unrealized Gains | Gross <br> Unrealize <br> Losses | Estimated <br> Fair Value | Amortized <br> Cost | Gross <br> Unrealize <br> Gains | Gross <br> Unrealized Losses | Estimated <br> Fair Value |
| Held to Maturity |  |  |  |  |  |  |  |  |
| U.S. Treasury | \$248,902 | \$15,844 | \$- | \$264,746 | \$248,592 | \$20,139 | \$- | \$268,731 |
| Residential mortgage-backed securities | 8,445 | 67 | 20 | 8,492 | 9,674 | 89 | 143 | 9,620 |
| States and political subdivisions | 2,683,315 | 28,822 | 15,940 | 2,696,197 | 2,880,482 | 7,691 | 137,861 | 2,750,312 |
| Other | 1,350 | - | - | 1,350 | 1,000 | - | - | 1,000 |
| Total | \$2,942,012 | \$44,733 | \$15,960 | \$2,970,785 | \$3,139,748 | \$27,919 | \$138,004 | \$3,029,663 |
| Available for Sale |  |  |  |  |  |  |  |  |
| U.S. Treasury | \$2,892,208 | \$16,937 | \$889 | \$2,908,256 | \$2,522,159 | \$18,395 | \$- | \$2,540,554 |
| U.S. Government agencies/corporations |  | - | - | - | 54,024 | - | 44 | 53,980 |
| Residential mortgage-backed securities | 1,415,433 | 68,839 | 661 | 1,483,611 | 1,710,664 | 66,791 | 1,439 | 1,776,016 |
| States and political subdivisions | 2,388,740 | 88,047 | - | 2,476,787 | 1,476,316 | 20,090 | 7,492 | 1,488,914 |
| Other | 42,998 | - | - | 42,998 | 35,972 | - | - | 35,972 |
| Total | \$6,739,379 | \$ 173,823 | \$1,550 | \$6,911,652 | \$5,799,135 | \$105,276 | \$8,975 | \$5,895,436 |

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At September 30, 2014, approximately $97.0 \%$ of the securities in the Corporation's municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately $62.3 \%$ are either guaranteed by the Texas Permanent School Fund, which has a "triple A" insurer financial strength rating, or secured by U.S. Treasury securities via defeasance of the debt by the issuers. Securities with limited marketability, such as stock in the Federal Reserve Bank and the Federal Home Loan Bank, are carried at cost and are reported as other available for sale securities in the above table. The carrying value of securities pledged to secure public funds, trust deposits, repurchase agreements and for other purposes, as required or permitted by law was $\$ 2.7$ billion at September 30, 2014 and $\$ 3.0$ billion and December 31, 2013.
During the fourth quarter of 2012, the Corporation reclassified certain securities from available for sale to held to maturity. The securities had an aggregate fair value of $\$ 2.3$ billion with an aggregate net unrealized gain of $\$ 165.7$ million ( $\$ 107.7$ million, net of tax) on the date of the transfer. The net unamortized, unrealized gain on the transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of September 30, 2014 totaled $\$ 102.2$ million ( $\$ 66.4$ million, net of tax). This amount will be amortized out of accumulated other comprehensive income over the remaining life of the underlying securities as an adjustment of the yield on those securities.
As of September 30, 2014, securities, with unrealized losses segregated by length of impairment, were as follows:

| Less than 12 Months | More than 12 Months |  | Total |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Estimated | Unrealized | Estimated <br> Fair Value | Unrealized <br> Losses | Fair Value <br> Lstimated <br> Losses | Unrealized <br> Fair Value |
| Losses |  |  |  |  |  |

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Residential mortgage-backed securities

| States and political subdivisions | 87,246 | 277 | 985,618 | 15,663 | $1,072,864$ | 15,940 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Total | $\$ 90,488$ | $\$ 297$ | $\$ 985,618$ | $\$ 15,663$ | $\$ 1,076,106$ | $\$ 15,960$ |
| Available for Sale | $\$ 247,480$ | $\$ 889$ | $\$-$ | $\$-$ | $\$ 247,480$ | $\$ 889$ |
| U.S. Treasury | $\$, 423$ | 54 | 17,105 | 607 | 24,528 | 661 |
| Residential mortgage-backed <br> securities | 7, |  | $\$ 17,105$ | $\$ 607$ | $\$ 272,008$ | $\$ 1,550$ |
| Total | $\$ 254,903$ | $\$ 943$ | $\$ 1$ |  |  |  |

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Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in cost.
Management has the ability and intent to hold the securities classified as held to maturity in the table above until they mature, at which time the Corporation will receive full value for the securities. Furthermore, as of September 30, 2014, management does not have the intent to sell any of the securities classified as available for sale in the table above and believes that it is more likely than not that the Corporation will not have to sell any such securities before a recovery of cost. Any unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of September 30, 2014, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation's consolidated income statement.
The amortized cost and estimated fair value of securities, excluding trading securities, at September 30, 2014 are presented below by contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Residential mortgage-backed securities and equity securities are shown separately since they are not due at a single maturity date.

| Held to Maturity |  | Available for Sale |  |
| :--- | :--- | :--- | :--- |
| Amortized | Estimated | Amortized | Estimated |
| Cost | Fair Value | Cost | Fair Value |
| $\$ 124,693$ | $\$ 127,767$ | $\$ 787,678$ | $\$ 791,624$ |
| 498,817 | 530,551 | $1,792,593$ | $1,806,723$ |
| 186,813 | 186,085 | $1,459,094$ | $1,488,506$ |
| $2,123,244$ | $2,117,890$ | $1,241,583$ | $1,298,190$ |
| 8,445 | 8,492 | $1,415,433$ | $1,483,611$ |
| - | - | 42,998 | 42,998 |
| $\$ 2,942,012$ | $\$ 2,970,785$ | $\$ 6,739,379$ | $\$ 6,911,652$ |

Due in one year or less
Due after one year through five years
Due after five years through ten years
Due after ten years
Residential mortgage-backed securities
Equity securities
Total
Sales of securities available for sale were as follows:


Purchase premiums and discounts on securities are amortized or accreted to interest income over the expected lives of the securities using the interest method with a constant effective yield. Expectations related to prepayments are considered in the calculation of the constant effective yield necessary to apply the interest method for mortgage-backed securities and certain pools of municipal securities. Premium amortization and discount accretion for mortgage-backed securities and pools of municipal securities is adjusted for changes in prepayment estimates, as applicable. Premium amortization and discount accretion included in interest income on securities was as follows:

|  | Three Months Ended |  | Nine Months Ended |  |
| :--- | :--- | :--- | :--- | :--- |
| September 30, | September 30, |  |  |  |
| Premium amortization | 2014 | 2013 | 2014 | 2013 |
| Prent | $(17,471$ | $)(13,526$ | $)(48,862$ | $(34,942$ |

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| Discount accretion | $\$ 1,865$ | $\$ 1,596$ | $\$ 4,897$ | $\$ 4,888$ |
| :--- | :--- | :--- | :--- | :--- |
| Net (premium amortization) discount accretion | $\$(15,606$ | $)$ | $\$(11,930$ | $)$ |$(43,965 \quad) \$(30,054 \quad)$

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Trading account securities, at estimated fair value, were as follows:
U.S. Treasury

States and political subdivisions
Total

| September 30, | December 31, |
| :--- | :--- |
| 2014 | 2013 |
| $\$ 15,689$ | $\$ 15,389$ |
| 863 | 1,009 |
| $\$ 16,552$ | $\$ 16,398$ |

Net gains and losses on trading account securities were as follows:

| Three Months Ended <br> September 30, |  | Nine Months Ended |  |
| :--- | :--- | :--- | :--- |
| 2014 | 2013 | September 30, |  |
| $\$ 167$ | $\$ 108$ | 2014 | 2013 |
| 13 | $(29$ | $\$ 660$ | $\$ 684$ |
| $\$ 180$ | $\$ 79$ | 10 | $(409$ |

Net gain on sales transactions
Net mark-to-market gains (losses)
Net gain (loss) on trading account securities
\$180 \$79
Note 4 - Loans
Loans were as follows:

Commercial and industrial:
Commercial
Leases
Total commercial and industrial
Commercial real estate:
Commercial mortgages
Construction
Land
Total commercial real estate
Consumer real estate:
Home equity loans
Home equity lines of credit
1-4 family residential mortgages
Construction
Other
Total consumer real estate
Total real estate
Consumer and other:
Consumer installment
Other
Total consumer and other
Unearned discounts
Total loans

| September 30, <br> 2014 | Percentage <br> of Total | December 31, <br> 2013 | Percentage <br> of Total |  |
| :--- | :--- | :--- | :--- | :--- |
| $\$ 5,188,609$ <br> 322,278 | 48.3 | $\%$ | $\$ 4,587,499$ | 48.2 |$\quad \%$

Loan Origination/Risk Management. The Corporation has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.
Commercial and industrial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and prudently expand its business. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and
solid business acumen, the Corporation's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the

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collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.
Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Corporation's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. As a general rule, the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk. The Corporation also utilizes third-party experts to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans. At September 30, 2014, approximately $55 \%$ of the outstanding principal balance of the Corporation's commercial real estate loans were secured by owner-occupied properties. With respect to loans to developers and builders that are secured by non-owner occupied properties that the Corporation may originate from time to time, the Corporation generally requires the borrower to have had an existing relationship with the Corporation and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Corporation until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.
The Corporation originates consumer loans utilizing a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum loan-to-value percentage of $80 \%$, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.
The Corporation maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Corporation's policies and procedures.
Concentrations of Credit. Most of the Corporation's lending activity occurs within the State of Texas, including the four largest metropolitan areas of Austin, Dallas/Ft. Worth, Houston and San Antonio, as well as other markets. The majority of the Corporation's loan portfolio consists of commercial and industrial and commercial real estate loans. As of September 30, 2014, there were no concentrations of loans related to any single industry in excess of $10 \%$ of total loans other than energy loans, which totaled $14.9 \%$ of total loans.
Foreign Loans. The Corporation has U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments were not significant
at September 30, 2014 or December 31, 2013.
Non-Accrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on non-accrual status when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provisions. In determining whether or not a borrower may be unable to meet payment obligations for each class of loans, the Corporation considers the borrower's debt service capacity through the analysis of current financial information, if available, and/or current information with regards to the Corporation's collateral position. Regulatory provisions would typically require the placement of a loan on

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non-accrual status if (i) principal or interest has been in default for a period of 90 days or more unless the loan is both well secured and in the process of collection or (ii) full payment of principal and interest is not expected. Loans may be placed on non-accrual status regardless of whether or not such loans are considered past due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income on non-accrual loans is recognized only to the extent that cash payments are received in excess of principal due. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.
Non-accrual loans, segregated by class of loans, were as follows:
September 30, December 31, 20142013
Commercial and industrial:
Energy
Other commercial
Commercial real estate:
Buildings, land and other
Construction
Consumer real estate
Consumer and other
Total
$\$ 638 \quad \$ 590$

As of September 30, 2014, non-accrual loans reported in the table above included $\$ 6.5$ million related to loans that were restructured as "troubled debt restructurings" during 2014. Had non-accrual loans performed in accordance with their original contract terms, the Corporation would have recognized additional interest income, net of tax, of approximately $\$ 414$ thousand and $\$ 1.1$ million for the three and nine months ended September 30, 2014, compared to $\$ 568$ thousand and $\$ 1.8$ million for the same periods in 2013.
An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of September 30, 2014 was as follows:

|  | Loans <br> 30-89 Days <br> Past Due | Loans <br> 90 or More <br> Days <br> Past Due | Total <br> Past Due <br> Loans | Current <br> Loans | Total <br> Loans | Accruing <br> Loans 90 or <br> More Days |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Past Due |  |  |  |  |  |  |

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectibility of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are
charged off when deemed uncollectible.
Regulatory guidelines require the Corporation to reevaluate the fair value of collateral supporting impaired collateral dependent loans on at least an annual basis. While the Corporation's policy is to comply with the regulatory guidelines, the Corporation's general practice is to reevaluate the fair value of collateral supporting impaired collateral dependent loans on a quarterly basis. Thus, appraisals are never considered to be outdated, and the Corporation does not need to make any adjustments to the appraised values. The fair value of collateral supporting impaired collateral dependent loans is evaluated by the Corporation's internal

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appraisal services using a methodology that is consistent with the Uniform Standards of Professional Appraisal Practice. The fair value of collateral supporting impaired collateral dependent construction loans is based on an "as is" valuation.
Impaired loans are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

| Unpaid | Recorded | Recorded | Total |  |
| :--- | :--- | :--- | :--- | :--- |
| Contractual | Investment | Investment | Recorded | Related |
| Principal | With No | With | Allowance |  |
| Balance | Allowance | Allowance | Investment |  |

September 30, 2014
Commercial and industrial:

| Energy | $\$ 706$ | $\$ 637$ | $\$-$ | $\$ 637$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Other commercial <br> Commercial real estate: | 42,058 | 27,967 | 3,082 | 31,049 | 1,413 |
| Buildings, land and other <br> Construction | 24,032 | 17,512 | 992 | 18,504 | 776 |
| Consumer real estate | 476 | 289 | - | 289 | - |
| Consumer and other | 825 | 624 | - | 624 | - |
| Total | - | - | - | - |  |
| December 31, 2013 <br> Commercial and industrial: <br> Energy | $\$ 68,097$ | $\$ 47,029$ | $\$ 4,074$ | $\$ 51,103$ | $\$ 2,189$ |
| Other commercial <br> Commercial real estate: | $\$ 545$ | $\$ 531$ | $\$-$ | $\$ 531$ | $\$-$ |
| Buildings, land and other <br> Construction | 31,429 | 15,337 | 7,004 | 22,341 | 4,140 |
| Consumer real estate | 27,792 | 15,697 | 8,870 | 24,567 | 2,786 |
| Consumer and other | - | - | - | - | - |
| Total | 907 | 745 | - | 745 | - |

The average recorded investment in impaired loans was as follows:
Three Months Ended
September 30,
Nine Months Ended September 30, 20142013
Commercial and industrial:

| Energy | $\$ 581$ | $\$ 269$ | $\$ 555$ | $\$ 402$ |
| :--- | :--- | :--- | :--- | :--- |
| Other commercial | 31,088 | 33,613 | 25,977 | 38,032 |
| Commercial real estate: |  |  |  |  |
| Buildings, land and other | 19,198 | 37,960 | 20,998 | 37,149 |
| Construction | 295 | 508 | 226 | 793 |
| Consumer real estate | 657 | 788 | 694 | 818 |
| Consumer and other | 126 | 338 | 199 | 365 |
| Total | $\$ 51,945$ | $\$ 73,476$ | $\$ 48,649$ | $\$ 77,559$ |

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Troubled Debt Restructurings. The restructuring of a loan is considered a "troubled debt restructuring" if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules, reductions in collateral and other actions intended to minimize potential losses.
Troubled debt restructurings during the nine months ended September 30, 2014 and September 30, 2013 are set forth in the following table.

| Commercial and industrial: |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
| Energy | $\$-$ | $\$-$ | $\$ 528$ | $\$ 537$ |
| Other commercial | 3,752 | 3,516 | 5,862 | 5,067 |
| Commercial real estate: |  |  |  |  |
| Buildings, land and other | 3,122 | 3,008 | 7,443 | 7,000 |
|  | $\$ 6,874$ | $\$ 6,524$ | $\$ 13,833$ | $\$ 12,604$ |

The modifications during the reported periods primarily related to extending amortization periods, converting the loans to interest only for a limited period of time, consolidating notes and/or reducing collateral or interest rates. The modifications did not significantly impact the Corporation's determination of the allowance for loan losses. Approximately $\$ 2.9$ million of commercial and industrial loans and $\$ 3.1$ million of the commercial real estate loans restructured during the nine months ended September 30, 2014 were related to a single loan relationship that was previously restructured during the third quarter of 2013. As of September 30, 2014, there were no loans restructured during the last year that were in excess of 90 days past due. During the nine months ended September 30, 2014, the Corporation charged-off $\$ 627$ thousand of commercial and industrial loans that were restructured during 2013. During the nine months ended September 30, 2014, the Corporation also foreclosed upon certain commercial real estate loans that were restructured during 2013. The Corporation recognized $\$ 500$ thousand of other real estate owned and no charge-offs in connection with these foreclosures. The aforementioned charge-offs, foreclosures and past due loans did not significantly impact the Corporation's determination of the allowance for loan losses.
Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Corporation's loan portfolio, management tracks certain credit quality indicators including trends related to (i) the weighted-average risk grade of commercial loans, (ii) the level of classified commercial loans, (iii) the delinquency status of consumer loans (see details above), (iv) net charge-offs, (v) non-performing loans (see details above) and (vi) the general economic conditions in the State of Texas.
The Corporation utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 14 . A description of the general characteristics of the 14 risk grades is as follows:
Grades 1, 2 and 3 - These grades include loans to very high credit quality borrowers of investment or near investment grade. These borrowers are generally publicly traded (grades 1 and 2), have significant capital strength, moderate leverage, stable earnings and growth, and readily available financing alternatives. Smaller entities, regardless of strength, would generally not fit in these grades.
Grades 4 and 5 - These grades include loans to borrowers of solid credit quality with moderate risk. Borrowers in these grades are differentiated from higher grades on the basis of size (capital and/or revenue), leverage, asset quality and the stability of the industry or market area.
Grades 6, 7 and 8-These grades include "pass grade" loans to borrowers of acceptable credit quality and risk. Such borrowers are differentiated from Grades 4 and 5 in terms of size, secondary sources of repayment or they are of desser stature in other key credit metrics in that they may be over-leveraged, under capitalized, inconsistent in performance or in an industry or an economic area that is known to have a higher level of risk, volatility, or susceptibility to weaknesses in the economy.

Grade 9 - This grade includes loans on management's "watch list" and is intended to be utilized on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near term.

Grade 10 - This grade is for "Other Assets Especially Mentioned" in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation.
Grade 11 - This grade includes "Substandard" loans, in accordance with regulatory guidelines, for which the accrual of interest has not been stopped. By definition under regulatory guidelines, a "Substandard" loan has defined weaknesses

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which make payment default or principal exposure likely, but not yet certain. Such loans are apt to be dependent upon collateral liquidation, a secondary source of repayment or an event outside of the normal course of business.
Grade 12 - This grade includes "Substandard" loans, in accordance with regulatory guidelines, for which the accrual of interest has been stopped. This grade includes loans where interest is more than 120 days past due and not fully secured and loans where a specific valuation allowance may be necessary, but generally does not exceed $30 \%$ of the principal balance.
Grade 13 - This grade includes "Doubtful" loans in accordance with regulatory guidelines. Such loans are placed on non-accrual status and may be dependent upon collateral having a value that is difficult to determine or upon some near-term event which lacks certainty. Additionally, these loans generally have a specific valuation allowance in excess of $30 \%$ of the principal balance.
Grade 14 - This grade includes "Loss" loans in accordance with regulatory guidelines. Such loans are to be charged-off or charged-down when payment is acknowledged to be uncertain or when the timing or value of payments cannot be determined. "Loss" is not intended to imply that the loan or some portion of it will never be paid, nor does it in any way imply that there has been a forgiveness of debt.

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In monitoring credit quality trends in the context of assessing the appropriate level of the allowance for loan losses, the Corporation monitors portfolio credit quality by the weighted-average risk grade of each class of commercial loan. Individual relationship managers review updated financial information for all pass grade loans to recalculate the risk grade on at least an annual basis. When a loan has a calculated risk grade of 9 , it is still considered a pass grade loan; however, it is considered to be on management's "watch list," where a significant risk-modifying action is anticipated in the near term. When a loan has a calculated risk grade of 10 or higher, a special assets officer monitors the loan on an on-going basis. The following table presents weighted average risk grades for all commercial loans by class.

| September 30, 2014 | December 31, 2013 |  |
| :--- | :--- | :--- |
| Weighted | Weighted |  |
| Average | Loans | Average |
| Risk Grade Loans |  |  |
| R |  | Risk Grade |

Commercial and industrial:
Energy
Risk grades 1-8 5.29
Risk grade 9
Risk grade 10
Risk grade 11
Risk grade 12
Risk grade 13
Total energy
Other commercial
Risk grades 1-8 5.94
Risk grade 9
Risk grade 10
Risk grade 11
Risk grade 12
Risk grade 13
Total other commercial

\$ 1,566,62
5.37
\$ 1,106,348
24,212
9.00

7,726
3,161 10.00
245
10.00

5,835 11.00
500
$\begin{array}{llll}12.00 & 637 & 12.00 & 590\end{array}$
13.00

- 13.00
\$ 1, 115,409
5.38
\$ 1,600,466
5.40
\$3,507,963
$\begin{array}{ll}\$ 3,697,503 & 5.95 \\ 58,045 & 9.00\end{array}$
74,766
65,561 10.00
89,878
10.00
11.00

55,403 11.00
92,917
12.00
$32,008 \quad 12.00$
21,389
13.00
$1,901 \quad 13.00$
4,754
6.18
\$3,910,421
6.27
\$3,791,667
Commercial real estate:
Buildings, land and other
Risk grades 1-8 6.5
Risk grade 9
Risk grade 10
Risk grade 11
Risk grade 12
Risk grade 13
Total commercial real estate
9.00

Construction
Risk grades 1-8 7.00
Risk grade 9
Risk grade 10
Risk grade 11
Risk grade 12
Risk grade 13
Total construction
9.00
10.00
11.00
12.00
13.00
7.05

| $\$ 3,164,357$ | 6.59 | $\$ 2,844,665$ |
| :--- | :--- | :--- |
| 80,878 | 9.00 | 65,770 |
| 70,312 | 10.00 | 49,881 |
| 41,549 | 11.00 | 53,208 |
| 19,614 | 12.00 | 24,387 |
| 776 | 13.00 | 2,786 |
| $\$ 3,377,486$ | 6.83 | $\$ 3,040,697$ |
|  |  |  |
| $\$ 631,616$ | 7.05 | $\$ 418,999$ |
| 2,494 | 9.00 | 1,301 |
| 5,855 | 10.00 | 5,931 |
| 2,738 | 11.00 | 408 |
| 289 | 12.00 | - |
| - | 13.00 | - |
| $\$ 642,992$ | 7.10 | $\$ 426,639$ |

The Corporation has established maximum loan to value standards to be applied during the origination process of commercial and consumer real estate loans. The Corporation does not subsequently monitor loan-to-value ratios (either individually or on a weighted-average basis) for loans that are subsequently considered to be of a pass grade (grades 9 or better) and/or current with respect to principal and interest payments. As stated above, when an individual
commercial real estate loan has a calculated risk grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired. At that time, the Corporation reassesses the loan to value position in the loan. If the loan is determined to be collateral dependent, specific allocations of the allowance for loan losses are made for the amount of any collateral deficiency. If a collateral deficiency is ultimately deemed to be uncollectible, the amount is charged-off. These loans and related assessments of collateral position are monitored on an individual, case-by-case basis. The Corporation does not monitor loan-to-value ratios on a weighted-average basis for commercial real estate loans having a calculated risk grade of 10 or higher. Nonetheless, there were five commercial real estate loans having

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a calculated risk grade of 10 or higher in excess of $\$ 5$ million as of September 30, 2014, which totaled $\$ 33.0$ million and had a weighted-average loan-to-value ratio of approximately $59.8 \%$. When an individual consumer real estate loan becomes past due by more than 10 days, the assigned relationship manager will begin collection efforts. The Corporation only reassesses the loan to value position in a consumer real estate loan if, during the course of the collections process, it is determined that the loan has become collateral dependent, and any collateral deficiency is recognized as a charge-off to the allowance for loan losses. Accordingly, the Corporation does not monitor loan-to-value ratios on a weighted-average basis for collateral dependent consumer real estate loans.
Generally, a commercial loan, or a portion thereof, is charged-off immediately when it is determined, through the analysis of any available current financial information with regards to the borrower, that the borrower is incapable of servicing unsecured debt, there is little or no prospect for near term improvement and no realistic strengthening action of significance is pending or, in the case of secured debt, when it is determined, through analysis of current information with regards to the Corporation's collateral position, that amounts due from the borrower are in excess of the calculated current fair value of the collateral. Notwithstanding the foregoing, generally, commercial loans that become past due 180 cumulative days are classified as a loss and charged-off. Generally, a consumer loan, or a portion thereof, is charged-off in accordance with regulatory guidelines which provide that such loans be charged-off when the Corporation becomes aware of the loss, such as from a triggering event that may include new information about a borrower's intent/ability to repay the loan, bankruptcy, fraud or death, among other things, but in no case should the charge-off exceed specified delinquency time frames. Such delinquency time frames state that closed-end retail loans (loans with pre-defined maturity dates, such as real estate mortgages, home equity loans and consumer installment loans) that become past due 120 cumulative days and open-end retail loans (loans that roll-over at the end of each term, such as home equity lines of credit) that become past due 180 cumulative days should be classified as a loss and charged-off.
Net (charge-offs)/recoveries, segregated by class of loans, were as follows:

Commercial and industrial:
Energy
Other commercial
Commercial real estate:
Buildings, land and other
Construction
Consumer real estate
Consumer and other
Total

Three Months Ended
September 30,
20142013
\$2 \$-
$738 \quad(4,296$

Nine Months Ended
September 30, 2014

2013
$\$ 449 \quad \$(900$
) $(2,539)(22,806$
$53 \quad 110 \quad(1,965) 81$
$31 \quad 16 \quad 346 \quad 246$
(609 ) (457 ) (613 ) (718 )
(579 ) (734 ) (1,718 ) (1,892 )
\$(364 ) \$(5,361 ) \$(6,040 ) \$(25,989 )

In assessing the general economic conditions in the State of Texas, management monitors and tracks the Texas Leading Index ("TLI"), which is produced by the Federal Reserve Bank of Dallas. The TLI is a single summary statistic that is designed to signal the likelihood of the Texas economy's transition from expansion to recession and vice versa. Management believes this index provides a reliable indication of the direction of overall credit quality. The TLI is a composite of the following eight leading indicators: (i) Texas Value of the Dollar, (ii) U.S. Leading Index, (iii) real oil prices (iv) well permits, (v) initial claims for unemployment insurance, (vi) Texas Stock Index, (vii) Help-Wanted Index and (viii) average weekly hours worked in manufacturing. The TLI totaled 132.4 at August 31, 2014 (most recent date available) and 129.1 at December 31, 2013. A higher TLI value implies more favorable economic conditions.
Allowance for Loan Losses. The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Corporation's allowance for loan loss methodology follows the accounting guidance set forth in U.S. generally accepted accounting principles and the Interagency Policy Statement
on the Allowance for Loan and Lease Losses, which was jointly issued by U.S. bank regulatory agencies. In that regard, the Corporation's allowance for loan losses includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In

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other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.
The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss and recovery experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate determination of the appropriate level of the allowance is dependent upon a variety of factors beyond the Corporation's control, including, among other things, the performance of the Corporation's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications. The Corporation monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time.
The Corporation's allowance for loan losses consists of three elements: (i) specific valuation allowances determined in accordance with ASC Topic 310 based on probable losses on specific loans; (ii) historical valuation allowances determined in accordance with ASC Topic 450 based on historical loan loss experience for similar loans with similar characteristics and trends, adjusted, as necessary, to reflect the impact of current conditions; and (iii) general valuation allowances determined in accordance with ASC Topic 450 based on general economic conditions and other risk factors both internal and external to the Corporation.
The allowances established for probable losses on specific loans are based on a regular analysis and evaluation of problem loans. Loans are classified based on an internal credit risk grading process that evaluates, among other things: (i) the obligor's ability to repay; (ii) the underlying collateral, if any; and (iii) the economic environment and industry in which the borrower operates. This analysis is performed at the relationship manager level for all commercial loans. When a loan has a calculated grade of 10 or higher, a special assets officer analyzes the loan to determine whether the loan is impaired and, if impaired, the need to specifically allocate a portion of the allowance for loan losses to the loan. Specific valuation allowances are determined by analyzing the borrower's ability to repay amounts owed, collateral deficiencies, the relative risk grade of the loan and economic conditions affecting the borrower's industry, among other things.
Historical valuation allowances are calculated based on the historical gross loss experience of specific types of loans and the internal risk grade of such loans at the time they were charged-off. The Corporation calculates historical gross loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical gross loss ratios are periodically (no less than annually) updated based on actual charge-off experience. A historical valuation allowance is established for each pool of similar loans based upon the product of the historical gross loss ratio and the total dollar amount of the loans in the pool. The Corporation's pools of similar loans include similarly risk-graded groups of commercial and industrial loans, commercial real estate loans, consumer real estate loans and consumer and other loans.
The components of the general valuation allowance include (i) the additional reserves allocated as a result of applying an environmental risk adjustment factor to the base historical loss allocation, (ii) the additional reserves allocated for loans to borrowers in distressed industries and (iii) the additional reserves allocated for groups of similar loans with risk characteristics that exceed certain concentration limits established by management.
The environmental adjustment factor is based upon a more qualitative analysis of risk and is calculated through a survey of senior officers who are involved in credit making decisions at a corporate-wide and/or regional level. On a quarterly basis, survey participants rate the degree of various risks utilizing a numeric scale that translates to varying grades of high, moderate or low levels of risk. The results are then input into a risk-weighting matrix to determine an appropriate environmental risk adjustment factor. The various risks that may be considered in the determination of the environmental adjustment factor include, among other things, (i) the experience, ability and effectiveness of the bank's lending management and staff; (ii) the effectiveness of the Corporation's loan policies, procedures and internal controls; (iii) changes in asset quality; (iv) the impact of legislative and governmental influences affecting industry
sectors; (v) the effectiveness of the internal loan review function; (vi) the impact of competition on loan structuring and pricing; and (vii) the impact of rising interest rates on portfolio risk. In periods where the surveyed risks are perceived to be higher, the risk-weighting matrix will generally result in a higher environmental adjustment factor, which, in turn will result in higher levels of general valuation allowance allocations. The opposite holds true in periods where the surveyed risks are perceived to be lower.
General valuation allowances also include amounts allocated for loans to borrowers in distressed industries. To determine the amount of the allocation for each loan portfolio segment, management calculates the weighted-average risk grade for all loans to borrowers in distressed industries by loan portfolio segment. A multiple is then applied to the amount by which the weighted-

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average risk grade for loans to borrowers in distressed industries exceeds the weighted-average risk grade for all pass-grade loans within the loan portfolio segment to derive an allocation factor for loans to borrowers in distressed industries. The amount of the allocation for each loan portfolio segment is the product of this allocation factor and the outstanding balance of pass-grade loans within the identified distressed industries that have a risk grade of 6 or higher. Management identifies potential distressed industries by analyzing industry trends related to delinquencies, classifications and charge-offs. At September 30, 2014 and December 31, 2013, certain segments of contractors were considered to be a distressed industry based on elevated levels of delinquencies, classifications and charge-offs relative to other industries within the Corporation's loan portfolio. Furthermore, the Corporation determined, through a review of borrower financial information that, as a whole, contractors have experienced, among other things, decreased revenues, reduced backlog of work, compressed margins and little, if any, net income.
General valuation allowances also include allocations for groups of loans with similar risk characteristics that exceed certain concentration limits established by management and/or the Corporation's board of directors. Concentration risk limits have been established, among other things, for certain industry concentrations, large balance and highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy, credit and/or collateral exceptions that exceed specified risk grades. Additionally, general valuation allowances are provided for loans that did not undergo a separate, independent concurrence review during the underwriting process (generally those loans under $\$ 1.0$ million at origination). The Corporation's allowance methodology for general valuation allowances also includes a reduction factor for recoveries of prior charge-offs to compensate for the fact that historical loss allocations are based upon gross charge-offs rather than net. The adjustment for recoveries is based on the lower of annualized, year-to-date gross recoveries or the total gross recoveries for the preceding four quarters, adjusted, when necessary, for expected future trends in recoveries. General valuation allowances are also allocated for general macroeconomic risk related to current economic trends and other quantitative and qualitative factors that could impact the Corporation's loan portfolio segments.
The following table presents details of the allowance for loan losses, segregated by loan portfolio segment.

|  | Commercial and Industrial | Commercial Real Estate | Consumer <br> Real Estate | Consumer and Other | Unallocated | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| September 30, 2014 |  |  |  |  |  |  |
| Historical valuation allowances | \$32,092 | \$14,638 | \$2,003 | \$ 10,425 | \$- | \$59,158 |
| Specific valuation allowances | 1,413 | 776 | - | - | - | 2,189 |
| General valuation allowances: |  |  |  |  |  |  |
| Environmental risk adjustment | 6,713 | 3,548 | 474 | 2,668 | - | 13,403 |
| Distressed industries | 3,784 | 2 | - | - | - | 3,786 |
| Excessive industry concentrations | 1,871 | 299 | - | - | - | 2,170 |
| Large relationship concentrations | 2,012 | 1,469 | - | - | - | 3,481 |
| Highly-leveraged credit relationships | 3,662 | 1,061 | - | - | - | 4,723 |
| Policy exceptions | 2,054 | 938 | - | - | - | 2,992 |
| Credit and collateral exceptions | 1,148 | 524 | - | - | - | 1,672 |
| Loans not reviewed by concurrence | 2,121 | 2,295 | 2,315 | 1,185 | - | 7,916 |
| Adjustment for recoveries | (4,517 ) | (1,640 | (264 | (7,372 | ) - | (13,793 |
| General macroeconomic risk | 6,283 | 2,870 | 579 | 883 | - | 10,615 |
| Total | \$58,636 | \$26,780 | \$5,107 | \$7,789 | \$- | \$98,312 |
| December 31, 2013 |  |  |  |  |  |  |
| Historical valuation allowances | \$29,357 | \$13,042 | \$2,644 | \$8,695 | \$- | \$53,738 |
| Specific valuation allowances | 4,140 | 2,786 | - | - | - | 6,926 |

General valuation allowances:

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| Environmental risk adjustment | 5,497 | 3,314 | 664 | 2,331 | - | 11,806 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Distressed industries | 7,812 | 384 | - | - | - | 8,196 |
| Excessive industry concentrations | 1,499 | 367 | - | - | - | 1,866 |
| Large relationship concentrations | 1,529 | 1,081 | - | - | - | 2,610 |
| Highly-leveraged credit relationships | 4,535 | 619 | - | - | - | 5,154 |
| Policy exceptions | - | - | - | - | 2,492 | 2,492 |
| Credit and collateral exceptions | - | - | - | - | 1,398 | 1,398 |
| Loans not reviewed by concurrence | 2,009 | 2,201 | 2,250 | 1,064 | - | 7,524 |
| Adjustment for recoveries | (3,588 | ) $(1,204$ | (328 | ) $(7,080$ | ) - | (12,200 |
| General macroeconomic risk | - | - | - | - | 2,928 | 2,928 |
| Total | \$52,790 | \$22,590 | \$5,230 | \$5,010 | \$6,818 | \$92,438 |

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The Corporation monitors whether or not the allowance for loan loss allocation model, as a whole, calculates an appropriate level of allowance for loan losses that moves in direct correlation to the general macroeconomic and loan portfolio conditions the Corporation experiences over time. In assessing the general macroeconomic trends/conditions, the Corporation analyzes trends in the components of the TLI, as well as any available information related to regional, national and international economic conditions and events and the impact such conditions and events may have on the Corporation and its customers. With regard to assessing loan portfolio conditions, the Corporation analyzes trends in weighted-average portfolio risk-grades, classified and non-performing loans and charge-off activity. In periods where general macroeconomic and loan portfolio conditions are in a deteriorating trend or remain at deteriorated levels, based on historical trends, the Corporation would expect to see the allowance for loan loss allocation model, as a whole, calculate higher levels of required allowances than in periods where general macroeconomic and loan portfolio conditions are in an improving trend or remain at an elevated level, based on historical trends.
The following table details activity in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2014 and 2013. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| Commercial | Commercial | Consumer | Consumer | Unallocated | Total |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | Real Estate | Real Estate | and Other |  |  |

Three months ended:
September 30, 2014
Beginning balance
Provision for loan losses
Charge-offs
Recoveries
Net charge-offs
Ending balance

| $\$ 55,672$ | $\$ 22,046$ | $\$ 4,659$ | $\$ 6,427$ | $\$ 9,482$ | $\$ 98,286$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 2,224 | 4,650 | 1,057 | 1,941 | $(9,482$ | $)$ | 390 |
| $(3,631$ | $)$ | $(393$ | $)(714$ | $)(2,523$ | $)$ | $(7,261$ |
| 4,371 | 477 | 105 | 1,944 | - | 6,897 |  |
| 740 | 84 | $(609$ | $)$ | $(579$ | $)$ | - |
| $\$ 58,636$ | $\$ 26,780$ | $\$ 5,107$ | $\$ 7,789$ | $\$-$ | $\$ 98,312$ |  |

September 30, 2013
Beginning balance
Provision for loan losses
Charge-offs
Recoveries
Net charge-offs
Ending balance

| $\$ 50,814$ | $\$ 23,573$ | $\$ 4,917$ | $\$ 4,130$ | $\$ 9,966$ | $\$ 93,400$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 8,060 | $(1,983$ | $)$ | 638 | 1,286 | $(2,893$ | $) 5,108$ |
| $(4,962$ | $)$ | $(56$ | $)(514$ | $)(2,610$ | $)-$ | $(8,142$ |
| 666 | 182 | 57 | 1,876 | - | 2,781 |  |
| $(4,296$ | $)$ | 126 | $(457$ | $)$ | $(734$ | $)$ |
| $\$ 54,578$ | $\$ 21,716$ | $\$ 5,098$ | $\$ 4,682$ | $\$ 7,073$ | $\$ 93,147$ |  |

Nine months ended:
September 30, 2014
Beginning balance
Provision for loan losses
Charge-offs
Recoveries
Net charge-offs
Ending balance

| $\$ 52,790$ | $\$ 22,590$ | $\$ 5,230$ | $\$ 5,010$ | $\$ 6,818$ | $\$ 92,438$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 7,936 | 5,809 | 490 | 4,497 | $(6,818$ | $) 11,914$ |  |
| $(9,026$ | $)$ | $(3,119$ | $)(840$ | $)(7,279$ | $)$ | $(20,264$ |
| 6,936 | 1,500 | 227 | 5,561 | - | 14,224 |  |
| $(2,090$ | $)$ | $(1,619$ | $)$ | $(613$ | $)$ | $(1,718$ |
| $\$ 58,636$ | $\$ 26,780$ | $\$ 5,107$ | $\$ 7,789$ | $\$-$ | $(6,040$ | $)$ |

September 30, 2013
Beginning balance
Provision for loan losses
Charge-offs
Recoveries
Net charge-offs

| $\$ 54,164$ | $\$ 29,346$ | $\$ 5,252$ | $\$ 3,507$ | $\$ 12,184$ | $\$ 104,453$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 24,120 | $(7,957$ | $)$ | 564 | 3,067 | $(5,111$ | $)$ |
| $(25,700$ | $)$ | $(737$ | $)$ | $(1,009$ | $)$ | $(7,161$ |
| 1,994 | 1,064 | 291 | 5,269 | - | $(34,607$ | $)$ |
| $(23,706$ | $)$ | 327 | $(718$ | $)$ | $(1,892$ | $)-$ |

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Ending balance
\$54,578
\$21,716
\$5,098
\$4,682
\$7,073
\$93,147

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The following table details the amount of the allowance for loan losses allocated to each portfolio segment as of September 30, 2014, December 31, 2013 and September 30, 2013, detailed on the basis of the impairment methodology used by the Corporation.

| Commercial | Commercial | Consumer | Consumer |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | Unallocated | Total |  |  |  |
| Industrial | Real Estate | Real Estate | and Other |  |  |

September 30, 2014

| Loans individually evaluated for $\$ 13,104$ impairment | \$1,867 | \$- | \$- | \$- | \$14,971 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Loans collectively evaluated for 45,532 impairment | 24,913 | 5,107 | 7,789 | - | 83,341 |
| Balance at September 30, 2014 \$58,636 December 31, 2013 | \$26,780 | \$5,107 | \$7,789 | \$- | \$98,312 |
| Loans individually evaluated for $\$ 16,682$ impairment | \$3,914 | \$- | \$- | \$- | \$20,596 |
| Loans collectively evaluated for impairment | 18,676 | 5,230 | 5,010 | 6,818 | 71,842 |
| Balance at December 31, 2013 \$52,790 | \$22,590 | \$5,230 | \$5,010 | \$6,818 | \$92,438 |
| September 30, 2013 |  |  |  |  |  |
| Loans individually evaluated for $\$ 15,912$ impairment | \$3,511 | \$- | \$- | \$- | \$ 19,423 |
| Loans collectively evaluated for 38,666 impairment | 18,205 | 5,098 | 4,682 | 7,073 | 73,724 |
| Balance at September 30, 2013 \$54,578 | \$21,716 | \$5,098 | \$4,682 | \$7,073 | \$93,147 |

The Corporation's recorded investment in loans as of September 30, 2014, December 31, 2013 and September 30, 2013 related to each balance in the allowance for loan losses by portfolio segment and detailed on the basis of the impairment methodology used by the Corporation was as follows:

| Commercial | Commercial | Consumer | Consumer | Unearned |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| and | Total |  |  |  |  |
| Industrial | Real Estate | Real Estate | and Other | Discounts |  |

September 30, 2014
Loans individually evaluated
for impairment
Loans collectively evaluated for

| Loans collectively evaluated for impairment | 5,346,381 | 3,879,345 | 846,444 | 391,498 | (23,147 |  | 10,440,521 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Ending balance | \$5,510,887 | \$4,020,478 | \$847,068 | \$391,498 | \$(23,147 |  | \$10,746,784 |
| December 31, 2013 |  |  |  |  |  |  |  |
| Loans individually evaluated for impairment | \$210,273 | \$136,601 | \$745 | \$278 | \$- |  | \$347,897 |
| Loans collectively evaluated for impairment | 4,696,803 | 3,330,735 | 807,459 | 357,838 | (25,032 |  | 9,167,803 |
| Ending balance | \$4,907,076 | \$3,467,336 | \$808,204 | \$358,116 | \$(25,032 | ) | \$9,515,700 |
| September 30, 2013 |  |  |  |  |  |  |  |
| Loans individually evaluated for impairment | \$173,513 | \$147,302 | \$773 | \$311 | \$- |  | \$321,899 |
| Loans collectively evaluated for impairment | 4,635,159 | 3,223,667 | 799,054 | 349,801 | (23,126 |  | 8,984,555 |
| Ending balance | \$4,808,672 | \$3,370,969 | \$799,827 | \$350,112 | \$(23,126 | ) | \$9,306,454 |

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Note 5 - Goodwill and Other Intangible Assets
Goodwill and other intangible assets are presented in the table below. During 2014, the Corporation preliminarily recorded goodwill totaling $\$ 117.2$ million and a core deposit intangible asset totaling $\$ 9.3$ million in connection with the acquisition of WNB. See Note 2 - Mergers and Acquisitions.

|  | $\begin{aligned} & \text { September 30, } \\ & 2014 \end{aligned}$ | $\begin{aligned} & \text { December 31, } \\ & 2013 \end{aligned}$ |
| :---: | :---: | :---: |
| Goodwill | \$653,849 | \$536,649 |
| Other intangible assets: |  |  |
| Core deposits | \$ 10,468 | \$3,005 |
| Customer relationships | 2,291 | 2,828 |
| Non-compete agreements | 362 | 512 |
|  | \$13,121 | \$6,345 |

The estimated aggregate future amortization expense for intangible assets remaining as of September 30, 2014 is as follows:
Remainder of 2014 \$997
2015 3,324
2016 2,412
2017 1,619
2018 1,346
Thereafter 3,423
Note 6 - Deposits
Deposits were as follows:
\(\left.$$
\begin{array}{lllll} & \begin{array}{l}\text { September 30, } \\
2014\end{array} & \begin{array}{l}\text { Percentage } \\
\text { of Total }\end{array} & \begin{array}{l}\text { December 31, } \\
2013\end{array} & \begin{array}{l}\text { Percentage } \\
\text { of Total }\end{array}
$$ <br>

Non-interest-bearing demand deposits: \& \$ 9,321,120 \& 39.7 \& \% \& \$ 7,445,656\end{array}\right] 36.0\)| $\%$ |
| :--- |
| Commercial and individual |
| Correspondent banks |
| Public funds |

The following table presents additional information about the Corporation's deposits:

Deposits from the Certificate of Deposit Account Registry Service (CDARS) \$31,150 \$200
Deposits from the Promontory Interfinancial Network Insured Cash Sweep Service (acquired in the acquisition of WNB)
Deposits from foreign sources (primarily Mexico)
737,435

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Note 7 - Commitments and Contingencies
Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, the Corporation enters into various transactions, which, in accordance with generally accepted accounting principles are not included in its consolidated balance sheets. The Corporation enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Corporation minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.
The Corporation enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment were funded, the Corporation would be entitled to seek recovery from the customer. The Corporation's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.
The Corporation considers the fees collected in connection with the issuance of standby letters of credit to be representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, the Corporation defers fees collected in connection with the issuance of standby letters of credit. The fees are then recognized in income proportionately over the life of the standby letter of credit agreement. The deferred standby letter of credit fees represent the fair value of the Corporation's potential obligations under the standby letter of credit guarantees.
Financial instruments with off-balance-sheet risk were as follows:

| Commitments to extend credit | $\$ 7,698,297$ | $\$ 6,919,942$ |
| :--- | :--- | :--- |
| Standby letters of credit | 228,265 | 186,857 |
| Deferred standby letter of credit fees | 1,532 | 1,450 |

Lease Commitments. The Corporation leases certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled $\$ 7.0$ million and $\$ 20.5$ million during the three and nine months ended September 30, 2014 and $\$ 6.4$ million and $\$ 18.4$ million during the three and nine months ended September 30, 2013. There has been no significant change in the future minimum lease payments payable by the Corporation since December 31, 2013. See the 2013 Form $10-\mathrm{K}$ for information regarding these commitments.
Litigation. The Corporation is subject to various claims and legal actions that have arisen in the course of conducting business. Management does not expect the ultimate disposition of these matters to have a material adverse impact on the Corporation's financial statements.
Note 8 - Capital and Regulatory Matters
Regulatory Capital Requirements. Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.
Quantitative measures established by regulations to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined). Cullen/Frost's and Frost Bank's Tier 1 capital consists of shareholders' equity excluding unrealized gains and losses on securities available for sale, the accumulated gain or loss on effective cash flow hedging derivatives, the net actuarial

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gain/loss on the Corporation's defined benefit post-retirement benefit plans, goodwill and other intangible assets. Tier 1 capital for Cullen/Frost also includes $\$ 144.5$ million of $5.375 \%$ non-cumulative perpetual preferred stock and $\$ 133$ million of trust preferred securities issued by its unconsolidated subsidiary trusts. Cullen/Frost's and Frost Bank's total capital is comprised of Tier 1 capital for each entity plus a permissible portion of the allowance for loan losses and outstanding subordinated debt. The Corporation's aggregate $\$ 100$ million of floating rate subordinated notes are not included in Tier 1 capital but the permissible portion (which decreases

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$20 \%$ per year during the final five years of the term of the notes) totaling $\$ 40$ million at September 30, 2014 and $\$ 60$ million at December 31, 2013, is included in total capital of Cullen/Frost.
The Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets, allocated by risk weight category, and certain off-balance-sheet items (primarily loan commitments). The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets.
Actual and required capital ratios for Cullen/Frost and Frost Bank were as follows:

| Minimum Required | Required to be <br> for Capital Adequacy <br> Purposes |
| :--- | :--- |
| Considered Well <br> Capital <br> Amount $\quad$ Ratio | Capitalized |
| Capital $\quad$ Ratio |  |

September 30, 2014
Total Capital to Risk-Weighted
Assets

| Cullen/Frost | $\$ 2,272,967$ | 14.81 | $\%$ | $\$ 1,228,072$ | 8.00 | $\%$ | $\$ 1,535,090$ | 10.00 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Frost Bank | $2,023,592$ | 13.21 | $1,225,704$ | 8.00 |  | $1,532,130$ | 10.00 |  |
| Tier 1 Capital to Risk-Weighted |  |  |  |  |  |  |  |  |
| Assets |  |  |  |  |  |  |  |  |
| Cullen/Frost | $2,134,655$ | 13.91 | 614,036 | 4.00 | 921,054 | 6.00 |  |  |
| Frost Bank | $1,932,526$ | 12.61 | 612,852 | 4.00 | 919,278 | 6.00 |  |  |
| Leverage Ratio |  |  |  |  |  |  |  |  |
| Cullen/Frost | $2,134,655$ | 8.27 | $1,031,906$ | 4.00 | $1,289,883$ | 5.00 |  |  |
| Frost Bank | $1,932,526$ | 7.50 | $1,030,358$ | 4.00 | $1,287,947$ | 5.00 |  |  |

December 31, 2013
Total Capital to Risk-Weighted
Assets

| Cullen/Frost | $\$ 2,110,774$ | 15.52 | $\%$ | $\$ 1,088,349$ | 8.00 | $\%$ | $\$ 1,360,437$ | 10.00 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Frost Bank | $1,780,313$ | 13.12 |  | $1,085,447$ | 8.00 |  | $1,356,809$ | 10.00 |

Tier 1 Capital to Risk-Weighted
Assets

| Cullen/Frost | $1,958,336$ | 14.39 | 544,175 | 4.00 | 816,262 | 6.00 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Frost Bank | $1,707,307$ | 12.58 | 542,724 | 4.00 | 814,085 | 6.00 |
| Leverage Ratio |  |  |  |  |  |  |
| Cullen/Frost | $1,958,336$ | 8.49 | 922,728 | 4.00 | $1,153,410$ | 5.00 |
| Frost Bank | $1,707,307$ | 7.42 | 920,107 | 4.00 | $1,150,134$ | 5.00 |

Management believes that, as of September 30, 2014, Cullen/Frost and its bank subsidiary, Frost Bank, were "well capitalized" based on the ratios presented above. In July 2013, Cullen/Frost's and Frost Bank's primary federal regulator, the Federal Reserve, published final rules establishing a new comprehensive capital framework for U.S. banking organizations which will become effective on January 1, 2015 (subject to a phase-in period) (the "Basel III Capital Rules"). Management believes that, as of September 30, 2014, Cullen/Frost and Frost Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect. See the section captioned "Supervision and Regulation" in Item 1. Business of the Corporation's 2013 Form 10-K for more information on the Basel III Capital Rules.
Cullen/Frost and Frost Bank are subject to the regulatory capital requirements administered by the Federal Reserve, and, for Frost Bank, the Federal Deposit Insurance Corporation ("FDIC"). Regulatory authorities can initiate certain mandatory actions if Cullen/Frost or Frost Bank fail to meet the minimum capital requirements, which could have a direct material effect on the Corporation's financial statements. Management believes, as of September 30, 2014, that

Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.
Trust Preferred Securities. In accordance with the applicable accounting standard related to variable interest entities, the accounts of the Corporation's wholly owned subsidiary trusts, Cullen/Frost Capital Trust II and WNB Capital Trust I, have not been included in the Corporation's consolidated financial statements. However, the $\$ 133.0$ million in trust preferred securities issued by these subsidiary trusts have been included in the Tier 1 capital of Cullen/Frost for regulatory capital purposes pursuant to guidance from the Federal Reserve. As more fully discussed in the Corporation's 2013 Form 10-K, new rules related to the implementation of the Basel III capital framework will require the phase-out of certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies beginning January 1, 2015.
Preferred Stock. On February 15, 2013, the Corporation issued and sold 6,000,000 shares, or $\$ 150.0$ million in aggregate liquidation preference, of its $5.375 \%$ Non-Cumulative Perpetual Preferred Stock, Series A, par value $\$ 0.01$ and liquidation

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preference $\$ 25$ per share ("Series A Preferred Stock"). Dividends on the Series A Preferred stock, if declared, accrue and are payable quarterly, in arrears, at a rate of $5.375 \%$. The Series A Preferred Stock qualifies as Tier 1 capital for the purposes of the regulatory capital calculations. The net proceeds from the issuance and sale of the Series A Preferred Stock, after deducting underwriting discount and commissions, and the payment of expenses, were approximately $\$ 144.5$ million. The net proceeds from the offering were used to fund the accelerated share repurchase further discussed below.
Stock Repurchase Plans. From time to time, the Corporation's board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. The accelerated share repurchase discussed below was part of a stock repurchase program that was authorized by the Corporation's board of directors in December 2012 to buy up to $\$ 150.0$ million of the Corporation's common stock.
Accelerated Share Repurchase. Concurrent with the issuance and sale of the Series A Preferred Stock, on February 12, 2013, the Corporation entered into an accelerated share repurchase agreement (the "ASR agreement") with Goldman, Sachs \& Co. ("Goldman Sachs"). Under the ASR agreement, the Corporation paid $\$ 144.0$ million to Goldman Sachs and received from Goldman Sachs 1,905,077 shares of the Corporation's common stock, representing approximately $80 \%$ of the estimated total number of shares to be repurchased. Goldman Sachs borrowed such shares delivered to the Corporation from stock lenders, and during the term of the ASR agreement, purchased shares in the open market to return to those stock lenders. Final settlement of the ASR agreement occurred on August 13, 2013 and the Corporation received an additional 331,671 shares. The total number of shares that the Corporation repurchased was based on the volume-weighted-average price per share of the Corporation's common stock during the repurchase period as adjusted pursuant to the terms and conditions of the ASR agreement.
Dividend Restrictions. In the ordinary course of business, Cullen/Frost is dependent upon dividends from Frost Bank to provide funds for the payment of dividends to shareholders and to provide for other cash requirements. Banking regulations may limit the amount of dividends that may be paid. Approval by regulatory authorities is required if the effect of dividends declared would cause the regulatory capital of Frost Bank to fall below specified minimum levels. Approval is also required if dividends declared exceed the net profits for that year combined with the retained net profits for the preceding two years. Under the foregoing dividend restrictions and while maintaining its "well capitalized" status, at September 30, 2014, Frost Bank could pay aggregate dividends of up to $\$ 321.8$ million to Cullen/Frost without prior regulatory approval.
Under the terms of the junior subordinated deferrable interest debentures that Cullen/Frost has issued to Cullen/Frost Capital Trust II and WNB Capital Trust I, Cullen/Frost has the right at any time during the term of the debentures to defer the payment of interest at any time or from time to time for an extension period not exceeding 20 consecutive quarterly periods with respect to each extension period. In the event that the Corporation has elected to defer interest on the debentures, the Corporation may not, with certain exceptions, declare or pay any dividends or distributions on its capital stock or purchase or acquire any of its capital stock.
Under the terms of the Series A Preferred Stock, in the event that the Corporation does not declare and pay dividends on the Series A Preferred Stock for the most recent dividend period, the Corporation may not, with certain exceptions, declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of its common stock or any securities of the Corporation that rank junior to the Series A Preferred Stock.
Note 9 - Derivative Financial Instruments
The fair value of derivative positions outstanding is included in accrued interest receivable and other assets and accrued interest payable and other liabilities in the accompanying consolidated balance sheets and in the net change in each of these financial statement line items in the accompanying consolidated statements of cash flows.
Interest Rate Derivatives. The Corporation utilizes interest rate swaps, caps and floors to mitigate exposure to interest rate risk and to facilitate the needs of its customers. The Corporation's objectives for utilizing these derivative instruments is described below:
The Corporation has entered into certain interest rate swap contracts that are matched to specific fixed-rate commercial loans or leases that the Corporation has entered into with its customers. These contracts have been

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designated as hedging instruments to hedge the risk of changes in the fair value of the underlying commercial loan/lease due to changes in interest rates. The related contracts are structured so that the notional amounts reduce over time to generally match the expected amortization of the underlying loan/lease.
During 2007, the Corporation entered into three interest rate swap contracts on variable-rate loans with a total notional amount of $\$ 1.2$ billion. The interest rate swap contracts were designated as hedging instruments in cash flow hedges with the objective of

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protecting the overall cash flows from the Corporation's monthly interest receipts on a rolling portfolio of $\$ 1.2$ billion of variable-rate loans outstanding throughout the 84-month period beginning in October 2007 and ending in October 2014 from the risk of variability of those cash flows such that the yield on the underlying loans would remain constant. As more fully discussed in the 2013 Form 10-K, the Corporation terminated portions of the hedges and settled portions of the interest rate swap contracts during November 2009 and terminated the remaining portions of the hedges and settled the remaining portions of the interest rate swap contracts during November 2010. The deferred accumulated gain applicable to the settled interest rate swap contracts included in accumulated other comprehensive income totaled $\$ 2.6$ million and $\$ 30.6$ million ( $\$ 1.7$ million and $\$ 19.9$ million on an after-tax basis) at September 30, 2014 and December 31, 2013. The remaining deferred gain of $\$ 2.6$ million ( $\$ 1.7$ million on an after-tax basis) at September 30, 2014 will be recognized in earnings in October 2014.
During 2008, the Corporation entered into an interest rate swap contract on junior subordinated deferrable interest debentures with a total notional amount of $\$ 120.0$ million. The interest rate swap contract was designated as a hedging instrument in a cash flow hedge with the objective of protecting the quarterly interest payments on the Corporation's $\$ 120.0$ million of junior subordinated deferrable interest debentures issued to Cullen/Frost Capital Trust II throughout a five-year period beginning in December 2008 and ending in December 2013 from the risk of variability of those payments resulting from changes in the three-month LIBOR interest rate. Under the swap, the Corporation paid a fixed interest rate of $5.47 \%$ and received a variable interest rate of three-month LIBOR plus a margin of $1.55 \%$ on a total notional amount of $\$ 120.0$ million, with quarterly settlements. The swap terminated in December 2013. The Corporation has entered into certain interest rate swap, cap and floor contracts that are not designated as hedging instruments. These derivative contracts relate to transactions in which the Corporation enters into an interest rate swap, cap and/or floor with a customer while at the same time entering into an offsetting interest rate swap, cap and/or floor with another financial institution. In connection with each swap transaction, the Corporation agrees to pay interest to the customer on a notional amount at a variable interest rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, the Corporation agrees to pay another financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. The transaction allows the Corporation's customer to effectively convert a variable rate loan to a fixed rate. Because the Corporation acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact the Corporation's results of operations.
The notional amounts and estimated fair values of interest rate derivative contracts are presented in the following table. The Corporation obtains dealer quotations to value its interest rate derivative contracts designated as hedges of cash flows, while the fair values of other interest rate derivative contracts are estimated utilizing internal valuation models with observable market data inputs.

Derivatives designated as hedges of fair value:
Financial institution counterparties:
Loan/lease interest rate swaps - assets
Loan/lease interest rate swaps - liabilities
Non-hedging interest rate derivatives:
Financial institution counterparties:
Loan/lease interest rate swaps - assets
Loan/lease interest rate swaps - liabilities
Loan/lease interest rate caps - assets
Customer counterparties:
Loan/lease interest rate swaps - assets
Loan/lease interest rate swaps - liabilities
Loan/lease interest rate caps - liabilities

September 30, 2014

| Notional | Estimated |
| :--- | :--- |
| Amount | Fair Value |


| $\$ 49,992$ | $\$ 870$ | $\$ 50,965$ | $\$ 1,386$ |
| :--- | :--- | :--- | :--- |
| 33,235 | $(3,307$ | $)$ | 43,631 |

$\left.\begin{array}{lllll}199,592 & 3,678 & & 195,234 & 9,573 \\ 625,931 & (33,669 & ) & 626,980 & (32,469 \\ 73,058 & 1,253 & 53,058 & 1,309 & \\ & & & & \\ 625,931 & 33,629 & 626,980 & 32,426 & \\ 199,592 & (3,678 & ) & 195,234 & (9,573 \\ 73,058 & (1,253 & ) & 53,058 & (1,309\end{array}\right)$

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The weighted-average rates paid and received for interest rate swaps outstanding at September 30, 2014 were as follows:

| Weighted-Average |  |  |  |
| :--- | :--- | :--- | :--- |
| Interest | Interest |  |  |
| Rate | Rate |  |  |
| Paid |  | Received |  |
|  |  |  |  |
| 2.55 | $\%$ | 0.15 | $\%$ |
| 4.06 | $\%$ | 1.69 | $\%$ |
| 1.69 | $\%$ | 4.06 | $\%$ |

Interest rate swaps:
Fair value hedge loan/lease interest rate swaps
Non-hedging interest rate swaps - financial institution counterparties
Non-hedging interest rate swaps - customer counterparties
1.69
\% 4.06
The weighted-average strike rate for outstanding interest rate caps was $2.99 \%$ at September 30, 2014.
Commodity Derivatives. The Corporation enters into commodity swaps and option contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a commodity swap or option contract with a customer, the Corporation simultaneously enters into an offsetting contract with a third party financial institution to mitigate the exposure to fluctuations in commodity prices.
The notional amounts and estimated fair values of non-hedging commodity swap and option derivative positions outstanding are presented in the following table. The Corporation obtains dealer quotations and uses internal valuation models with observable market data inputs to value its commodity derivative positions.

September 30, $2014 \quad$ December 31, 2013

Financial institution counterparties:
$\left.\begin{array}{lllllll}\text { Oil }- \text { assets } & \text { Barrels } & 664 & \$ 2,228 & 356 & \$ 1,004 \\ \text { Oil - liabilities } & \text { Barrels } & 402 & (339 & ) & 1,574 & (2,704 \\ \text { Natural gas - assets } & \text { MMBTUs } & 14,410 & 3,893 & 14,240 & 2,903 & ) \\ \text { Natural gas - liabilities } & \text { MMBTUs } & 16,740 & (2,236 & ) & 22,510 & (3,212\end{array}\right)$

Foreign Currency Derivatives. The Corporation enters into foreign currency forward contracts that are not designated as hedging instruments primarily to accommodate the business needs of its customers. Upon the origination of a foreign currency denominated transaction with a customer, the Corporation simultaneously enters into an offsetting contract with a third party to negate the exposure to fluctuations in foreign currency exchange rates. The Corporation also utilizes foreign currency forward contracts that are not designated as hedging instruments to mitigate the economic effect of fluctuations in foreign currency exchange rates on certain short-term, non-U.S. dollar denominated loans. The notional amounts and fair values of open foreign currency forward contracts were as follows:

|  |  | September 30, 2014 |  | December 31, 2013 |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Notional | Notional | Estimated | Notional | Estimated |
|  | Currency | Amount | Fair Value | Amount | Fair Value |
| Financial institution counterparties: |  |  |  |  |  |
| Forward contracts - assets | EUR | 967 | \$7 | 1,175 | \$5 |
| Forward contracts - assets | CAD | 27,571 | 816 | 18,886 | 85 |
| Forward contracts - assets | GBP | 501 | - | - | - |
| Forward contracts - liabilities | EUR | - | - | 494 | (4 |
| Forward contracts - liabilities | CAD | - | - | 14,078 | (23 |
| Customer counterparties: |  |  |  |  |  |
| Forward contracts - assets | CAD | - | - | 14,055 | 45 |

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Forward contracts - liabilities CAD 27,528 (773 ) 18,859 (58 ) Gains, Losses and Derivative Cash Flows. For fair value hedges, the changes in the fair value of both the derivative hedging instrument and the hedged item are included in other non-interest income or other non-interest expense. The extent that such changes in fair value do not offset represents hedge ineffectiveness. Net cash flows from interest rate swaps on commercial loans/

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leases designated as hedging instruments in effective hedges of fair value are included in interest income on loans. For cash flow hedges, the effective portion of the gain or loss due to changes in the fair value of the derivative hedging instrument is included in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is included in other non-interest income or other non-interest expense. Net cash flows from interest rate swaps on variable-rate loans designated as hedging instruments in effective hedges of cash flows and the reclassification from other comprehensive income of deferred gains associated with the termination of those hedges are included in interest income on loans. Net cash flows from the interest rate swap on junior subordinated deferrable interest debentures designated as a hedging instrument in an effective hedge of cash flows were included in interest expense on junior subordinated deferrable interest debentures during 2013. For non-hedging derivative instruments, gains and losses due to changes in fair value and all cash flows are included in other non-interest income and other non-interest expense.
Amounts included in the consolidated statements of income related to interest rate derivatives designated as hedges of fair value were as follows:

| Three Months Ended | Nine Months Ended |  |
| :--- | :--- | :--- |
| September 30, | September 30, |  |
| 2014 | 2013 | 2014 |

Commercial loan/lease interest rate swaps:
Amount of gain (loss) included in interest income on loans
Amount of (gain) loss included in other non-interest expense
Amounts included in the consolidated statements of income and in other comprehensive income for the period related to interest rate derivatives designated as hedges of cash flows were as follows:

Three Months Ended September 30, 20142013

Nine Months Ended
September 30, 2014

2013
Interest rate swaps/caps/floors on variable-rate loans:
Amount reclassified from accumulated other comprehensive income to interest income on loans \$9,345
\$9,345
\$28,035
\$28,035
Interest rate swaps on junior subordinated deferrable
interest debentures:
Amount reclassified from accumulated other comprehensive income to interest expense on junior subordinated deferrable interest debentures Amount of gain (loss) recognized in other comprehensive income

No ineffectiveness related to interest rate derivatives designated as hedges of cash flows was recognized in the consolidated statements of income during the reported periods. The accumulated net after-tax gain related to effective cash flow hedges included in accumulated other comprehensive income totaled $\$ 1.7$ million at September 30, 2014 and $\$ 19.9$ million at December 31, 2013. The Corporation expects that the entire net after-tax gain of $\$ 1.7$ million related to effective cash flow hedges included in accumulated other comprehensive income at September 30, 2014 will be recognized in earnings in October 2014.
As stated above, the Corporation enters into non-hedge related derivative positions primarily to accommodate the business needs of its customers. Upon the origination of a derivative contract with a customer, the Corporation simultaneously enters into an offsetting derivative contract with a third party. The Corporation recognizes immediate income based upon the difference in the bid/ask spread of the underlying transactions with its customers and the third party. Because the Corporation acts only as an intermediary for its customer, subsequent changes in the fair value of
the underlying derivative contracts for the most part offset each other and do not significantly impact the Corporation's results of operations.

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Amounts included in the consolidated statements of income related to non-hedging interest rate, commodity and foreign currency derivative instruments are presented in the table below. Three Months Ended
September 30,
20142013
Nine Months Ended
September 30, 2014 2013
Non-hedging interest rate derivatives:
Other non-interest income
$\$ 414 \quad \$ 54$
(5
) (28
\$1,279
\$239
Other non-interest expense

7
75
100
331
Other non-interest income
Non-hedging foreign currency derivatives:
Other non-interest income
43
30
118
103
Counterparty Credit Risk. Derivative contracts involve the risk of dealing with both bank customers and institutional derivative counterparties and their ability to meet contractual terms. Institutional counterparties must have an investment grade credit rating and be approved by the Corporation's Asset/Liability Management Committee. The Corporation's credit exposure on interest rate swaps is limited to the net favorable value and interest payments of all swaps by each counterparty, while the Corporation's credit exposure on commodity swaps/options and foreign currency forward contracts is limited to the net favorable value of all contracts by each counterparty. Credit exposure may be reduced by the amount of collateral pledged by the counterparty. There are no credit-risk-related contingent features associated with any of the Corporation's derivative contracts. Certain derivative contracts with upstream financial institution counterparties may be terminated with respect to a party in the transaction, if such party does not have at least a minimum level rating assigned to either its senior unsecured long-term debt or its deposit obligations by certain third-party rating agencies.
The Corporation's credit exposure relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with bank customers was approximately $\$ 33.7$ million at September 30, 2014. This credit exposure is partly mitigated as transactions with customers are generally secured by the collateral, if any, securing the underlying transaction being hedged. The Corporation's credit exposure, net of collateral pledged, relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with upstream financial institution counterparties was approximately $\$ 6.1$ million at September 30, 2014. This amount was mostly related to excess collateral posted by the Corporation to counterparties. Collateral levels for upstream financial institution counterparties are monitored and adjusted as necessary. See Note 10 - Balance Sheet Offsetting for additional information regarding the Corporation's credit exposure with upstream financial institution counterparties. The aggregate fair value of securities posted as collateral by the Corporation related to derivative contracts totaled $\$ 32.4$ million at September 30, 2014.

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Note 10 - Balance Sheet Offsetting
Certain financial instruments, including resell and repurchase agreements, securities lending arrangements and derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements or similar agreements. The Corporation's derivative transactions with upstream financial institution counterparties are generally executed under International Swaps and Derivative Association ("ISDA") master agreements which include "right of set-off" provisions. In such cases there is generally a legally enforceable right to offset recognized amounts and there may be an intention to settle such amounts on a net basis. Nonetheless, the Corporation does not generally offset such financial instruments for financial reporting purposes.
Information about financial instruments that are eligible for offset in the consolidated balance sheet as of September 30, 2014 is presented in the following tables.

September 30, 2014
Financial assets:
Derivatives:
Loan/lease interest rate swaps and caps
Commodity swaps and options
Foreign currency forward contracts
Total derivatives
Resell agreements
Total
Financial liabilities:
Derivatives:

| Loan/lease interest rate swaps | $\$ 36,976$ | $\$-$ | $\$ 36,976$ |
| :--- | :--- | :--- | :--- |
| Commodity swaps and options | 2,575 | - | 2,575 |
| Foreign currency forward contracts | - | - | - |
| Total derivatives | 39,551 | - | 39,551 |
| Repurchase agreements | 576,040 | - | 576,040 |
| Total |  | $\$ 615,591$ | $\$-$ |
|  |  | Gross Amounts Not Offset | $\$ 615,591$ |
|  |  | Net Amount | Financial |
|  | Recognized | Instruments | Collateral |

September 30, 2014
Financial assets:
Derivatives:
Counterparty A
Counterparty B
Counterparty C

| $\$ 1,493$ | $\$(1,493$ | $)$ | $\$-$ |
| :--- | :--- | :--- | :--- |
| 5,140 | $(5,140$ | $)-$ | $\$-$ |
| 2,157 | $(2,157$ | $)-$ | - |
| 3,955 | $(3,474$ | $)(212$ | $)-$ |
| 12,745 | $(12,264$ | $)(212$ | $) 269$ |
| 4,898 | - | $(4,898$ | $)-$ |
| $\$ 17,643$ | $\$(12,264$ | $) \$(5,110$ | $) \$ 269$ |

Financial liabilities:
Derivatives:
Counterparty A $\quad \$ 17,875 \quad \$(1,493) \$(15,943) \$ 439$
Counterparty B
Counterparty C
Other counterparties
Total derivatives
7,146
7,440
7,090
39,551
$(5,140)(2,006)$ -
$(2,157)(5,283)-$
$(3,474)(3,302) 314$
$(12,264)(26,534) 753$

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| Repurchase agreements | 576,040 | - | $(576,040$ | $)$ |
| :--- | :--- | :--- | :--- | :--- |
| Total | $\$ 615,591$ | $\$(12,264$ | $\$(602,574$ | ) $\$ 753$ |

Repurchase agreements
Total
$\$ 615,591 \quad \$(12,264) \$(602,574) \$ 753$

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Information about financial instruments that are eligible for offset in the consolidated balance sheet as of December 31, 2013 is presented in the following tables.

December 31, 2013
Financial assets:
Derivatives:
Loan/lease interest rate swaps and caps
Commodity swaps and options
Foreign currency forward contracts
Total derivatives
Resell agreements
Total

| Gross Amount | Gross Amount | Net Amount |
| :--- | :--- | :--- |
| Recognized | Offset | Recognized |

Financial liabilities:
Derivatives:
Loan/lease interest rate swaps
Commodity swaps and options
Foreign currency forward contracts
Total derivatives
Repurchase agreements
Total

December 31, 2013
Financial assets:
Derivatives:
Counterparty A
Counterparty B
Counterparty C
Other counterparties
Total derivatives
Resell agreements
Total
Financial liabilities:
Derivatives:
Counterparty A
Counterparty B
Counterparty C
Other counterparties
Total derivatives
Repurchase agreements
Total

| \$3,342 | \$ 3,342 | ) | \$- |  | \$- |
| :---: | :---: | :---: | :---: | :---: | :---: |
| 8,196 | (8,196 | ) | - |  | - |
| 1,187 | (1,187 | ) | - |  | - |
| 3,540 | (2,099 | ) | (1,360 | ) | 81 |
| 16,265 | (14,824 | ) | (1,360 | ) | 81 |
| 7,898 | - |  | (7,898 |  | - |
| \$24,163 | \$(14,824 | ) | \$(9,258 | ) | \$81 |
| \$18,615 | \$ 3,342 | ) | \$(15,167 | ) | \$106 |
| 9,054 | (8,196 | ) | (613 | ) | 245 |
| 10,870 | (1,187 | ) | (9,683 |  | - |
| 4,064 | (2,099 | ) | (1,549 |  | 416 |
| 42,603 | (14,824 | ) | (27,012 | ) | 767 |
| 668,053 | - |  | (668,053 | ) | - |
| \$710,656 | \$(14,824 | ) | \$(695,065 | ) | \$767 |

Note 11 - Earnings Per Common Share
Earnings per common share is computed using the two-class method. Basic earnings per common share is computed by dividing net earnings allocated to common stock by the weighted-average number of common shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include non-vested stock awards/stock units and deferred stock units, though no actual shares of common stock related to non-vested stock units and deferred stock units have been issued. Non-vested stock awards/stock units and deferred stock units
are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as holders of the Corporation's common stock. Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the dilutive effect of stock compensation using the treasury stock method.

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The following table presents a reconciliation of net income available to common shareholders, net earnings allocated to common stock and the number of shares used in the calculation of basic and diluted earnings per common share.

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 | 2013 | 2014 | 2013 |
| Net income | \$77,615 | \$60,444 | \$ 205,273 | \$175,295 |
| Less: Preferred stock dividends | 2,016 | 2,015 | 6,047 | 4,703 |
| Net income available to common shareholders | 75,599 | 58,429 | 199,226 | 170,592 |
| Less: Earnings allocated to participating securities | 286 | 214 | 758 | 621 |
| Net earnings allocated to common stock | \$75,313 | \$58,215 | \$198,468 | \$169,971 |
| Distributed earnings allocated to common stock | \$32,113 | \$30,202 | \$94,534 | \$88,935 |
| Undistributed earnings allocated to common stock | 43,200 | 28,013 | 103,934 | 81,036 |
| Net earnings allocated to common stock | \$75,313 | \$58,215 | \$ 198,468 | \$169,971 |
| Weighted-average shares outstanding for basic earnings per common share | 62,939,149 | 60,339,509 | 61,738,831 | 60,313,274 |
| Dilutive effect of stock compensation | 933,479 | 866,616 | 913,774 | 724,039 |
| Weighted-average shares outstanding for diluted earnings per common share | 63,872,628 | 61,206,125 | 62,652,605 | 61,037,313 |

Note 12 - Stock-Based Compensation
A combined summary of activity in the Corporation's active stock-based compensation plans is presented in the following table.

|  |  |  | Non-Vested Stock <br> Awards/Stock Units <br> Outstanding | Stock Options <br> Outstanding |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  | Shares <br> Available <br> for Grant | Director <br> Deferred | Stock Units <br> Outstanding |  | Number <br> of Shares | Weighted- <br> Average <br> Grant-Date | | Number |
| :--- |
| of Shares |$\quad$| Weighted- |
| :--- |
| Average |
| Exercise |

Shares issued in connection with stock compensation awards are issued from available treasury shares. If no treasury shares are available, new shares are issued from available authorized shares. Shares issued in connection with stock compensation awards along with other related information were as follows:

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2014 | 2013 | 2014 | 2013 |
| New shares issued from available authorized shares | - | - | - | 153,275 |
| Issued from available treasury stock | 106,900 | 587,650 | 491,675 | 1,096,599 |
| Total | 106,900 | 587,650 | 491,675 | 1,249,874 |
| Proceeds from stock option exercises | \$5,464 | \$30,837 | \$25,573 | \$65,026 |

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Stock-based compensation expense is recognized ratably over the requisite service period for all awards. Stock-based compensation expense was as follows:

|  | Three Months Ended |  | Nine Months Ended |  |
| :--- | :--- | :--- | :--- | :--- |
| September 30, |  | September 30, |  |  |
|  | 2014 | 2013 | 2014 | 2013 |
| Stock options | $\$ 1,877$ | $\$ 1,981$ | $\$ 5,401$ | $\$ 5,947$ |
| Non-vested stock awards/stock units | 365 | 344 | 1,097 | 1,033 |
| Deferred stock units | - | - | 440 | 330 |
| Total | $\$ 2,242$ | $\$ 2,325$ | $\$ 6,938$ | $\$ 7,310$ |

Unrecognized stock-based compensation expense at September 30, 2014 was as follows:
Stock options
\$11,997
Non-vested stock awards/stock units 1,731
Total
\$13,728
Note 13 - Defined Benefit Plans
The components of the combined net periodic expense (benefit) for the Corporation's defined benefit pension plans were as follows:

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2014 |  | 2013 |  | 2014 |  | 2013 |
| Expected return on plan assets, net of expenses | \$(3,129 | ) | \$(2,772 | ) | \$(9,386 | ) | \$(8,316 |
| Interest cost on projected benefit obligation | 2,001 |  | 1,835 |  | 6,002 |  | 5,506 |
| Net amortization and deferral | 672 |  | 1,640 |  | 2,015 |  | 4,919 |
| Net periodic expense (benefit) | \$(456 | ) | \$703 |  | \$(1,369 |  | \$2,109 |

The Corporation's non-qualified defined benefit pension plan is not funded. No contributions to the qualified defined benefit pension plan were made during the nine months ended September 30, 2014. The Corporation does not expect to make any contributions to the qualified defined benefit plan during the remainder of 2014.
Note 14 - Income Taxes
Income tax expense was as follows:


Net deferred tax liabilities totaled $\$ 60.7$ million at September 30, 2014 and $\$ 62.8$ million at December 31, 2013. No valuation allowance was recorded against deferred tax assets at September 30, 2014 as management believes it is more likely than not that all of the deferred tax assets will be realized because they were supported by recoverable taxes paid in prior years. There were no unrecognized tax benefits during any of the reported periods. Interest and/or penalties related to income taxes are reported as a component of income tax expense. Such amounts were not significant during the reported periods.
The Corporation files income tax returns in the U.S. federal jurisdiction. The Company is no longer subject to U.S. federal income tax examinations by tax authorities for years before 2011.

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Note 15 - Other Comprehensive Income (Loss)
The before and after tax amounts allocated to each component of other comprehensive income (loss) are presented in the following table. Reclassification adjustments related to securities available for sale are included in net gain (loss) on securities transactions in the accompanying consolidated statements of income. The change in the net actuarial gain/loss on defined-benefit post-retirement benefit plans is included in the computation of net periodic pension expense (see Note 13 - Defined Benefit Plans). Reclassification adjustments related to interest rate swaps on variable-rate loans are included in interest income and fees on loans in the accompanying consolidated statements of income. Reclassification adjustments related to the interest rate swap on junior subordinated deferrable interest debentures were included in interest expense on junior subordinated deferrable interest debentures in the accompanying consolidated statements of income.

Three Months Ended
September 30, 2014

| Before Tax | Tax | Net of |
| :--- | :--- | :--- |
| Amount | Expense, <br> (Benefit) | Tax |
|  | Amount |  |

Three Months Ended
September 30, 2013
$\begin{array}{lll}\text { Before Tax } & \text { Tax } & \text { Net of } \\ \text { Amount } & \begin{array}{l}\text { Expense, } \\ \text { (Benefit) }\end{array} & \text { Amount }\end{array}$
Securities available for sale and transferred securities:
Change in net unrealized gain/loss during the period
Change in net unrealized gain on securities transferred to held to maturity
Reclassification adjustment for net (gains) losses included in net income
Total securities available for sale and transferred securities
Defined-benefit post-retirement benefit plans:
$\left.\begin{array}{lllllllll}\begin{array}{l}\text { Change in the net actuarial gain/loss } \\ \text { Derivatives: } \\ \text { Change in the accumulated gain/loss on } \\ \text { effective cash flow hedge derivatives }\end{array} & 672 & 235 & 437 & 1,640 & 574 & 1,066 \\ \begin{array}{l}\text { Reclassification adjustments for (gains) losses } \\ \text { included in net income: }\end{array} & & - & - & - & (15 & ) & (5) & (10\end{array}\right)$

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Securities available for sale and transferred securities:
Change in net unrealized gain/loss during the period

| Nine Months Ended |  | Nine Months Ended |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| September 30, 2014 |  | September 30, 2013 |  |  |  |
| Before Tax | Tax | Net of | Before Tax | Tax | Net of |
| Amount | Expense, | Tax | Ampense, | Tax |  |
|  | (Benefit) | Amount |  | (Benefit) | Amount |

Change in net unrealized gain on securities transferred to held to maturity
Reclassification adjustment for net (gains) losses included in net income
Total securities available for sale and transferred securities
Defined-benefit post-retirement benefit plans:
$\begin{array}{lllllll}\text { Change in the net actuarial gain/loss } & 2,015 & 705 & 1,310 & 4,919 & 1,722 & 3,197\end{array}$
Derivatives:
Change in the accumulated gain/loss on effective cash flow hedge derivatives
$\left.\begin{array}{llllll}\$ 76,007 & \$ 26,602 & \$ 49,405 & \$(95,920) & \$(33,572) \$(62,348) \\ (27,119\end{array}\right)(9,492)(17,627)(26,258)(9,190)(17,068)$

Reclassification adjustments for (gains) losses included in net income:
Interest rate swaps on variable-rate loans
Interest rate swap on junior subordinated $\begin{array}{llllllll}\text { deferrable interest debentures } & - & - & - & 3,308 & 1,158 & 2,150\end{array}$
Total derivatives (28,035 ) (9,812 ) (18,223 ) (24,775 ) (8,671 ) (16,104 )
Total other comprehensive income (loss) $\quad \$ 22,833 \quad \$ 7,991 \quad \$ 14,842 \quad \$(142,031) \$(49,710) \$(92,321)$
Activity in accumulated other comprehensive income (loss), net of tax, was as follows:

Balance January 1, 2014
Other comprehensive income (loss) before reclassifications
Amounts reclassified from accumulated other comprehensive income (loss)
Net other comprehensive income (loss) during period
Balance September 30, 2014
Balance January 1, 2013
Other comprehensive income (loss) before
reclassifications
Amounts reclassified from accumulated other comprehensive income (loss)
Net other comprehensive income (loss) during period
Balance September 30, 2013

| Securities <br> Available <br> For Sale |  | Defined <br> Benefit <br> Plans |  | Derivatives |  | Accumulated <br> Other <br> Comprehensive <br> Income |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| \$146,672 |  | \$(26,131 | ) | \$19,893 |  | \$140,434 |
| 31,778 |  | 1,310 |  | - |  | 33,088 |
| (23 | ) | - |  | (18,223 | ) | (18,246 ) |
| 31,755 |  | 1,310 |  | (18,223 | ) | 14,842 |
| \$178,427 |  | \$(24,821 | ) | \$1,670 |  | \$155,276 |
| \$245,539 |  | \$(49,071 | ) | \$41,580 |  | \$238,048 |
| (79,416 | ) | 3,197 |  | (31 | ) | (76,250 ) |
| 2 |  | - |  | (16,073 | ) | (16,071 ) |
| (79,414 | ) | 3,197 |  | (16,104 | ) | (92,321 ) |
| \$ 166,125 |  | \$(45,874 | ) | \$25,476 |  | \$145,727 |

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Note 16 - Operating Segments
The Corporation is managed under a matrix organizational structure whereby its two primary operating segments, Banking and Frost Wealth Advisors, overlap a regional reporting structure. The regions are primarily based upon geographic location and include Austin, Corpus Christi, Dallas, Fort Worth, Houston, Permian Basin, Rio Grande Valley, San Antonio and Statewide. The Corporation is primarily managed based on the line of business structure. In that regard, all regions have the same lines of business, which have the same product and service offerings, have similar types and classes of customers and utilize similar service delivery methods. Pricing guidelines for products and services are the same across all regions. The regional reporting structure is primarily a means to scale the lines of business to provide a local, community focus for customer relations and business development.
Banking and Frost Wealth Advisors are delineated by the products and services that each segment offers. The Banking operating segment includes both commercial and consumer banking services, Frost Securities, Inc. and Frost Insurance Agency. Commercial banking services are provided to corporations and other business clients and include a wide array of lending and cash management products. Consumer banking services include direct lending and depository services. Frost Insurance Agency provides insurance brokerage services to individuals and businesses covering corporate and personal property and casualty products, as well as group health and life insurance products and human resources consulting services. Frost Securities, Inc. provides advisory and private equity services to middle market companies. The Frost Wealth Advisors operating segment includes fee-based services within private trust, retirement services, and financial management services, including personal wealth management and brokerage services. A third operating segment, Non-Banks, is for the most part the parent holding company, as well as certain other insignificant non-bank subsidiaries of the parent that, for the most part, have little or no activity. The parent company's principal activities include the direct and indirect ownership of the Corporation's banking and non-banking subsidiaries and the issuance of debt and equity. Its principal source of revenue is dividends from its subsidiaries. The accounting policies of each reportable segment are the same as those of the Corporation except for the following items, which impact the Banking and Frost Wealth Advisors segments: (i) expenses for consolidated back-office operations and general overhead-type expenses such as executive administration, accounting and internal audit are allocated to operating segments based on estimated uses of those services, (ii) income tax expense for the individual segments is calculated essentially at the statutory rate, and (iii) the parent company records the tax expense or benefit necessary to reconcile to the consolidated total.
The Corporation uses a match-funded transfer pricing process to assess operating segment performance. The process helps the Corporation to (i) identify the cost or opportunity value of funds within each business segment, (ii) measure the profitability of a particular business segment by relating appropriate costs to revenues, (iii) evaluate each business segment in a manner consistent with its economic impact on consolidated earnings, and (iv) enhance asset and liability pricing decisions.
Summarized operating results by segment were as follows:

Revenues from (expenses to) external customers:
Three months ended:
September 30, 2014
September 30, 2013
Nine months ended:
September 30, 2014
September 30, 2013
Net income (loss):
Three months ended:
September 30, 2014
September 30, 2013
Nine months ended:
September 30, 2014

Banking
Frost Wealth Advisors

| $\$ 226,166$ | $\$ 32,662$ | $\$ 12$ | $\$ 258,840$ |
| :--- | :--- | :--- | :--- |
| 201,374 | 28,790 | $(820$ | $)$ |
|  |  |  |  |
| $\$ 648,638$ | $\$ 96,069$ | $\$ 737$ | $\$ 745,444$ |
| 603,840 | 84,272 | $(2,485$ | $)$ |


| $\$ 71,563$ | $\$ 5,873$ | $\$ 179$ | $\$ 77,615$ |
| :--- | :--- | :--- | :--- |
| 57,903 | 3,800 | $(1,259$ | $)$ |
|  |  |  | 60,444 |
| $\$ 191,491$ | $\$ 16,345$ | $\$(2,563$ | $)$ |

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168,038
11,301
(4,044
) 175,295

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## Note 17 - Fair Value Measurements

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Corporation utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:
Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.
In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Corporation's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Corporation's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. A more detailed description of the valuation methodologies used for assets and liabilities measured at fair value is set forth below. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Corporation's monthly and/or quarterly valuation process.
Financial Assets and Financial Liabilities: Financial assets and financial liabilities measured at fair value on a recurring basis include the following:
Securities Available for Sale. U.S. Treasury securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements 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.
The Corporation reviews the prices supplied by the independent pricing service, as well as their underlying pricing methodologies, for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In general, the Corporation does not purchase investment portfolio securities that are esoteric or that have a complicated structure. The Corporation's entire portfolio consists of traditional investments, nearly all of which are U.S. Treasury obligations, federal agency bullet or mortgage pass-through securities, or general obligation or revenue based municipal bonds. Pricing for such instruments is fairly generic and is easily obtained. From time to time, the Corporation will validate prices supplied by the independent pricing service by comparison to prices obtained from third-party sources or derived using internal models.

Trading Securities. U.S. Treasury securities and exchange-listed common stock are reported at fair value utilizing Level 1 inputs. Other securities classified as trading are reported at fair value utilizing Level 2 inputs in the same manner as described above for securities available for sale.
Derivatives. Derivatives are generally reported at fair value utilizing Level 2 inputs, except for foreign currency contracts, which are reported at fair value utilizing Level 1 inputs. The Corporation obtains dealer quotations and utilizes internally developed valuation models to value the swap related to its junior subordinated deferrable interest debentures and commodity swaps/options. The Corporation utilizes internally developed valuation models and/or third-party models with observable market data inputs to

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validate the valuations provided by the dealers. Though there has never been a significant discrepancy in the valuations, should such a significant discrepancy arise, the Corporation would obtain price verification from a third-party dealer. The Corporation utilizes internal valuation models with observable market data inputs to estimate fair values of customer interest rate swaps, caps and floors. The Corporation also obtains dealer quotations for these derivatives for comparative purposes to assess the reasonableness of the model valuations. In cases where significant credit valuation adjustments are incorporated into the estimation of fair value, reported amounts are considered to have been derived utilizing Level 3 inputs.
For purposes of potential valuation adjustments to its derivative positions, the Corporation evaluates the credit risk of its counterparties as well as that of the Corporation. Accordingly, the Corporation has considered factors such as the likelihood of default by the Corporation and its counterparties, its net exposures, and remaining contractual life, among other things, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by netting positions that are subject to master netting arrangements, as well as considering the amount of collateral securing the position. The Corporation reviews its counterparty exposure on a regular basis, and, when necessary, appropriate business actions are taken to adjust the exposure. The Corporation also utilizes this approach to estimate its own credit risk on derivative liability positions. To date, the Corporation has not realized any significant losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of derivative assets and derivative liabilities attributable to credit risk was not significant during the reported periods. The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

| Level 1 | Level 2 | Level 3 | Total Fair |
| :--- | :--- | :--- | :--- |
| Inputs | Inputs | Inputs | Value |

September 30, 2014
Securities available for sale:

| U.S. Treasury | $\$ 2,908,256$ | $\$-$ | $\$-$ | $\$ 2,908,256$ |
| :--- | :--- | :--- | :--- | :--- |
| Residential mortgage-backed securities | - | $1,483,611$ | - | $1,483,611$ |
| States and political subdivisions | - | $2,476,787$ | - | $2,476,787$ |
| Other | - | 42,998 | - | 42,998 |
| Trading account securities: | 15,689 | - | - | 15,689 |
| U.S. Treasury | - | 863 | - | 863 |
| States and political subdivisions | - | 39,266 | 164 | 39,430 |
| Derivative assets: | - | 8,720 | - | 8,720 |
| Interest rate swaps, caps and floors | - | 823 | - | 823 |
| Commodity swaps and options | - | 41,907 | - | 41,907 |
| Foreign currency forward contracts | - | 8,549 | - | 8,549 |
| Derivative liabilities: | - | - | 773 |  |
| Interest rate swaps, caps and floors | - |  |  |  |
| Commodity swaps and options |  |  |  |  |
| Foreign currency forward contracts |  |  |  | - |

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December 31, 2013
Securities available for sale:
U.S. Treasury
U.S. Government agencies/corporations

Residential mortgage-backed securities
States and political subdivisions
Other
Trading account securities:
U.S. Treasury

States and political subdivisions
Derivative assets:
Interest rate swaps, caps and floors
Commodity swaps and options
Foreign currency forward contracts
Derivative liabilities:
Interest rate swaps, caps and floors
Commodity swaps and options
Foreign currency forward contracts

| Level 1 <br> Inputs | Level 2 Inputs | Level 3 <br> Inputs | Total Fair Value |
| :---: | :---: | :---: | :---: |
| \$2,540,554 | \$- | \$- | \$2,540,554 |
| - | 53,980 | - | 53,980 |
| - | 1,776,016 | - | 1,776,016 |
| - | 1,488,914 | - | 1,488,914 |
| - | 35,972 | - | 35,972 |
| 15,389 | - | - | 15,389 |
| - | 1,009 | - | 1,009 |
| - | 44,520 | 174 | 44,694 |
| - | 10,026 | - | 10,026 |
| 135 | - | - | 135 |
| - | 47,542 | - | 47,542 |
|  | 9,712 | - | 9,712 |
| 85 | - | - | 85 |

Derivative assets, measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the reported periods consist of interest rate swaps sold to loan customers. The significant unobservable (Level 3) inputs used in the fair value measurement of these interest rate swaps sold to loan customers primarily relate to the probability of default and loss severity in the event of default. The probability of default is determined by the underlying risk grade of the loan (see Note 4 - Loans) underlying the interest rate swap in that the probability of default increases as a loan's risk grade deteriorates, while the loss severity is estimated through an analysis of the collateral supporting both the underlying loan and interest rate swap. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity. As of September 30, 2014, the weighted-average risk grade of loans underlying interest rate swaps measured at fair value using significant unobservable (Level 3) inputs was 11.0. The weighted-average loss severity in the event of default on the interest rate swaps was $20 \%$. A reconciliation of the beginning and ending balances of derivative assets measured at fair value on a recurring basis using significant unobservable (Level 3) inputs is not presented as such amounts were not significant during the reported periods.
Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, 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). Financial assets measured at fair value on a non-recurring basis during the reported periods include certain impaired loans reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based on observable market data, typically in the case of real estate collateral, or Level 3 inputs based on customized discounting criteria, typically in the case of non-real estate collateral such as inventory, accounts receivable, equipment or other business assets.
The following table presents impaired loans that were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for loan losses based upon the fair value of the underlying collateral during the reported periods.

|  | Nine Months Ended |  | Nine Months Ended |  |
| :--- | :--- | :--- | :--- | :--- |
|  | September 30, 2014 | September 30, 2013 |  |  |
|  | Level 2 | Level 3 | Level 2 | Level 3 |
| Carrying value of impaired loans before allocations | $\$-$ | $\$ 2,944$ | $\$ 13,870$ | $\$ 4,430$ |
| Specific valuation allowance allocations | - | $(1,275$ | $)$ | $(2,098$ |$)\left(\begin{array}{ll}(2,370\end{array}\right.$

Fair value $\quad \$-\quad \$ 1,669 \quad \$ 11,772 \quad \$ 2,060$

Non-Financial Assets and Non-Financial Liabilities: The Corporation has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Non-financial assets measured at fair value on a non-recurring basis during the

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reported periods include certain foreclosed assets which, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for loan losses and certain foreclosed assets which, subsequent to their initial recognition, were remeasured at fair value through a write-down included in other non-interest expense. The fair value of a foreclosed asset is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. During the reported periods, all fair value measurements for foreclosed assets utilized Level 2 inputs.
The following table presents foreclosed assets that were remeasured and reported at fair value during the reported periods:

| Nine Months Ended <br> September 30, <br> 2014 | 2013 |
| :--- | :--- |
|  |  |
| $\$ 4,077$ | $\$ 3,839$ |
| $(285$ | $(588$ |
| $\$ 3,792$ | $\$ 3,251$ |
|  |  |
| $\$ 5,002$ | $\$ 4,778$ |
| $(1,277$ | $)$ |
| $\$ 3,725$ | $\$ 3,949$ |

Foreclosed assets remeasured at initial recognition:
Carrying value of foreclosed assets prior to remeasurement
Charge-offs recognized in the allowance for loan losses
Fair value
Foreclosed assets remeasured subsequent to initial recognition:
Carrying value of foreclosed assets prior to remeasurement
(1,277
\$3,949
Fair value
\$3,725
Charge-offs recognized upon loan foreclosures are generally offset by general or specific allocations of the allowance for loan losses and generally do not, and did not during the reported periods, significantly impact the Corporation's provision for loan losses. Regulatory guidelines require the Corporation to reevaluate the fair value of other real estate owned on at least an annual basis. The Corporation's policy is to comply with the regulatory guidelines. Accordingly, appraisals are never considered to be outdated, and the Corporation does not make any adjustments to the appraised values.
FASB ASC Topic 825 "Financial Instruments," requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. A detailed description of the valuation methodologies used in estimating the fair value of financial instruments is set forth in the 2013 Form 10-K.
The estimated fair values of financial instruments that are reported at amortized cost in the Corporation's consolidated balance sheets, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value, were as follows:

Financial assets:
Level 2 inputs:
Cash and cash equivalents
Securities held to maturity
Cash surrender value of life insurance policies
Accrued interest receivable
September 30, 2014

| Carrying | Estimated |
| :--- | :--- |
| Amount | Fair Value |

December 31, 2013

Fair Value Amount Fair Value

Level 3 inputs:
Loans, net

| $\$ 5,300,453$ | $\$ 5,300,453$ | $\$ 4,556,125$ | $\$ 4,556,125$ |
| :--- | :--- | :--- | :--- |
| $2,942,012$ | $2,970,785$ | $3,139,748$ | $3,029,663$ |
| 171,142 | 171,142 | 141,108 | 141,108 |
| 75,953 | 75,953 | 99,281 | 99,281 |
|  |  |  |  |
| $10,648,472$ | $10,712,497$ | $9,423,262$ | $9,582,734$ |

Financial liabilities:
Level 2 inputs:
$\begin{array}{lllll} & 23,490,603 & 23,491,181 & 20,688,786 & 20,689,323 \\ \text { Deposits } & 580,965 & 580,965 & 668,253 & 668,253 \\ \text { Federal funds purchased and repurchase agreements } & 137,115 & 123,712 & 123,712 \\ \text { Junior subordinated deferrable interest debentures } & 137,115 & 10 & 100,000 & 92,552\end{array}$
$\begin{array}{lllll}\text { Accrued interest payable } & 1,485 & 1,485 & 1,300 & 1,300\end{array}$ Under ASC Topic 825, entities may choose to measure eligible financial instruments at fair value at specified election dates. The fair value measurement option (i) may be applied instrument by instrument, with certain exceptions, (ii) is generally irrevocable and (iii) is applied only to entire instruments and not to portions of instruments. Unrealized gains and losses on items for which the fair value measurement option has been elected must be reported in earnings at each subsequent reporting date. During the reported periods, the Corporation had no financial instruments measured at fair value under the fair value measurement option.

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Note 18 - Accounting Standards Updates
ASU 2011-11, "Balance Sheet (Topic 210) - Disclosures about Offsetting Assets and Liabilities." ASU 2011-11 amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU No. 2013-01, "Balance Sheet (Topic 210) Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," clarifies that ordinary trade receivables are not within the scope of ASU 2011-11. ASU 2011-11, as amended by ASU 2013-01, became effective for the Corporation on January 1, 2013. See Note 10 - Balance Sheet Offsetting for applicable disclosures.
ASU 2012-02, "Intangibles - Goodwill and Other (Topic 350) - Testing Indefinite-Lived Intangible Assets for Impairment." ASU 2012-02 gives entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is impaired, then the entity must perform the quantitative impairment test. If, under the quantitative impairment test, the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in ASU 2011-08. ASU 2012-02 became effective for the Corporation on January 1, 2013 and did not have a significant impact on the Corporation's financial statements.
ASU 2012-06, "Business Combinations (Topic 805) - Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution (a consensus of the FASB Emerging Issues Task Force)." ASU 2012-06 clarifies the applicable guidance for subsequently measuring an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. Under ASU 2012-06, when a reporting entity recognizes an indemnification asset as a result of a government-assisted acquisition of a financial institution and, subsequently, a change in the cash flows expected to be collected on the indemnification asset occurs (as a result of a change in cash flows expected to be collected on the assets subject to indemnification), the reporting entity should subsequently account for the change in the measurement of the indemnification asset on the same basis as the change in the assets subject to indemnification. Any amortization of changes in value should be limited to the contractual term of the indemnification agreement (that is, the lesser of the term of the indemnification agreement and the remaining life of the indemnified assets). ASU 2012-06 became effective for the Corporation on January 1, 2013 and did not have a significant impact on the Corporation's financial statements.
ASU 2013-02, "Comprehensive Income (Topic 220) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." ASU 2013-02 amends recent guidance related to the reporting of comprehensive income to enhance the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 became effective for the Corporation on January 1, 2013 and did not have a significant impact on the Corporation's financial statements. See Note 15 - Other Comprehensive Income (Loss).
ASU 2013-08, "Financial Services - Investment Companies (Topic 946) - Amendments to the Scope, Measurement and Disclosure Requirements." ASU 2013-08 clarifies the characteristics of investment companies and sets forth a new approach for determining whether a company is an investment company. The fundamental characteristics of an investment company include (i) the company obtains funds from investors and provides the investors with investment management services; (ii) the company commits to its investors that its business purpose and only substantive activities are investing the funds for returns solely from capital appreciation, investment income, or both; and (iii) the company or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income. ASU 2013-08 also sets forth the scope, measurement and disclosure requirements for investment companies. ASU 2013-08 became effective for the Corporation on January 1, 2014 and did not have a significant impact on the Corporation's financial statements.

ASU 2013-10, "Derivatives and Hedging (Topic 815) - Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes." ASU 2013-10 permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to interest rates on direct Treasury obligations of the U.S. government and the London Interbank Offered Rate ("LIBOR"). ASU 2013-10 became effective for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013 and did not have a significant impact on the Corporation's financial statements.
ASU 2013-12, "Definition of a Public Business Entity - An Addition to the Master Glossary." ASU 2013-12 amends the Master Glossary of the FASB Accounting Standards Codification to include one definition of public business entity for future use in U.S. GAAP and identifies the types of business entities that are excluded from the scope of the Private Company Decision-Making

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Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies. ASU 2013-12 did not have a significant impact on the Corporation's financial statements.
ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective for the Corporation on January 1, 2017. The Corporation is still evaluating the potential impact on the Corporation's financial statements.
ASU 2014-11, "Transfers and Servicing (Topic 860)." ASU 2014-11 requires that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 requires separate accounting for repurchase financings, which entails the transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty. ASU 2014-11 requires entities to disclose certain information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements. In addition, ASU 2014-11 requires disclosures related to collateral, remaining contractual tenor and of the potential risks associated with repurchase agreements, securities lending transactions and repurchase-to-maturity transactions. ASU 2014-11 is effective for the Corporation on January 1, 2015 and is not expected to have a significant impact on the Corporation's financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Financial Review
Cullen/Frost Bankers, Inc.
The following discussion should be read in conjunction with the Corporation's consolidated financial statements, and notes thereto, for the year ended December 31, 2013, included in the 2013 Form 10-K. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for the year ending December 31, 2014 or any future period.
Dollar amounts in tables are stated in thousands, except for per share amounts.
Forward-Looking Statements and Factors that Could Affect Future Results
Certain statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified as such. In addition, certain statements may be contained in the Corporation's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Corporation that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans, objectives and expectations of Cullen/Frost or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes", "anticipates", "expects", "intends", "targeted", "continue", "remain", "will", "should", "may" and other similar exp intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:
Local, regional, national and international economic conditions and the impact they may have on the Corporation and its customers and the Corporation's assessment of that impact.
Volatility and disruption in national and international financial markets.
Government intervention in the U.S. financial system.
Changes in the mix of loan geographies, sectors and types or the level of non-performing assets and charge-offs.
Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.
The effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board.
Inflation, interest rate, securities market and monetary fluctuations.
The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities
and insurance) with which the Corporation and its subsidiaries must comply.
The soundness of other financial institutions.
Political instability.
Impairment of the Corporation's goodwill or other intangible assets.
Acts of God or of war or terrorism.
The timely development and acceptance of new products and services and perceived overall value of these products and services by users.
Changes in consumer spending, borrowings and savings habits.
Changes in the financial performance and/or condition of the Corporation's borrowers.
Technological changes.
Acquisitions and integration of acquired businesses.
The ability to increase market share and control expenses.
The Corporation's ability to attract and retain qualified employees.

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Changes in the competitive environment in the Corporation's markets and among banking organizations and other financial service providers.
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 standard setters.

Changes in the reliability of the Corporation's vendors, internal control systems or information systems.
Changes in the Corporation's liquidity position.
Changes in the Corporation's organization, compensation and benefit plans.

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The costs and effects of legal and regulatory developments, the resolution of legal proceedings or regulatory or other governmental inquiries, the results of regulatory examinations or reviews and the ability to obtain required regulatory approvals.
Greater than expected costs or difficulties related to the integration of new products and lines of business.

- The Corporation'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. The Corporation undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.
Application of Critical Accounting Policies and Accounting Estimates
The accounting and reporting policies followed by the Corporation conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Corporation bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.
The Corporation considers accounting estimates to be critical to reported financial results if (i) the accounting estimate requires management to make assumptions about matters that are highly uncertain and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Corporation's financial statements. Accounting policies related to the allowance for loan losses are considered to be critical, as these policies involve considerable subjective judgment and estimation by management.
For additional information regarding critical accounting policies, refer to Note 1 - Summary of Significant Accounting Policies in the notes to consolidated financial statements and the sections captioned "Application of Critical Accounting Policies and Accounting Estimates" and "Allowance for Loan Losses" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2013 Form 10-K. There have been no significant changes in the Corporation's application of critical accounting policies related to the allowance for loan losses since December 31, 2013.


## Overview

A discussion of the Corporation's results of operations is presented below. Certain reclassifications have been made to make prior periods comparable. Taxable-equivalent adjustments are the result of increasing income from tax-free loans and securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a $35 \%$ federal income tax rate, thus making tax-exempt asset yields comparable to taxable asset yields.

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Results of Operations
Net income available to common shareholders totaled $\$ 75.6$ million, or $\$ 1.19$ diluted per common share, and $\$ 199.2$ million, or $\$ 3.18$ diluted per common share, for the three and nine months ended September 30, 2014 compared to $\$ 58.4$ million, or $\$ 0.96$ diluted per common share, and $\$ 170.6$ million, or $\$ 2.81$ diluted per common share, for the three and nine months ended September 30, 2013, respectively. During the second quarter of 2014, the Corporation acquired WNB Bancshares, Inc. ("WNB"). Accordingly, the operating results of WNB are included with the Corporation's results of operations since May 30, 2014. See Note 2 - Mergers and Acquisitions in the accompanying consolidated financial statements.
Selected income statement data, returns on average assets and average common equity and dividends per common share for the comparable periods was as follows:

Taxable-equivalent net interest income
Taxable-equivalent adjustment
Net interest income
Provision for loan losses
Net interest income after provision for loan losses 177,588
Non-interest income
Non-interest expense
Income before income taxes
Income taxes
Net income
Preferred stock dividends
Net income available to common shareholders
Earnings per common share - basic
Earnings per common share - diluted
Dividends per common share
Return on average assets
Return on average common equity
Average shareholders' equity to average assets

Three Months Ended
$\begin{array}{ll}\text { September 30, } & \text { September 30, } \\ 2014 & 2013\end{array}$

| 2014 | 2013 |
| :--- | :--- |
| $\$ 208,590$ | $\$ 179,121$ |

30,612 23,768
177,978 390

80,862
163,828
94,622 72,413
$17,007 \quad 11,969$
77,615 60,444
2,016
\$75,599 \$58,429
$\$ 1.20 \quad \$ 0.96$
$1.19 \quad 0.96$
$0.51 \quad 0.5$
1.13
11.32
10.51
\% 1.01 \%

Net income available to common shareholders increased $\$ 17.2$ million, or $29.4 \%$ for the three months ended September 30, 2014 and increased $\$ 28.6$ million, or $16.8 \%$ for the nine months ended September 30, 2014 compared to the same periods in 2013. The increase during the three months ended September 30, 2014 was primarily the result of a $\$ 22.6$ million increase in net interest income, a $\$ 6.9$ million increase in non-interest income and a $\$ 4.7$ million decrease in the provision for loan losses partly offset by a $\$ 12.0$ million increase in non-interest expense and a $\$ 5.0$ million increase in income tax expense. The increase during the nine months ended September 30, 2014 was primarily the result of a $\$ 46.6$ million increase in net interest income, a $\$ 13.2$ million increase in non-interest income and a $\$ 2.8$ million decrease in the provision for loan losses partly offset by a $\$ 28.3$ million increase in non-interest expense, a $\$ 4.3$ million increase in income tax expense and a $\$ 1.3$ million increase in preferred stock dividends.
The Corporation's preferred stock was issued on February 15, 2013. The initial quarterly dividend payment during the second quarter of 2013 occurred on June 15, 2013. This dividend payment included an additional amount applicable to the period from the issuance date through March 15, 2013, the start date of the normal quarterly dividend cycle. Details of the changes in the various components of net income are further discussed below.
Net Interest Income
Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Corporation's largest source of revenue, representing $68.1 \%$ of total revenue during the first nine months of 2014. Net interest margin is the ratio of taxable-equivalent net interest income to average earning assets for the

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period. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and net interest margin.
The Federal Reserve influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Corporation's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, remained at $3.25 \%$ for the entire year in 2013 and

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through the third quarter of 2014. The Corporation's loan portfolio is also impacted, to a lesser extent, by changes in the London Interbank Offered Rate (LIBOR). At September 30, 2014, the one-month and three-month U.S. dollar LIBOR rates were $0.15 \%$ and $0.23 \%$, respectively, while at September 30, 2013, the one-month and three-month U.S. dollar LIBOR rates were $0.18 \%$ and $0.25 \%$, respectively. The intended federal funds rate, which is the cost of immediately available overnight funds, remained at zero to $0.25 \%$ for the entire year in 2013 and through the third quarter of 2014.
The Corporation's balance sheet has historically been asset sensitive, meaning that earning assets generally reprice more quickly than interest-bearing liabilities. Therefore, the Corporation's net interest margin was likely to increase in sustained periods of rising interest rates and decrease in sustained periods of declining interest rates. During the fourth quarter of 2007, in an effort to make the Corporation's balance sheet less sensitive to changes in interest rates, the Corporation entered into various interest rate swaps which effectively converted certain variable-rate loans into fixed-rate instruments for a period of seven years. During the fourth quarter of 2008, the Corporation also entered into an interest rate swap which effectively converted variable-rate debt into fixed-rate debt for a period of five years. As a result of these actions, the Corporation's balance sheet was more interest-rate neutral and changes in interest rates had a less significant impact on the Corporation's net interest margin than would have otherwise been the case. During the fourth quarter of 2009, a portion of the interest rate swaps on variable-rate loans was terminated, while the remaining interest rate swaps on variable-rate loans were terminated during the fourth quarter of 2010. These actions increased the asset sensitivity of the Corporation's balance sheet. The deferred accumulated gain applicable to the settled interest rate contracts included in accumulated other comprehensive income totaled $\$ 2.6$ million ( $\$ 1.7$ million on an after-tax basis) at September 30, 2014. The remaining deferred gain of $\$ 2.6$ million ( $\$ 1.7$ million on an after-tax basis) will be recognized in interest income in October 2014. See Note 9 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report for additional information related to these interest rate swaps.
The Corporation is primarily funded by core deposits, with non-interest-bearing demand deposits historically being a significant source of funds. This lower-cost funding base is expected to have a positive impact on the Corporation's net interest income and net interest margin in a rising interest rate environment. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") repealed the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the impact of this legislation on the Corporation has not yet been determined, the Corporation may begin to incur interest costs associated with demand deposits in the future as market conditions warrant. See Item 3. Quantitative and Qualitative Disclosures About Market Risk elsewhere in this report for information about the expected impact of this legislation on the Corporation's sensitivity to interest rates. Further analysis of the components of the Corporation's net interest margin is presented below.
The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or the average interest rate change in proportion to the absolute amounts of the change in each.

## Due to changes in average volumes

Due to changes in average interest rates
Total change

| Quarter to Date | Year to Date |
| :--- | :--- |
| September 30, | September 30, |
| 2014 | 2014 |
| vs. | vs. |
| September 30, | September 30, |
| 2013 | 2013 |
| $\$ 28,721$ | $\$ 67,512$ |
| 748 | 1,908 |
| $\$ 29,469$ | $\$ 69,420$ |

Taxable-equivalent net interest income for the three months ended September 30, 2014 increased $\$ 29.5$ million, or $16.5 \%$, while taxable-equivalent net interest income for the nine months ended September 30, 2014 increased $\$ 69.4$

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million, or $13.2 \%$, compared to the same periods in 2013 , respectively. The increases during the three and nine months ended September 30, 2014 were primarily related to increases in the average volume of interest-earning assets. The average volume of interest-earning assets for the three months ended September 30, 2014 increased $\$ 3.4$ billion, while the average volume of interest-earning assets for the nine months ended September 30, 2014 increased $\$ 2.6$ billion compared to the same periods in 2013. Over the same time frame, the net interest margin increased 1 basis point from $3.38 \%$ during the three months ended September 30, 2013 to $3.39 \%$ during the three months ended September 30, 2014 and increased 1 basis point from $3.42 \%$ during the nine months ended September 30, 2013 to $3.43 \%$ during the nine months ended September 30, 2014. The net interest margin during the three and nine months ended September 30, 2014 was positively impacted by an increase in the average yield on securities combined with a decrease in the average cost of funds. The net interest margin was negatively impacted by an increase in the relative proportion of average interest-earning assets invested in lower-yielding, interest-bearing deposits during 2014 compared to 2013 while the relative proportion of interest-earning assets invested in higher-yielding securities and loans decreased. These items are more fully discussed below.

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The average yield on interest-earning assets decreased 4 basis points from $3.53 \%$ in the first nine months of 2013 to $3.49 \%$ in the first nine months of 2014 while the average cost of funds decreased 8 basis points from $0.19 \%$ in the first nine months of 2013 to $0.11 \%$ in the first nine months of 2014 . The average yield on interest-earning assets is primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of interest-earning assets. As stated above, market interest rates have remained at historically low levels during the reported periods. The effect of lower average market interest rates during the reported periods on the average yield on average interest-earning assets was partly limited by the aforementioned interest rate swaps on variable-rate loans. The average volume of loans during the first nine months of 2014 increased $\$ 903.8$ million compared to the same period in 2013. Loans made up approximately $43.3 \%$ of average interest-earning assets during the first nine months of 2014 compared to $44.4 \%$ during the first nine months of 2013. The average yield on loans decreased 13 basis points from $4.57 \%$ during the first nine months of 2013 to $4.44 \%$ during the first nine months of 2014 . The decrease in the average yield on loans was partly related to lower average spreads due to increased competition in loan pricing. Loans generally have significantly higher yields compared to securities, interest-bearing deposits and federal funds sold and resell agreements and, as such, have a more positive effect on the net interest margin.
The average volume of securities during the first nine months of 2014 increased $\$ 77.4$ million compared to the same period in 2013. Securities made up approximately $38.6 \%$ of average interest-earning assets during the first nine months of 2014 compared to $43.1 \%$ during the first nine months of 2013. The average yield on securities was $3.95 \%$ in the first nine months of 2014 compared to $3.41 \%$ in the first nine months of 2013. The average yield on securities increased 54 basis points during the first nine months of 2014 compared to the first nine months of 2013 primarily as a result of an increase in the relative proportion of investments held in higher-yielding, tax-exempt municipal securities. Tax-exempt municipal securities totaled $52.6 \%$ of average securities during the first nine months of 2014 compared to $38.8 \%$ during the first nine months of 2013. The average yield on taxable securities was $2.12 \%$ in the first nine months of 2014 compared to $1.90 \%$ in the first nine months of 2013, while the average taxable-equivalent yield on tax-exempt securities was $5.59 \%$ in the first nine months of 2014 compared to $5.76 \%$ in the first nine months of 2013. The average taxable-equivalent yield on tax-exempt securities decreased 17 basis points during the first nine months of 2014 compared to the first nine months of 2013 in part due to the investment of funds in lower-yielding, shorter duration municipal securities during the latter part of 2013.
Average federal funds sold, resell agreements and interest-bearing deposits during the first nine months of 2014 increased $\$ 1.6$ billion compared to the same period in 2013. Federal funds sold, resell agreements and interest-bearing deposits made up approximately $18.1 \%$ of average interest-earning assets during the first nine months of 2014 compared to $12.5 \%$ during the first nine months of 2013. The combined average yield on federal funds sold, resell agreements and interest-bearing deposits was $0.26 \%$ during both the first nine months of 2014 and 2013, respectively. The increase in average federal funds sold, resell agreements and interest-bearing deposits compared to the first nine months of 2013 was primarily related to excess liquidity from deposit growth.
Average deposits increased $\$ 2.5$ billion during the first nine months of 2014 compared to the first nine months of 2013. Average interest-bearing deposits for the first nine months of 2014 increased $\$ 1.2$ billion compared to the same period in 2013, while average non-interest-bearing deposits for the first nine months of 2014 increased $\$ 1.3$ billion compared to the same period in 2013. The ratio of average interest-bearing deposits to total average deposits was $59.0 \%$ during the first nine months of 2014 compared to $60.3 \%$ during the first nine months of 2013. The average cost of deposits is primarily impacted by changes in market interest rates as well as changes in the volume and relative mix of interest-bearing deposits. The average cost of interest-bearing deposits and total deposits was $0.09 \%$ and $0.05 \%$ during the first nine months of 2014 compared to $0.13 \%$ and $0.08 \%$ during the same period in 2013. The decrease in the average cost of interest-bearing deposits during the comparable periods was primarily the result of decreases in interest rates offered on certain deposit products due to decreases in average market interest rates and decreases in renewal interest rates on maturing certificates of deposit given the current low interest rate environment. Additionally, the relative proportion of higher-cost certificates of deposit to total average interest-bearing deposits decreased from $8.6 \%$ during the first nine months of 2013 to $7.7 \%$ during the first nine months of 2014.
The Corporation's net interest spread, which represents the difference between the average rate earned on earning assets and the average rate paid on interest-bearing liabilities, was $3.38 \%$ during the first nine months of 2014
compared to $3.34 \%$ during the first nine months of 2013. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.
The Corporation's hedging policies permit the use of various derivative financial instruments, including interest rate swaps, swaptions, caps and floors, to manage exposure to changes in interest rates. Details of the Corporation's derivatives and hedging activities are set forth in Note 9 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements

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included elsewhere in this report. Information regarding the impact of fluctuations in interest rates on the Corporation's derivative financial instruments is set forth in Item 3. Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.
Provision for Loan Losses
The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses totaled $\$ 390$ thousand and $\$ 11.9$ million for the three and nine months ended September 30, 2014 compared to $\$ 5.1$ million and $\$ 14.7$ million for the three and nine months ended September 30, 2013. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion for further analysis of the provision for loan losses.
Non-Interest Income
The components of non-interest income were as follows:

| Three Months Ended | Nine Months Ended |  |  |
| :--- | :--- | :--- | :--- |
| September 30, | September 30, | September 30, | September 30, |
| 2014 | 2013 | 2014 | 2013 |
| $\$ 26,807$ | $\$ 22,692$ | $\$ 78,966$ | $\$ 67,138$ |
| 20,819 | 20,742 | 61,255 | 60,830 |
| 11,348 | 10,371 | 34,297 | 32,707 |
| 4,719 | 4,376 | 13,589 | 12,655 |
| 9,804 | 9,266 | 26,561 | 25,599 |
| 33 | $(14$ | $) 35$ | $(3$ |
| 7,332 | 6,558 | 22,799 | 25,354 |
| $\$ 80,862$ | $\$ 73,991$ | $\$ 237,502$ | $\$ 224,280$ |

Trust and investment management fees
Service charges on deposit accounts
Insurance commissions and fees
Interchange and debit card transaction fees
Other charges, commissions and fees
Net gain (loss) on securities transactions
Other
Total
\$80,862
\$73,991
\$237,502
\$224,280
Total non-interest income for the three and nine months ended September 30, 2014 increased $\$ 6.9$ million, or $9.3 \%$ and $\$ 13.2$ million, or $5.9 \%$, compared to the same periods in 2013. Changes in the components of non-interest income are discussed below.
Trust and Investment Management Fees. Trust and investment management fees for the three and nine months ended September 30, 2014 increased $\$ 4.1$ million, or $18.1 \%$, and $\$ 11.8$ million, or $17.6 \%$, compared to the same periods in 2013. Trust investment fees are the most significant component of trust and investment management fees, making up approximately $68 \%$ and $67 \%$ of total trust and investment management fees for the first nine months of 2014 and 2013, respectively. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related trust investment fees.
The increase in trust and investment management fees during the three months ended September 30, 2014 compared to the same period in 2013 was primarily the result of an increase in trust investment fees (up $\$ 3.1$ million), oil and gas fees (up $\$ 930$ thousand) and real estate fees (up $\$ 195$ thousand). The increase in trust and investment management fees during the nine months ended September 30, 2014 compared to the same period in 2013 was primarily the result of an increase in trust investment fees (up $\$ 8.8$ million), oil and gas fees (up $\$ 2.0$ million), real estate fees (up $\$ 645$ thousand) and estate fees (up $\$ 483$ thousand). The increases in trust investment fees during the three and nine months ended September 30, 2014 compared to the same periods in 2013 were partly due to higher average equity valuations during 2014, business development efforts and a change in the fee schedule beginning in the fourth quarter of 2013. The increases in oil and gas fees during the three and nine months ended September 30, 2014 compared to the same periods in 2013 were partly related to increased mineral production.
At September 30, 2014, trust assets, including both managed assets and custody assets, were primarily composed of equity securities ( $46.4 \%$ of assets), fixed income securities ( $39.5 \%$ of assets) and cash equivalents ( $8.1 \%$ of assets). The estimated fair value of these assets was $\$ 30.3$ billion (including managed assets of $\$ 12.8$ billion and custody assets of $\$ 17.5$ billion) at September 30, 2014, compared to $\$ 29.0$ billion (including managed assets of $\$ 11.9$ billion and custody assets of $\$ 17.1$ billion) at December 31, 2013 and $\$ 27.6$ billion (including managed assets of $\$ 11.6$ billion and custody assets of $\$ 16.0$ billion) at September 30, 2013.

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Service Charges on Deposit Accounts. Service charges on deposit accounts for the three and nine months ended September 30, 2014 increased $\$ 77$ thousand, or $0.4 \%$, and $\$ 425$ thousand, or $0.7 \%$, compared to the same periods in 2013. The increase was primarily due to increases in service charges on commercial accounts (up $\$ 332$ thousand and $\$ 1.3$ million during the three and nine months ended September 30, 2014, respectively) partly offset by a decrease in overdraft/insufficient funds charges on consumer accounts (down $\$ 188$ thousand and $\$ 661$ thousand during the three and nine months ended September 30, 2014, respectively).

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Overdraft/insufficient funds charges totaled $\$ 8.5$ million ( $\$ 6.6$ million consumer and $\$ 1.9$ million commercial) during the three months ended September 30, 2014 compared to $\$ 8.6$ million ( $\$ 6.8$ million consumer and $\$ 1.8$ million commercial) during the same period in 2013. Overdraft/insufficient funds charges totaled $\$ 23.9$ million ( $\$ 18.5$ million consumer and $\$ 5.4$ million commercial) during the nine months ended September 30, 2014 compared to $\$ 24.5$ million ( $\$ 19.1$ million consumer and $\$ 5.4$ million commercial) during nine months ended September 30, 2013.
Insurance Commissions and Fees. Insurance commissions and fees for the three and nine months ended September 30, 2014 increased $\$ 977$ thousand, or $9.4 \%$, and $\$ 1.6$ million, or $4.9 \%$, compared to the same periods in 2013. The increase during the three months ended September 30, 2014 was related to an increase in commission income (up $\$ 1.1$ million) partly offset by a decrease in contingent commissions (down $\$ 84$ thousand). The increase during the nine months ended September 30, 2014 was related to an increase in commission income (up $\$ 1.7$ million) partly offset by a decrease in contingent commissions (down $\$ 111$ thousand). The increases in commission income during the three and nine months ended September 30, 2014 were primarily related to increases in commercial lines property and casualty commissions resulting from new business, the impact of the acquisition of Kolkhorst Insurance Agency during the fourth quarter of 2013 and, to a lesser extent, higher rates, partly offset by decreases in employee benefit commissions and fees. The decrease in employee benefit commissions and fees during 2014 was partly related to customers electing to early renew policies during the fourth quarter of 2013 as a result of the Affordable Care Act. Insurance commissions and fees include contingent commissions totaling $\$ 303$ thousand and $\$ 3.4$ million during the three and nine months ended September 30, 2014 compared to $\$ 387$ thousand and $\$ 3.5$ million during the three and nine months ended September 30, 2013. Contingent commissions primarily consist of amounts received from various property and casualty insurance carriers related to the loss performance of insurance policies previously placed. Such commissions are seasonal in nature and are generally received during the first quarter of each year. These commissions totaled $\$ 2.0$ million and $\$ 2.1$ million during the nine months ended September 30, 2014 and 2013, respectively. Contingent commissions also include amounts received from various benefit plan insurance companies related to the volume of business generated and/or the subsequent retention of such business. These benefit plan related commissions totaled $\$ 303$ thousand and $\$ 1.4$ million during the three and nine months ended September 30, 2014 and $\$ 382$ thousand and $\$ 1.4$ million during the three and nine months ended September 30, 2013.
Interchange and Debit Card Transaction Fees. Interchange and debit card transaction fees consist of income from check card usage, point of sale income from PIN-based debit card transactions and ATM service fees. Interchange and debit card transaction fees for the three and nine months ended September 30, 2014 increased $\$ 343$ thousand, or $7.8 \%$, and $\$ 934$ thousand, or $7.4 \%$, compared to the three and nine months ended September 30, 2013. The increases are primarily due to increases in income from check card usage (up $\$ 309$ thousand and $\$ 1.7$ million for the three and nine months ended September 30, 2014, respectively) and increases in income from ATM service fees (up $\$ 58$ thousand and $\$ 41$ thousand for the three and nine months ended September 30, 2014, respectively) partly offset by decreases in point of sale income from PIN-based debit card transactions (down $\$ 24$ thousand and $\$ 839$ thousand for the three and nine months ended September 30, 2014, respectively).
Federal Reserve rules applicable to financial institutions that have assets of $\$ 10$ billion or more provide that the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. An upward adjustment of no more than 1 cent to an issuer's debit card interchange fee is allowed if the card issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. In July 2013, a federal judge vacated the Federal Reserve's rule setting debit transaction interchange fees under the Dodd-Frank Act, on the basis that the rule violated the intent of the law. The ruling states that only incremental costs, such as those related to authorization, clearing and settlement, incurred by the issuer for a particular debit transaction should be allowed and the Federal Reserve should not have considered fixed costs, fraud prevention costs, fraud losses and network fees when determining the fee cap. The judge's ruling was stayed in September 2013 and subsequently reversed on appeal in March 2014. In August 2014, the plaintiffs in the case filed a petition for a writ of certiorari for further appellate review of the court of appeals' decision by the U.S. Supreme Court. Because of the uncertainty as to the outcome of further proceedings and any future rulemaking by the Federal Reserve, the Corporation cannot provide any assurance as to the ultimate impact of any rule change on the amount of interchange and debit card transaction fees reported in future periods.

Other Charges, Commissions and Fees. Other charges, commissions and fees for the three months ended September 30, 2014 increased $\$ 538$ thousand, or $5.8 \%$, compared to the same period in 2013. The increase included increases in investment banking and capital markets fees related to advisory services (up $\$ 898$ thousand), income from the sale of mutual funds (up $\$ 471$ thousand) and wire transfer fees, (up $\$ 397$ thousand). The increases were partly offset by decreases in income related to the sale of annuities (down $\$ 715$ thousand) and other service charges (down $\$ 426$ thousand). Other charges, commissions and fees for the nine months ended September 30, 2014 increased $\$ 962$ thousand, or $3.8 \%$, compared to the same period in 2013. The increase included increases in wire transfer fees (up $\$ 1.1$ million), investment banking and capital markets fees related to advisory services (up $\$ 867$ thousand) and income from the sale of mutual funds (up $\$ 463$ thousand). These increases were partly offset by decreases in income related to the sale of annuities (down $\$ 706$ thousand) and other service charges (down $\$ 631$ thousand). The increases in wire transfer fees during the comparable periods was partly related to a new fee schedule. Investment banking and capital markets advisory services

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are transactional in nature and, as such, fees for such services can vary significantly from quarter to quarter. The increase in commission income related to the sale of mutual funds and the concurrent decrease in commission income related to the sale of annuities during the comparable periods reflects customers preference to invest in equities as market conditions have improved. The decrease in other service charges during the comparable periods was partly related to a decrease in fees associated with asset based lending services.
Net Gain/Loss on Securities Transactions. During the nine months ended September 30, 2014, the Corporation sold available-for-sale securities with an amortized cost totaling $\$ 3.7$ billion and realized a net gain of $\$ 35$ thousand on those sales. The majority of these securities were primarily purchased during 2014 and subsequently sold in connection with the Corporation's tax planning strategies related to the Texas franchise tax. The gross proceeds from the sales of these securities outside of Texas are included in total revenues/receipts from all sources reported for Texas franchise tax purposes, which results in a reduction in the overall percentage of revenues/receipts apportioned to Texas and subjected to taxation under the Texas franchise tax. The Corporation also sold approximately $\$ 2.0$ million of municipal securities acquired in connection with the acquisition of WNB during the second quarter of 2014. During the nine months ended September 30, 2013, the Corporation sold available-for-sale securities with an amortized cost totaling $\$ 8.5$ billion and realized a net loss of $\$ 3$ thousand on those sales. These securities were primarily purchased during 2013 and subsequently sold in connection with the aforementioned tax planning strategy related to the Texas franchise tax.
Other Non-Interest Income. Other non-interest income for the three months ended September 30, 2014 increased \$774 thousand, or $11.8 \%$, compared to the same period in 2013. Other non-interest income during the three months ended September 30, 2014 included increases in sundry income from various miscellaneous items (up $\$ 806$ thousand), income from securities trading and customer derivative transactions (up $\$ 405$ thousand) and earnings on the cash surrender value of life insurance policies (up $\$ 197$ thousand). During the third quarter of 2014, sundry income from various miscellaneous items included $\$ 1.1$ million related to a distribution received on a small business investment company ("SBIC") investment. The increase in income from securities trading and customer derivative transactions was primarily related to an increase in customer interest rate swap transaction fees. The increase from the aforementioned items was partly offset by decreases in income from public finance underwriting (down $\$ 284$ thousand) and mineral interest income related to bonus, rental and shut-in payments and oil and gas royalties received from severed mineral interests on property owned by Main Plaza Corporation, a wholly owned non-banking subsidiary of the Corporation (down $\$ 211$ thousand).
Other non-interest income for the nine months ended September 30, 2014 decreased $\$ 2.6$ million, or $10.1 \%$, compared to the same period in 2013. Other non-interest income during the nine months ended September 30, 2013 included $\$ 4.7$ million related to the sale of a building and parking garage, as further discussed below. Excluding the impact of the prior-year gain, other non-interest income effectively increased $\$ 2.1$ million. This effective increase in other non-interest income during the nine months ended September 30, 2014 included increases in sundry income from various miscellaneous items (up $\$ 1.9$ million) and income from securities trading and customer derivative transactions (up $\$ 1.2$ million). The increase from these items was partly offset by decreases in income from public finance underwriting (down $\$ 687$ thousand). Sundry income from various miscellaneous items during the nine months ended September 30, 2014 included $\$ 2.4$ million related to distributions received on an SBIC investment and $\$ 1.3$ million related to the recovery of interest on loans charged-off in previous years. The increase in income from securities trading and customer derivative transactions was primarily related to an increase in customer interest rate swap transaction fees.
During the first quarter of 2013, the Corporation realized a $\$ 5.6$ million gain related to the sale of a building and parking garage. The Corporation leased back portions of the building through the third quarter of 2013 and the first quarter of 2015. As a result, a portion of the gain was deferred and only $\$ 4.7$ million of the total $\$ 5.6$ million gain was recognized during the nine months ended September 30, 2013. During the first nine months of 2014, other non-interest income included $\$ 461$ thousand related to the amortization of the deferred gain. The remaining deferred portion of the gain, which totaled $\$ 307$ thousand at September 30, 2014, will be recognized ratably over the remaining lease period.

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Non-Interest Expense
The components of non-interest expense were as follows:

|  | Three Months Ended |  | Nine Months Ended |  |
| :--- | :--- | :--- | :--- | :--- |
|  | September 30, | September 30, | September 30, | September 30, |
|  | 2014 | 2013 | 2014 | 2013 |
| Salaries and wages | $\$ 73,756$ | $\$ 68,524$ | $\$ 214,446$ | $\$ 201,491$ |
| Employee benefits | 14,639 | 14,989 | 46,833 | 47,609 |
| Net occupancy | 14,049 | 13,094 | 40,735 | 37,718 |
| Furniture and equipment | 16,078 | 14,629 | 46,238 | 43,800 |
| Deposit insurance | 3,421 | 2,921 | 9,683 | 8,645 |
| Intangible amortization | 1,029 | 780 | 2,524 | 2,388 |
| Other | 40,856 | 36,886 | 125,280 | 115,744 |
| Total | $\$ 163,828$ | $\$ 151,823$ | $\$ 485,739$ | $\$ 457,395$ |

Total non-interest expense for the three and nine months ended September 30, 2014 increased $\$ 12.0$ million, or $7.9 \%$, and $\$ 28.3$ million, or $6.2 \%$, compared to the same periods in 2013 . Other non-interest expense during the three and nine months ended September 30, 2014 was particularly impacted by the acquisition of WNB. Changes in the components of non-interest expense, including the aforementioned acquisition related expenses, are discussed below. Salaries and Wages. Salaries and wages for the three and nine months ended September 30, 2014 increased $\$ 5.2$ million, or $7.6 \%$, and $\$ 13.0$ million, or $6.4 \%$ compared to the same periods in 2013. These increases were primarily related to an increase in the number of employees, partly related to the acquisition of WNB, and normal annual merit and market increases partly offset by decreases in stock-based compensation expense.
Employee Benefits. Employee benefits expense for the three months ended September 30, 2014 decreased $\$ 350$ thousand, or $2.3 \%$, compared to the same period in 2013. The decrease was primarily related to a decrease in expenses related to the Corporation's defined benefit retirement plans. The Corporation recognized a combined net periodic pension benefit of $\$ 456$ thousand on its defined benefit retirement plans during the third quarter of 2014 compared to a combined net periodic pension expense of $\$ 703$ thousand during the third quarter of 2013, resulting in a $\$ 1.2$ million decrease in expenses related to the Corporation's defined benefit retirement plans. This decrease was partly offset by increases in medical insurance expense (up $\$ 266$ thousand), payroll taxes (up $\$ 258$ thousand) and expenses related to the Corporation's $401(\mathrm{k})$ and profit sharing plans (up $\$ 125$ thousand). Employee benefits expense for the nine months ended September 30, 2014 decreased $\$ 776$ thousand, or $1.6 \%$, compared to the same period in 2013. The decrease was primarily related to a decrease in expenses related to the Corporation's defined benefit retirement plans (down $\$ 3.5$ million). The Corporation recognized a combined net periodic pension benefit of $\$ 1.4$ million on its defined benefit retirement plans during the first nine months of 2014 compared to a combined net periodic pension expense of $\$ 2.1$ million during the first nine months of 2013. This decrease was partly offset by increases in medical insurance expense (up $\$ 951$ thousand), payroll taxes (up $\$ 818$ thousand) and expenses related to the Corporation's $401(\mathrm{k})$ and profit sharing plans (up $\$ 632$ thousand).
The Corporation's defined benefit retirement and restoration plans were frozen effective as of December 31, 2001 and were replaced by a profit sharing plan. Management believes these actions helped to reduce the volatility in retirement plan expense. However, the Corporation still has funding obligations related to the defined benefit and restoration plans and could recognize retirement expense related to these plans in future years, which would be dependent on the return earned on plan assets, the level of interest rates and employee turnover.
Net Occupancy. Net occupancy expense for the three and nine months ended September 30, 2014 increased $\$ 955$ thousand, or $7.3 \%$, and $\$ 3.0$ million, or $8.0 \%$, compared to the same periods in 2013. The increases were primarily related to increases in lease expense (up $\$ 618$ thousand and $\$ 2.0$ million during the three and nine months ended September 30, 2014, respectively), repairs and maintenance expense (up $\$ 319$ thousand and $\$ 706$ thousand during the three and nine months ended September 30, 2014, respectively) and building depreciation (up $\$ 103$ thousand and $\$ 294$ thousand during the three and nine months ended September 30, 2014, respectively). The increases in these items were partly related to the additional facilities added in connection with the acquisition of WNB during the second quarter of 2014.

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Furniture and Equipment. Furniture and equipment expense for the three and nine months ended September 30, 2014 increased $\$ 1.4$ million, or $9.9 \%$, and $\$ 2.4$ million, or $5.6 \%$, compared to the same periods in 2013. The increases during the three and nine months ended September 30, 2014 were primarily related to increases in software maintenance (up $\$ 1.0$ million and $\$ 1.9$ million during the three and nine months ended September 30, 2014, respectively), furniture and fixtures depreciation (up $\$ 167$ thousand and $\$ 592$ thousand during the three and nine months ended September 30, 2014, respectively) and service contracts expense (up $\$ 353$ thousand and $\$ 155$ thousand for the three and nine months ended September 30, 2014, respectively).

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Deposit Insurance. Deposit insurance expense totaled $\$ 3.4$ million and $\$ 9.7$ million for the three and nine months ended September 30, 2014 compared to $\$ 2.9$ million and $\$ 8.6$ million for the three and nine months ended September 30, 2013. The increases in deposit insurance expense for the three and nine months ended 2014 compared to the same periods in 2013 were primarily related to an increase in assets.
Intangible Amortization. Intangible amortization is primarily related to core deposit intangibles and, to a lesser extent, intangibles related to customer relationships and non-compete agreements. Intangible amortization for the three months ended September 30, 2014 increased $\$ 249$ thousand, or $31.9 \%$, while intangible amortization for the nine months ended September 30, 2014 increased $\$ 136$ thousand, or $5.7 \%$,compared to the same periods in 2013. Intangible amortization during the three and nine months ended September 30, 2014 was impacted by the additional amortization related to intangible assets recorded in connection with the acquisition of Kolkhorst Insurance Agency, Inc. during the fourth quarter of 2013 and the core deposit intangible recorded in connection with the acquisition of WNB during the second quarter of 2014. The impact of this additional amortization was partly limited by the completion of amortization of certain previously recognized intangible assets as well as a reduction in the annual amortization rate of certain previously recognized intangible assets as the Corporation uses an accelerated amortization approach which results in higher amortization rates during the earlier years of the useful lives of intangible assets.
Other Non-Interest Expense. Other non-interest expense for the three and nine months ended September 30, 2014 increased $\$ 4.0$ million, or $10.8 \%$, and $\$ 9.5$ million, or $8.2 \%$, compared to the same periods in 2013. The increases were impacted by expenses related to the acquisition of WNB during the second quarter of 2014. Acquisition related expenses included in other non-interest expense totaled $\$ 1.1$ million and $\$ 7.1$ million during the three and nine months ended September 30, 2014, respectively. Such amounts included $\$ 3.5$ million in professional services expenses, $\$ 1.3$ million in severance and $\$ 2.3$ million in various other expenses during the nine months ended September 30, 2014. Additionally, during the nine months ended September 30, 2013, the Corporation wrote down certain land and other assets totaling $\$ 7.2$ million. Approximately, $\$ 6.2$ million of this amount was related to the write-down of certain long-term bank owned property in downtown San Antonio that was made available for sale. Excluding the aforementioned acquisition related expenses during 2014 and the write-downs in 2013, other non-interest expense for the three and nine months ended September 30, 2014 effectively increased $\$ 3.7$ million, or $10.3 \%$, and $\$ 11.0$ million, or $10.3 \%$,compared to the same periods in 2013. The effective increase during the three months ended September 30, 2014 was partly related to increases in sundry and other miscellaneous expenses (up $\$ 2.1$ million), check card expense (up $\$ 630$ thousand) and donations expense (up $\$ 557$ thousand), among other things, partly offset by a decrease in professional services expense (down $\$ 1.2$ million), among other things. The effective increase during the nine months ended September 30, 2014 was partly related to increases in check card expense (up $\$ 3.2$ million), sundry and other miscellaneous expenses (up $\$ 2.2$ million), amortization of net deferred cost related to loan commitments (up $\$ 1.5$ million), donations expense (up $\$ 684$ thousand) and advertising/promotions expense (up $\$ 545$ thousand), among other things, partly offset by a decrease in fraud loss expense (down $\$ 695$ thousand).
Results of Segment Operations
The Corporation's operations are managed along two operating segments: Banking and Frost Wealth Advisors. A description of each business and the methodologies used to measure financial performance is described in Note 16 - Operating Segments in the accompanying notes to consolidated financial statements included elsewhere in this report. Net income (loss) by operating segment is presented below:

| Three Months Ended | Nine Months Ended |  |  |
| :--- | :--- | :--- | :--- |
| September 30, | September 30, | September 30, | September 30, |
| 2014 | 2013 | 2014 | 2013 |
| $\$ 71,563$ | $\$ 57,903$ | $\$ 191,491$ | $\$ 168,038$ |
| 5,873 | 3,800 | 16,345 | 11,301 |
| 179 | $(1,259$ | $)(2,563$ | $(4,044$ |
| $\$ 77,615$ | $\$ 60,444$ | $\$ 205,273$ | $\$ 175,295$ |

Banking
Frost Wealth Advisors
Non-Banks
Consolidated net income
Banking

Net income for the three and nine months ended September 30, 2014 increased $\$ 13.7$ million, or $23.6 \%$, and $\$ 23.5$ million, or $14.0 \%$, compared to the same periods in 2013. The increase during the three months ended September 30, 2014 was primarily the result of a $\$ 21.6$ million increase in net interest income, a $\$ 4.7$ million decrease in the provision for loan losses and a $\$ 3.2$ million increase in non-interest income partly offset by a $\$ 12.5$ million increase in non-interest expense and a $\$ 3.3$ million increase in income tax expense. The increase during the nine months ended September 30, 2014 was primarily the result of a $\$ 43.3$ million increase in net interest income, a $\$ 2.8$ million decrease in the provision for loan losses and a $\$ 1.5$ million increase in non-interest income partly offset by a $\$ 23.5$ million increase in non-interest expense and a $\$ 631$ thousand increase in income tax expense.

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Net interest income for the three and nine months ended September 30, 2014 increased $\$ 21.6$ million, or $13.9 \%$, and $\$ 43.3$ million, or $9.4 \%$, compared to the same periods in 2013. The increases were primarily related to increases in the average volume of interest-earning assets. See the analysis of net interest income included in the section captioned "Net Interest Income" included elsewhere in this discussion.
The provision for loan losses for the three and nine months ended September 30, 2014 totaled $\$ 390$ thousand and $\$ 11.9$ million compared to $\$ 5.1$ million and $\$ 14.7$ million for the same periods in 2013. See the analysis of the provision for loan losses included in the section captioned "Allowance for Loan Losses" included elsewhere in this discussion.
Non-interest income for the three and nine months ended September 30, 2014 increased $\$ 3.2$ million, or $7.1 \%$, and $\$ 1.5$ million, or $1.1 \%$, compared to the same periods in 2013. The increase in non-interest income during the three months ended September 30, 2014 was primarily related to increases in other non-interest income, insurance commissions and fees, other charges, commissions and fees and interchange and debit card transaction fees. The increase in non-interest income during the nine months ended September 30, 2014 was primarily related to an increase in insurance commissions and fees, other charges, commissions and fees, interchange and debit card transaction fees, and service charges on deposit accounts partly offset by a decrease in other non-interest income. The increase in other non-interest income during the three months ended September 30, 2014 was partly related to a distribution received on an SBIC investment, an increase in income from securities trading and customer derivative transactions and an increase in earnings on the cash surrender value of life insurance policies, partly offset by a decrease in income from public finance underwriting. The decrease in other non-interest income during the nine months ended was primarily related to a non-recurring gain realized on the sale of a building and parking garage during the first nine months of 2013.The increases in insurance commissions and fees for the three and nine months ended September 30, 2014 were primarily related to increases in commercial lines property and casualty commissions resulting from new business, the impact of the acquisition of Kolkhorst Insurance Agency during the fourth quarter of 2013 and, to a lesser extent, higher rates, partly offset by decreases in employee benefit commissions and fees. The increases in other charges, commissions and fees for the three and nine months ended September 30, 2014 were primarily related to increases in investment banking and capital markets fees related to advisory services, and wire transfer fees, partly offset by a decrease in other service charges. Investment banking and capital markets advisory services are transactional in nature and, as such, fees for such services can vary significantly from quarter to quarter. The increases in wire transfer fees during the comparable periods was partly related to a new fee schedule. The decrease in other service charges during the comparable periods was partly related to a decrease in fees associated with asset based lending services. The increases in interchange and debit card transaction fees for the three and nine months ended September 30, 2014 were primarily due to increases in income from check card usage and increases in income from ATM service fees partly offset by decreases in point of sale income from PIN-based debit card transactions. See the analysis of these categories of non-interest income included in the section captioned "Non-Interest Income" included elsewhere in this discussion. Non-interest expense for the three and nine months ended September 30, 2014 increased $\$ 12.5$ million, or $9.9 \%$, and $\$ 23.5$ million, or $6.1 \%$, compared to the same periods in 2013. The increases during the three and nine months ended September 30, 2014 were primarily due to increases in salaries and wages, other non-interest expense, net occupancy and furniture and equipment expense. The increases in salaries and wages during the three and nine months ended September 30, 2014 were primarily related to an increase in the number of employees and normal annual merit and market increases partly offset by decreases in stock-based compensation expense.
The increase in other non-interest expense during the three months ended September 30, 2014 was partly related to increases in sundry and other miscellaneous expenses, check card expense and donations expense, among other things, partly offset by a decrease in professional services expense, among other things. The increase in other non-interest expense during the nine months ended September 30, 2014 was partly related to increases in check card expense; sundry and other miscellaneous expenses; amortization of net deferred cost related to loan commitments; donations expense; and advertising/promotion expense, among other things, partly offset by a decrease in fraud loss expense. The increases in salaries and wages during the three and nine months ended September 30, 2014 were primarily related to an increase in the number of employees and normal annual merit and market increases partly offset by decreases in stock-based compensation expense. The increases in net occupancy expense during the three and nine

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months ended September 30, 2014 were primarily related to increases in lease expense, repairs and maintenance expense and building depreciation. Net occupancy expense was also partly impacted by the additional facilities added in connection with the acquisition of WNB during the second quarter of 2014. The increase in furniture and equipment expense during the three and nine months ended September 30, 2014 was primarily related to increases in software maintenance depreciation, furniture and fixtures depreciation, and service contracts expense. See the analysis of these items included in the section captioned "Non-Interest Expense" included elsewhere in this discussion.
Frost Insurance Agency, which is included in the Banking operating segment, had gross commission revenues of $\$ 11.3$ million and $\$ 34.4$ million during the three and nine months ended September 30, 2014 and $\$ 10.4$ million and $\$ 32.8$ million during the three and nine months ended September 30, 2013. The increases during the three and nine months ended September 30, 2014 were related to increases in commission income partially offset by decreases in contingent commissions. See the analysis of insurance

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commissions and fees included in the section captioned "Non-Interest Income" included elsewhere in this discussion. Frost Insurance Agency also had consulting revenues totaling $\$ 206$ thousand and $\$ 804$ thousand during the three and nine months ended September 30, 2014 and $\$ 415$ thousand and $\$ 1.1$ million during the three and nine months ended September 30, 2013. Consulting revenues are primarily related to human resources consulting services and are reported as a component of other charges, commissions and fees.

## Frost Wealth Advisors

Net income for the three and nine months ended September 30, 2014 increased $\$ 2.1$ million, or $54.6 \%$, and $\$ 5.0$ million, or $44.6 \%$, compared to the same periods in 2013. The increase during the three months ended September 30, 2014 was primarily due to a $\$ 3.9$ million increase in non-interest income partly offset by a $\$ 1.1$ million increase in income tax expense and a $\$ 684$ thousand increase in non-interest expense. The increase during the nine months ended September 30, 2014 was primarily due to an $\$ 11.8$ million increase in non-interest income partly offset by a $\$ 4.0$ million increase in non-interest expense and a $\$ 2.7$ million increase in income tax expense.
Non-interest income for the three and nine months ended September 30, 2014 increased $\$ 3.9$ million, or $14.3 \%$, and $\$ 11.8$ million, or $14.8 \%$, compared to the same periods in 2013. The increases during the three and nine months ended September 30, 2014 were primarily related to increases in trust and investment management fees. Trust and investment management fee income is the most significant income component for Frost Wealth Advisors. Investment fees are the most significant component of trust and investment management fees, making up approximately $68 \%$ of total trust and investment management fees for the first nine months of 2014. Investment and other custodial account fees are generally based on the market value of assets within a trust account. Volatility in the equity and bond markets impacts the market value of trust assets and the related investment fees. The increase in trust and investment management fee income during the three and nine months ended September 30, 2014 compared to the same periods in 2013 was primarily the result of an increase in trust investment fees, oil and gas fees, real estate fees and, for the nine months ended September 30, 2014, an increase in estate fees. The increases in trust investment fees during the three and nine months ended September 30, 2014 compared to the same periods in 2013 were primarily due to higher average equity valuations during 2014, business development efforts and a change in the fee schedule beginning in the fourth quarter of 2013. See the analysis of trust and investment management fees included in the section captioned "Non-Interest Income" included elsewhere in this discussion.
Non-interest expense for the three and nine months ended September 30, 2014 increased $\$ 684$ thousand, or $3.0 \%$, and $\$ 4.0$ million, or $6.0 \%$, compared to the same periods in 2013 . The increases were primarily due to increases in other non-interest expense (up $\$ 522$ thousand and $\$ 2.3$ million, respectively), and salaries and wages (up $\$ 133$ thousand and $\$ 1.5$ million, respectively). The increases in other non-interest expense were related to increases in various miscellaneous categories of expense and overhead cost allocations. The increase in salaries and wages were primarily related to normal annual merit and market increases.
Non-Banks
The Non-Banks operating segment had net income of $\$ 179$ thousand for the three months ended September 30, 2014 and a net loss of $\$ 2.6$ million for the nine months ended September 30, 2014, compared to a net loss of $\$ 1.3$ million and $\$ 4.0$ million for the same periods in 2013. The increase in net income during the three months ended September 30, 2014 was primarily due to a $\$ 1.2$ million decrease in non-interest expense and a $\$ 1.1$ million decrease in net-interest expense, partly offset by a $\$ 587$ thousand decrease in income tax benefit and a $\$ 232$ thousand decrease in non-interest income. The decrease in net loss during the nine months ended September 30, 2014 was primarily due to a $\$ 3.3$ million decrease in net interest expense, partly offset by a $\$ 918$ thousand decrease in income tax benefit and a $\$ 823$ thousand increase in non-interest expense. The decreases in net interest expense for the three and nine months ended September 30, 2014 were primarily related to a decrease in the interest rate paid on the Corporation's junior subordinated deferrable interest debentures as a result of the termination of an interest rate swap on the debentures in December of 2013. See Note 9 - Derivative Financial Instruments in the accompanying notes to consolidated financial statements included elsewhere in this report for additional information related to the interest rate swap.
The decrease in non-interest expense during the three months ended September 30, 2014 was primarily related to a decrease in professional service expenses, largely due to a decrease in expenses associated with the acquisition of WNB, which was completed during the second quarter of 2014. The increase in non-interest expense during the nine
months ended September 30, 2014 was primarily related to expenses associated with the acquisition of WNB which included approximately $\$ 3.0$ million, primarily related to professional services, that were included in the non-banks segment.

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Income Taxes
The Corporation recognized income tax expense of $\$ 17.0$ million and $\$ 42.5$ million, for an effective tax rate of $18.0 \%$ and $17.2 \%$, respectively, for the three and nine months ended September 30, 2014 compared to $\$ 12.0$ million and $\$ 38.3$ million, for an effective tax rate of $16.5 \%$ and $17.9 \%$, respectively, for the three and nine months ended September 30, 2013. The effective income tax rates differed from the U.S. statutory rate of $35 \%$ during the comparable periods primarily due to the effect of tax-exempt income from loans, securities and life insurance policies. The increase in the effective tax rate during the three months ended September 30, 2014 was partly related to an overall increase in taxable income, due in part to the acquisition of WNB during the second quarter of 2014. The lower effective tax rate during the nine months ended September 30, 2014 was partly related to an increase in the relative proportion of tax-exempt income as the Corporation purchased additional tax-exempt municipal securities. Average Balance Sheet
Average assets totaled $\$ 25.2$ billion for the nine months ended September 30, 2014 representing an increase of $\$ 2.7$ billion, or $12.0 \%$, compared to average assets for the same period in 2013. The growth in average assets was primarily funded by an increase in average deposits. Average assets during the nine months ended September 30, 2014 were also partly impacted by the acquisition of WNB on May 30, 2014. See Note 2 - Mergers and Acquisitions in the accompany consolidated financial statements included elsewhere in this report for additional information related to this acquisition. The increase was primarily reflected in earning assets, which increased $\$ 2.6$ billion, or $12.6 \%$, during the first nine months of 2014 compared to the same period of 2013. The increase in earning assets was primarily due to a $\$ 1.6$ billion increase in average interest-bearing deposits and a $\$ 903.8$ million increase in average loans. The Corporation acquired cash and cash equivalents totaling $\$ 879.7$ million and loans totaling $\$ 670.6$ million in connection with the acquisition of WNB. Total deposits averaged $\$ 21.5$ billion for the first nine months of 2014, increasing $\$ 2.5$ billion, or $13.2 \%$, compared to the same period in 2013. The Corporation acquired deposits totaling $\$ 1.6$ billion in connection with the acquisition of WNB. Average interest-bearing deposit accounts totaled $59.0 \%$ and $60.3 \%$ of average total deposits during the first nine months of 2014 and 2013, respectively.
Loans
Loans were as follows as of the dates indicated:

Commercial and industrial:
Commercial
Leases
Total commercial and industrial
Commercial real estate:
Commercial mortgages
Construction
Land
Total commercial real estate
Consumer real estate:
Home equity loans
Home equity lines of credit
1-4 family residential mortgages
Construction
Other
Total consumer real estate
Total real estate
Consumer and other:
Consumer installment
Other
Total consumer and other

| $\begin{aligned} & \text { September 30, } \\ & 2014 \end{aligned}$ | Percentage of Total |  | $\begin{aligned} & \text { December 31, } \\ & 2013 \end{aligned}$ | Percentage of Total |
| :---: | :---: | :---: | :---: | :---: |
| \$5,188,609 | 48.3 | \% | \$4,587,499 | 48.2 |
| 322,278 | 3.0 |  | 319,577 | 3.4 |
| 5,510,887 | 51.3 |  | 4,907,076 | 51.6 |
| 3,077,172 | 28.6 |  | 2,800,760 | 29.4 |
| 642,992 | 6.0 |  | 426,639 | 4.5 |
| 300,314 | 2.8 |  | 239,937 | 2.5 |
| 4,020,478 | 37.4 |  | 3,467,336 | 36.4 |
| 337,879 | 3.1 |  | 329,853 | 3.5 |
| 216,281 | 2.0 |  | 195,132 | 2.1 |
| 28,416 | 0.3 |  | 32,447 | 0.3 |
| 17,080 | 0.2 |  | 13,123 | 0.1 |
| 247,412 | 2.3 |  | 237,649 | 2.5 |
| 847,068 | 7.9 |  | 808,204 | 8.5 |
| 4,867,546 | 45.3 |  | 4,275,540 | 44.9 |
| 384,931 | 3.6 |  | 350,827 | 3.7 |
| 6,567 | - |  | 7,289 | 0.1 |
| 391,498 | 3.6 |  | 358,116 | 3.8 |

$\left.\begin{array}{llllllll}\text { Unearned discounts } & (23,147 & ) & (0.2 & ) & (25,032 & ) & (0.3\end{array}\right)$ )

Loans increased $\$ 1.2$ billion, or $12.9 \%$, compared to December 31, 2013. The majority of the Corporation's loan portfolio is comprised of commercial and industrial loans and real estate loans. Commercial and industrial loans made up $51.3 \%$ and $51.6 \%$ of total loans at September 30, 2014 and December 31, 2013, respectively, while real estate loans made up $45.3 \%$ and $44.9 \%$ of

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total loans, respectively, at those dates. Real estate loans include both commercial and consumer balances. The Corporation acquired $\$ 670.6$ million of loans in connection with the acquisition of WNB during the second quarter of 2014.

Commercial and industrial loans increased $\$ 603.8$ million, or $12.3 \%$, during the first nine months of 2014 . The Corporation acquired approximately $\$ 437.0$ million of commercial and industrial loans in connection with the acquisition of WNB. The Corporation's commercial and industrial loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Corporation's loan policy guidelines. The commercial and industrial loan portfolio also includes commercial leases and purchased shared national credits ("SNC"s) which are discussed in more detail below.
Purchased shared national credits are participations purchased from upstream financial organizations and tend to be larger in size than the Corporation's originated portfolio. The Corporation's purchased SNC portfolio totaled $\$ 694.1$ million at September 30, 2014, increasing $\$ 107.8$ million, or $18.4 \%$, from $\$ 586.2$ million at December 31, 2013. At September 30, 2014, $57.5 \%$ of outstanding purchased SNCs were related to the energy industry. The remaining purchased SNCs were diversified throughout various other industries, with no other single industry exceeding $10 \%$ of the total purchased SNC portfolio. Additionally, almost all of the outstanding balance of purchased SNCs was included in the commercial and industrial portfolio, with the remainder included in the real estate categories. SNC participations are originated in the normal course of business to meet the needs of the Corporation's customers. As a matter of policy, the Corporation generally only participates in SNCs for companies headquartered in or which have significant operations within the Corporation's market areas. In addition, the Corporation must have direct access to the company's management, an existing banking relationship or the expectation of broadening the relationship with other banking products and services within the following 12 to 24 months. SNCs are reviewed at least quarterly for credit quality and business development successes.
Real estate loans increased $\$ 592.0$ million, or $13.8 \%$, during the first nine months of 2014. The Corporation acquired approximately $\$ 227.9$ million of real estate loans (including approximately $\$ 135.4$ million of commercial real estate, approximately $\$ 73.2$ million of real estate construction and approximately $\$ 19.3$ million of consumer real estate) in connection with the acquisition of WNB. Real estate loans include both commercial and consumer balances. Commercial real estate loans totaled $\$ 4.0$ billion at September 30, 2014 and represented $82.6 \%$ of total real estate loans. The majority of this portfolio consists of commercial real estate mortgages, which includes both permanent and intermediate term loans. The Corporation's primary focus for its commercial real estate portfolio has been growth in loans secured by owner-occupied properties. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Consequently, these loans must undergo the analysis and underwriting process of a commercial and industrial loan, as well as that of a real estate loan.
The consumer loan portfolio, including all consumer real estate and consumer installment loans, totaled $\$ 1.2$ billion at both September 30, 2014 and December 31, 2013. Consumer real estate loans, increased $\$ 38.9$ million, or $4.8 \%$, from December 31, 2013. Combined, home equity loans and lines of credit made up $65.4 \%$ and $65.0 \%$ of the consumer real estate loan total at September 30, 2014 and December 31, 2013, respectively. The Corporation offers home equity loans up to $80 \%$ of the estimated value of the personal residence of the borrower, less the value of existing mortgages and home improvement loans. In general, the Corporation no longer originates 1-4 family mortgage loans. Consumer installment loans, increased $\$ 34.1$ million, or $9.7 \%$, from December 31, 2013. The consumer installment loan portfolio primarily consists of automobile loans, unsecured revolving credit products, personal loans secured by cash and cash equivalents, and other similar types of credit facilities.

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Non-Performing Assets
Non-performing assets and accruing past due loans are presented in the table below. Troubled debt restructurings on non-accrual status are reported as non-accrual loans. Troubled debt restructurings on accrual status are reported separately.

Non-accrual loans:

| Commercial and industrial | $\$ 33,969$ | $\$ 26,733$ |
| :--- | :--- | :--- |
| Commercial real estate | 20,679 | 27,035 |
| Consumer real estate | 1,973 | 2,207 |
| Consumer and other | 479 | 745 |
| Total non-accrual loans | 57,100 | 56,720 |
| Restructured loans | - | 1,137 |
| Foreclosed assets: | 5,866 | 11,916 |
| Real estate | - | - |
| Other | 5,866 | 11,916 |
| Total foreclosed assets | $\$ 62,966$ | $\$ 69,773$ |

Ratio of non-performing assets to:
$\begin{array}{llll}\text { Total loans and foreclosed assets } & 0.59 & \% & 0.73\end{array}$
Total assets
0.23
0.29

Accruing past due loans:
30 to 89 days past due
90 or more days past due
\$61,519 \$31,297

Total accruing past due loans
20,287
7,635
Ratio of accruing past due loans to total loans:
30 to 89 days past due
$\$ 81,806 \quad \$ 38,932$

90 or more days past due
$0.57 \quad \% \quad 0.33 \quad \%$

Total accruing past due loans
0.19

Non-performing assets include non-accrual loans, troubled debt restructurings and foreclosed assets. Non-performing assets at September 30, 2014 decreased $\$ 6.8$ million from December 31, 2013. Non-accrual commercial and industrial loans included one credit relationship in excess of $\$ 5$ million totaling $\$ 15.2$ million at September 30, 2014 and one credit relationship in excess of $\$ 5$ million totaling $\$ 6.3$ million at December 31, 2013. Non-accrual real estate loans primarily consist of land development, 1-4 family residential construction credit relationships and loans secured by office buildings and religious facilities. Non-accrual commercial real estate loans included one credit relationship in excess of $\$ 5$ million totaling $\$ 6.6$ million at September 30, 2014 and one credit relationship in excess of $\$ 5$ million totaling $\$ 7.3$ million at December 31, 2013, respectively. One credit relationship totaling $\$ 5.8$ million at September 30, 2014 and $\$ 7.9$ million at December 31, 2013, was included in both non-accrual commercial and industrial loans ( $\$ 2.8$ million at September 30, 2014 and $\$ 4.7$ million at December 31, 2013) and non-accrual commercial real estate loans (\$3.0 million at September 30, 2014 and $\$ 3.2$ million at December 31, 2013).
Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectibility of the principal and/or interest to be in question, as well as when required by regulatory requirements. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Classification of a loan as non-accrual does not preclude the ultimate collection of loan principal or interest.
Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at

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foreclosure are charged against the allowance for loan losses. Regulatory guidelines require the Corporation to reevaluate the fair value of foreclosed assets on at least an annual basis. The Corporation's policy is to comply with the regulatory guidelines. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties. Write-downs of foreclosed assets totaled $\$ 1.3$ million and $\$ 829$ thousand, during the nine months ended September 30, 2014 and 2013, respectively. There were no significant concentrations of any properties, to which the aforementioned write-downs relate, in any single geographic region.

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Potential problem loans consist of loans that are performing in accordance with contractual terms but for which management has concerns about the ability of an obligor to continue to comply with repayment terms because of the obligor's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. At September 30, 2014 and December 31, 2013, the Corporation had $\$ 10.1$ million and $\$ 13.8$ million in loans of this type which are not included in any one of the non-accrual, restructured or 90 days past due loan categories. At September 30, 2014, potential problem loans consisted of four credit relationships. Of the total outstanding balance at September 30, 2014, 45.7\% related to a customer in construction, $27.6 \%$ related to a municipality, $16.2 \%$ related to a customer in commercial real estate/real estate development and $10.5 \%$ related to a customer in the aviation industry. Weakness in these organizations' operating performance and financial condition has caused the Corporation to heighten the attention given to these credits.
Allowance for Loan Losses
The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Corporation's allowance for loan loss methodology includes allowance allocations calculated in accordance with ASC Topic 310, "Receivables" and allowance allocations calculated in accordance with ASC Topic 450, "Contingencies." Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions. The Corporation's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, classified and criticized loans and net charge-offs or recoveries, among other factors. The provision for loan losses also reflects the totality of actions taken on all loans for a particular period. In other words, the amount of the provision reflects not only the necessary increases in the allowance for loan losses related to newly identified criticized loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools. See Note 4 - Loans in the accompanying notes to consolidated financial statements included elsewhere in this report for further details regarding the Corporation's methodology for estimating the appropriate level of the allowance for loan losses.
The table below provides, as of the dates indicated, an allocation of the allowance for loan losses by loan type; however, allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories:

Commercial and industrial
Commercial real estate
Consumer real estate
Consumer and other
Unallocated
Total

| September 30, | December 31, <br> 2014 |
| :--- | :--- |
| $\$ 58,636$ | $\$ 52,790$ |
| 26,780 | 22,590 |
| 5,107 | 5,230 |
| 7,789 | 5,010 |
| - | 6,818 |
| $\$ 98,312$ | $\$ 92,438$ |

The reserve allocated to commercial and industrial loans at September 30, 2014 increased $\$ 5.8$ million compared to December 31, 2013. At September 30, 2014, the reserve allocated to commercial and industrial loans includes reserves allocated for policy exceptions ( $\$ 2.1$ million), credit and collateral exceptions ( $\$ 1.1$ million) and general macroeconomic risk ( $\$ 6.3$ million) which, prior to September 30, 2014, were reported as unallocated. Excluding the effect of these items, the reserve allocated to commercial and industrial loans at September 30, 2014 decreased $\$ 3.6$ million compared to December 31, 2013. This decrease was primarily related to decreases in the distressed industries allocation and allocations for specific loans, an increase in the adjustment for recoveries and a decrease in reserves allocated for highly leveraged credit relationships partly offset by increases in historical valuation allowances and the environmental risk adjustment. The distressed industries allocation related to commercial and industrial loans decreased $\$ 4.0$ million from $\$ 7.8$ million at December 31, 2013 to $\$ 3.8$ million at September 30, 2014. The decrease
was primarily related to improvements in the weighted-average risk grades of certain segments of the contractors industry to a level below that of the weighted-average risk grade for all pass-grade loans within the overall loan portfolio segment. As a result, additional distressed industry allocations were no longer necessary for these segments of the contractors industry. Allocations for specific loans decreased $\$ 2.7$ million from $\$ 4.1$ million at December 31, 2013 to $\$ 1.4$ million at September 30, 2014. The reserve allocated for highly leveraged credit relationships decreased $\$ 873$ thousand from $\$ 4.5$ million at December 31, 2013 to $\$ 3.7$ million at September 30, 2014 primarily due to a decrease in the volume of such credit relationships. Historical valuation allowances increased $\$ 2.7$ million from $\$ 29.4$ million at December 31, 2013 to $\$ 32.1$ million at September 30, 2014. The increase in historical valuation allowances was primarily due to increases in the historical loss allocation factors applied to certain categories of non-classified and classified commercial and industrial loans and an increase in the volume of non-classified commercial and industrial loans. The environmental risk adjustment increased $\$ 1.2$ million from $\$ 5.5$ million at December 31, 2013 to $\$ 6.7$ million

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at September 30, 2014. Although the environmental risk adjustment factor decreased at September 30, 2014 compared to December 31, 2013, the dollar amount of the environmental risk adjustment increased as a result of the aforementioned increases in the base historical loss allocation factors to which the environmental risk adjustment factor is applied. The adjustment for recoveries increased $\$ 929$ thousand from $\$ 3.6$ million at December 31, 2013 to $\$ 4.5$ million at September 30, 2014 primarily due to the higher level of recoveries, on an annualized basis, experienced in the first nine months of 2014 relative to annual recoveries for 2013. Classified commercial and industrial loans (loans having a risk grade of 11, 12 or 13) totaled $\$ 95.8$ million at September 30, 2014 compared to $\$ 120.2$ million at December 31, 2013.
The reserve allocated to commercial real estate loans increased $\$ 4.2$ million from $\$ 22.6$ million at December 31, 2013 to $\$ 26.8$ million at September 30, 2014. At September 30, 2014, the reserve allocated to commercial real estate loans includes reserves allocated for policy exceptions ( $\$ 938$ thousand), credit and collateral exceptions ( $\$ 524$ thousand) and general macroeconomic risk ( $\$ 2.9$ million) which, prior to September 30, 2014, were reported as unallocated. Excluding the effect of these items, the reserve allocated to commercial real estate loans at September 30, 2014 decreased $\$ 142$ thousand compared to December 31, 2013. This decrease was primarily related to a decrease in allocations for specific loans, an increase in the adjustment for recoveries and a decrease in the distressed industries allocation mostly offset by increases in historical valuation allowances, the reserve allocated for highly leveraged credit relationships and the reserve allocated for large credit relationships. Allocations for specific loans decreased $\$ 2.0$ million from $\$ 2.8$ million at December 31, 2013 to $\$ 776$ thousand at September 30, 2014. The adjustment for recoveries increased $\$ 436$ thousand from $\$ 1.2$ million at December 31, 2013 to $\$ 1.6$ million at September 30, 2014 primarily due to the higher level of recoveries, on an annualized basis, experienced in the first nine months of 2014 relative to annual recoveries for 2013.The distressed industries allocation related to commercial real estate loans decreased $\$ 382$ thousand. As mentioned above, the decrease was primarily related to improvements in the weighted-average risk grades of certain segments of the contractors industry. Historical valuation allowances increased $\$ 1.6$ million from $\$ 13.0$ million at December 31, 2013 to $\$ 14.6$ million at September 30, 2014 primarily due to an increase in the volume of pass grade commercial real estate loans. The reserve allocated for highly leveraged credit relationships and the reserve allocated for large credit relationships increased \$442 thousand and \$388 thousand, respectively, from December 31, 2013 to September 30, 2014 primarily due to increases in the volumes of such credit relationships. Classified commercial real estate loans totaled $\$ 65.0$ million at September 30, 2014 compared to $\$ 80.8$ million at December 31, 2013.
The reserve allocated to consumer real estate loans at September 30, 2014 decreased $\$ 123$ thousand compared to December 31, 2013. At September 30, 2014, the reserve allocated to consumer real estate loans includes reserves allocated for general macroeconomic risk (\$579 thousand) which, prior to September 30, 2014, were reported as unallocated. Excluding the effect of this allocation, the reserve allocated to consumer real estate loans at September 30, 2014 decreased $\$ 702$ thousand compared to December 31, 2013. This decrease was primarily due to a decrease in historical valuation allowances which decreased $\$ 641$ thousand from $\$ 2.6$ million at December 31, 2013 to $\$ 2.0$ million at September 30, 2014. The decrease in historical valuation allowances was primarily related to a decrease in the historical loss allocation factor applied to pass grade consumer real estate loans. A decrease in the environmental risk adjustment was mostly offset by an increase in the allocation for loans not reviewed by concurrence combined with a decrease in the adjustment for recoveries.
The reserve allocated to consumer and other loans at September 30, 2014 increased $\$ 2.8$ million compared to December 31, 2013. At September 30, 2014, the reserve allocated to consumer and other loans includes reserves allocated for general macroeconomic risk (\$883 thousand) which, prior to September 30, 2014, were reported as unallocated. Excluding the effect of this allocation, the reserve allocated to consumer and other loans at September 30, 2014 increased $\$ 1.9$ million compared to December 31, 2013.The increase was primarily related to an increase in the historical valuation allowances due to an increase in the historical loss allocation factor applied to consumer and other loans and an increase in the volume of such loans combined with an increase in the environmental risk adjustment. There was no unallocated portion of the allowance for loan losses at September 30, 2014. At December 31, 2013, the unallocated portion of the allowance for loan losses totaled $\$ 6.8$ million. As discussed above, as of September 30, 2014, reserves allocated for loans originated with policy, credit and/or collateral exceptions that exceed specified risk
grades and reserves allocated for general macroeconomic risk have been allocated to specific loan portfolio segments, rather then left unallocated. The aggregate reserve allocated to specific loan portfolio segments for policy exceptions totaled $\$ 3.0$ million at September 30, 2014 compared to $\$ 2.5$ million in reserves for policy exceptions reported as a part of the unallocated portion of the allowance for loan losses at December 31, 2013. The aggregate reserve allocated to specific loan portfolio segments for credit and collateral exceptions totaled $\$ 1.7$ million at September 30, 2014 compared to $\$ 1.4$ million in reserves for credit and collateral exceptions reported as a part of the unallocated portion of the allowance for loan losses at December 31, 2013. The aggregate reserve allocated to specific loan portfolio segments for general macroeconomic risk totaled $\$ 10.6$ million at September 30, 2014 compared to $\$ 2.9$ million in reserves for general macroeconomic risk reported as a part of the unallocated portion of the allowance for loan losses at December 31, 2013. The overall increase in the reserves allocated to specific loan portfolio segments for general macroeconomic risk is reflective of loan growth that is occurring in a positively trending but uncertain economic environment as reflected in recent market volatility and decreasing oil prices. The Corporation has also experienced an increase in past due loans, though the overall

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level of classified commercial and industrial and commercial real estate loans has decreased $\$ 40.2$ million since December 31, 2013 while the weighted-average risk grades of these portfolios was $6.30 \%$ at September 30, 2014 compared to $6.40 \%$ at December 31, 2013.
Activity in the allowance for loan losses is presented in the following table.

| Three Months Ended | Nine Months Ended |  |  |
| :--- | :--- | :--- | :--- |
| September 30, September 30, | September 30, September 30, |  |  |
| 2014 | 2013 | 2014 | 2013 |
| $\$ 98,286$ | $\$ 93,400$ | $\$ 92,438$ | $\$ 104,453$ |
| 390 | 5,108 | 11,914 | 14,683 |

Charge-offs:
Commercial and industrial
Commercial real estate
Consumer real estate
Consumer and other
Total charge-offs
Recoveries:
Commercial and industrial
Commercial real estate
Consumer real estate
Consumer and other
Total recoveries
Net charge-offs
Balance at end of period
$\left.\begin{array}{lllllll}(3,631 & ) & (4,962 & ) & (9,026 & ) & (25,700\end{array}\right)$

Ratio of allowance for loan losses to:

| Total loans | 0.91 | $\%$ | 1.00 | $\%$ | 0.91 | $\%$ | 1.00 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Non-accrual loans | 172.18 | 117.79 |  | 172.18 | 117.79 | $\%$ |  |
| Ratio of annualized net charge-offs to average total loans | 0.01 | 0.23 | 0.08 | 0.38 |  |  |  |

The provision for loan losses decreased $\$ 4.7$ million, or $92.4 \%$ during the three months ended September 30, 2014 and decreased $\$ 2.8$ million, or $18.9 \%$, during the nine months ended September 30, 2014 compared to the same periods in 2013. The decrease in the provision for loan losses during the three months ended September 30, 2014 was primarily due to increased recoveries. During the third quarter of 2014, the Corporation recognized a $\$ 3.4$ million recovery related to a single commercial and industrial loan relationship. Net charge-offs as a percentage of average loans (on an annualized basis) totaled $0.08 \%$ during the first nine months of 2014 decreasing 30 basis points compared to $0.38 \%$ during the first nine months of 2013. During the first nine months of 2013, the Corporation recognized a $\$ 15.0$ million charge-off related to a single commercial and industrial loan relationship. The loan was not past due or previously considered to be a non-performing, impaired or potential problem loan; however, in April 2013, the borrower entered into bankruptcy proceedings. The level of the provision for loan losses during the first nine months of 2013 was impacted by this charge-off.
The ratio of the allowance for loan losses to total loans was $0.91 \%$ at September 30, 2014 compared to $0.97 \%$ at December 31, 2013. The acquisition of WNB during the second quarter of 2014 did not significantly impact management's determination of the allowance for loan losses at September 30, 2014. Management believes the recorded amount of the allowance for loan losses is appropriate based upon management's best estimate of probable losses that have been incurred within the existing portfolio of loans. Should any of the factors considered by management in evaluating the appropriate level of the allowance for loan losses change, the Corporation's estimate of probable loan losses could also change, which could affect the level of future provisions for loan losses.
Capital and Liquidity
Capital. Shareholders' equity totaled $\$ 2.8$ billion and $\$ 2.5$ billion at September 30, 2014 and December 31, 2013. In addition to net income of $\$ 205.3$ million, other sources of capital during the nine months ended September 30, 2014
included $\$ 149.7$ million in common stock issued in connection with the acquisition of WNB, $\$ 25.6$ million in proceeds from stock option exercises and related tax benefits of $\$ 2.3$ million, other comprehensive income, net of tax, of $\$ 14.8$ million and $\$ 6.9$ million related to stock-based compensation. Uses of capital during the nine months ended September 30, 2014 included $\$ 100.9$ million of dividends paid on preferred and common stock.

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The accumulated other comprehensive income/loss component of shareholders' equity totaled a net, after-tax, unrealized gain of $\$ 155.3$ million at September 30, 2014 compared to a net, after-tax, unrealized gain of $\$ 140.4$ million at December 31, 2013. The increase was primarily due to a $\$ 49.4$ million net after-tax increase in the net unrealized gain on securities available for sale and a $\$ 1.3$ million net after-tax decrease in the net actuarial loss of the Corporation's defined benefit post-retirement benefit plans partly offset by an $\$ 18.2$ million net after-tax decrease in the accumulated net gain on effective cash flow hedges and a $\$ 17.6$ million net after-tax decrease in the net unrealized gain on securities transferred to held to maturity.
Under current regulatory requirements, amounts reported as accumulated other comprehensive income/loss related to securities available for sale, effective cash flow hedges and defined benefit post-retirement benefit plans do not increase or reduce regulatory capital and are not included in the calculation of risk-based capital and leverage ratios. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items. See Note 8 - Capital and Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report.
On February 15, 2013, the Corporation issued and sold $6,000,000$ shares, or $\$ 150$ million in aggregate liquidation preference, of its $5.375 \%$ Non-Cumulative Perpetual Preferred Stock, Series A, par value $\$ 0.01$ and liquidation preference $\$ 25$ per share ("Series A Preferred Stock"). The net proceeds from the offering were used to fund an accelerated share repurchase. See Note 8 - Capital and Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report.
The Corporation paid quarterly dividends of $\$ 0.50, \$ 0.51$ and $\$ 0.51$ per common share during the first, second and third quarters of 2014 and quarterly dividends of $\$ 0.48, \$ 0.50$ and $\$ 0.50$ per common share during the first, second and third quarters of 2013. This equates to a common stock dividend payout ratio of $51.5 \%, 49.9 \%$ and $42.6 \%$ during the first, second and third quarters of 2014 and $52.1 \%, 53.0 \%$ and $51.9 \%$ during the first, second and third quarters of 2013. Under the terms of the junior subordinated deferrable interest debentures that Cullen/Frost has issued to Cullen/Frost Capital Trust II and WNB Capital Trust I, Cullen/Frost has the right at any time during the term of the debentures to defer the payment of interest at any time or from time to time for an extension period not exceeding 20 consecutive quarterly periods with respect to each extension period. The ability of the Corporation to declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of its capital stock is subject to certain restrictions during any such extension period.
Under the terms of the Series A Preferred Stock, the ability of the Corporation to declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of its common stock or any securities of the Corporation that rank junior to the Series A Preferred Stock is subject to certain restrictions in the event that the Corporation does not declare and pay dividends on the Series A Preferred Stock for the most recent dividend period.
From time to time, the Corporation's board of directors has authorized stock repurchase plans. Stock repurchase plans allow the Corporation to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Corporation with shares of common stock necessary to satisfy obligations related to stock compensation awards. The aforementioned accelerated share repurchase was part of a stock repurchase program that was authorized by the Corporation's board of directors in December 2012 to buy up to $\$ 150.0$ million of the Corporation's common stock. During 2013, the Corporation repurchased 2,236,748 shares ( $1,905,077$ shares in the first quarter and 331,671 during the third quarter) under the stock repurchase plan. No shares were repurchased under stock repurchase plans during the first nine months of 2014. See Part II, Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds, included elsewhere in this report, for details of stock repurchases during the quarter.
Basel III Capital Rules. In July 2013, Cullen/Frost's and Frost Bank's primary federal regulator, the Federal Reserve, published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, including Cullen/Frost and Frost Bank, compared to the current U.S. risk-based capital rules. The Basel

III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach, which was derived from Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee's 2004 "Basel II" capital accords. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules. The Basel III Capital Rules are effective for Cullen/Frost and Frost Bank on January 1, 2015 (subject to a phase-in period). Management believes that, as of September 30, 2014, Cullen/Frost and Frost Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis if such requirements were currently effective. See the section captioned "Supervision and Regulation" in Item 1. Business of the Corporation's 2013 Form 10-K for more information on the Basel III Capital Rules.

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Liquidity. Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial obligations is a function of its balance sheet structure, its ability to liquidate assets and its access to alternative sources of funds. The objective of the Corporation's liquidity management is to manage cash flow and liquidity reserves so that they are adequate to fund the Corporation's operations and to meet obligations and other commitments on a timely basis and at a reasonable cost. The Corporation seeks to achieve this objective and ensure that funding needs are met by maintaining an appropriate level of liquid funds through asset/liability management, which includes managing the mix and time to maturity of financial assets and financial liabilities on the Corporation's balance sheet. The Company's liquidity position is enhanced by its ability to raise additional funds as needed in the wholesale markets.
Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale, maturities and cash flow from securities held to maturity, and federal funds sold and resell agreements.
Liability liquidity is provided by access to funding sources which include core deposits and correspondent banks in the Corporation's natural trade area that maintain accounts with and sell federal funds to Frost Bank, as well as federal funds purchased and repurchase agreements from upstream banks and deposits obtained through financial intermediaries.
The liquidity position of the Corporation is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Liquidity risk management is an important element in the Corporation's asset/liability management process. The Corporation regularly models liquidity stress scenarios to assess potential liquidity outflows or funding problems resulting from economic disruptions, volatility in the financial markets, unexpected credit events or other significant occurrences deemed problematic by management. These scenarios are incorporated into the Corporation's contingency funding plan, which provides the basis for the identification of the Corporation's liquidity needs. As of September 30, 2014, management is not aware of any events that are reasonably likely to have a material adverse effect on the Corporation's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, including the Basel III liquidity framework, which, if implemented, would have a material adverse effect on the Corporation. Since Cullen/Frost is a holding company and does not conduct operations, its primary sources of liquidity are dividends upstreamed from Frost Bank and borrowings from outside sources. Banking regulations may limit the amount of dividends that may be paid by Frost Bank. See Note 8 - Capital and Regulatory Matters in the accompanying notes to consolidated financial statements included elsewhere in this report regarding such dividends. At September 30, 2014, Cullen/Frost had liquid assets, including cash and resell agreements, totaling $\$ 289.7$ million. Accounting Standards Updates
See Note 18 - Accounting Standards Updates in the accompanying notes to consolidated financial statements included elsewhere in this report for details of recently issued accounting pronouncements and their expected impact on the Corporation's financial statements.

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Consolidated Average Balance Sheets and Interest Income Analysis - Quarter To Date (Dollars in thousands - taxable-equivalent basis)

|  | September 30, 2014 |  | September 30, 2013 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average Balance | Interest <br> Income/ <br> Expense | Yield/ Cost |  | Average Balance | Interest <br> Income/ <br> Expense | Yield/ Cost |
| Assets: |  |  |  |  |  |  |  |
| Interest-bearing deposits | \$4,593,380 | \$2,960 | 0.26 | \% | \$3,200,511 | \$2,077 | 0.26 |
| Federal funds sold and resell agreements | 18,071 | 20 | 0.44 |  | 14,409 | 16 | 0.44 |
| Securities: |  |  |  |  |  |  |  |
| Taxable | 4,451,410 | 22,855 | 2.10 |  | 4,922,489 | 23,007 | 1.91 |
| Tax-exempt | 4,962,137 | 68,714 | 5.63 |  | 3,810,428 | 53,701 | 5.65 |
| Total securities | 9,413,547 | 91,569 | 3.96 |  | 8,732,917 | 76,708 | 3.56 |
| Loans, net of unearned discounts | 10,611,041 | 117,948 | 4.41 |  | 9,251,470 | 105,818 | 4.54 |
| Total Earning Assets and Average Earned | 24,636,039 | 212,497 | 3.46 |  | 21,199,307 | 184,619 | 3.48 |
| Cash and due from banks | 540,188 |  |  |  | 536,259 |  |  |
| Allowance for loan losses | (100,161 |  |  |  | (93,884 |  |  |
| Premises and equipment, net | 382,878 |  |  |  | 306,978 |  |  |
| Accrued interest and other assets | 1,132,794 |  |  |  | 977,104 |  |  |
| Total Assets | \$26,591,738 |  |  |  | \$22,925,764 |  |  |

Liabilities:
Non-interest-bearing demand deposits:
Commercial and individual
\$8,824,830 \$7,070,308
Correspondent banks
331,277
Public funds
375,524
Total non-interest-bearing demand
deposits
9,531,631 7,738,134
Interest-bearing deposits:
Private accounts

| Savings and interest checking | $4,270,419$ | 234 | 0.02 | $3,588,252$ | 324 | 0.04 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Money market deposit accounts | $7,571,075$ | 2,110 | 0.11 | $6,754,558$ | 2,483 | 0.15 |
| Time accounts | $1,013,725$ | 610 | 0.24 | 965,859 | 575 | 0.24 |
| Public funds | 360,766 | 37 | 0.04 | 412,780 | 140 | 0.13 |
| Total interest-bearing deposits $13,215,985$ 2,991 <br> Total deposits   | $22,747,616$ |  | 0.09 | $11,721,449$ | 3,522 | 0.12 |
| Federal funds purchased and <br> repurchase agreements | 604,436 | 35 | 0.02 | 553,980 | 30 | 0.02 |
| Junior subordinated deferrable interest <br> debentures | 137,115 | 659 | 1.92 | 123,712 | 1,710 | 5.53 |
| Subordinated notes payable and other <br> notes | 100,000 | 222 | 0.89 | 100,000 | 236 | 0.94 |
| Total Interest-Bearing Funds and <br> Average Rate Paid | $14,057,536$ | 3,907 | 0.11 | $12,499,141$ | 5,498 | 0.18 |
| Accrued interest and other liabilities | 208,698 |  |  | 241,931 |  |  |
| Total Liabilities | $23,797,865$ |  |  | $20,479,206$ |  |  |
| Shareholders' Equity | $2,793,873$ |  |  | $2,446,558$ |  |  |


| Total Liabilities and Shareholders' | $\$ 26,591,738$ |  |  |  | $\$ 22,925,764$ |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Equity | $\$ 208,590$ |  |  | $\$ 179,121$ |  |  |  |
| Net interest income |  | 3.35 | $\%$ |  | 3.30 | $\%$ |  |
| Net interest spread |  | 3.39 | $\%$ |  | 3.38 | $\%$ |  |

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a $35 \%$ tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

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Consolidated Average Balance Sheets and Interest Income Analysis - Year To Date
(Dollars in thousands - taxable-equivalent basis)

|  | September 30, 2014 |  | September 30, 2013 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Average Balance | Interest <br> Income/ <br> Expense | Yield/ Cost |  | Average Balance | Interest <br> Income/ <br> Expense | Yield/ Cost |
| Assets: |  |  |  |  |  |  |  |
| Interest-bearing deposits | \$4,201,732 | \$8,045 | 0.26 | \% | \$2,573,719 | \$4,928 | 0.26 |
| Federal funds sold and resell agreements | 19,554 | 63 | 0.43 |  | 18,342 | 67 | 0.49 |
| Securities: |  |  |  |  |  |  |  |
| Taxable | 4,265,720 | 66,372 | 2.12 |  | 5,456,207 | 75,869 | 1.90 |
| Tax-exempt | 4,727,020 | 195,968 | 5.59 |  | 3,459,109 | 148,187 | 5.76 |
| Total securities | 8,992,740 | 262,340 | 3.95 |  | 8,915,316 | 224,056 | 3.41 |
| Loans, net of unearned discounts | 10,093,433 | 335,566 | 4.44 |  | 9,189,648 | 314,123 | 4.57 |
| Total Earning Assets and Average Rate $23,307,459$ |  | 606,014 | 3.49 |  | 20,697,025 | 543,174 | 3.53 |
| Cash and due from banks | 546,100 |  |  |  | 555,910 |  |  |
| Allowance for loan losses | (96,895 |  |  |  | (97,589 |  |  |
| Premises and equipment, net | 346,833 |  |  |  | 310,278 |  |  |
| Accrued interest and other assets | 1,047,820 |  |  |  | 993,356 |  |  |
| Total Assets | \$25,151,317 |  |  |  | \$22,458,980 |  |  |

Liabilities:
Non-interest-bearing demand deposits:
Commercial and individual
\$8,082,259
\$6,864,030
Correspondent banks
346,242
383,329
8,811,830
deposits
Interest-bearing deposits:
Private accounts
$\left.\begin{array}{lllllll}\text { Savings and interest checking } & 4,111,678 & 681 & 0.02 & 3,551,941 & 1,077 & 0.04 \\ \text { Money market deposit accounts } & 7,187,004 & 5,703 & 0.11 & 6,484,811 & 7,925 & 0.16 \\ \text { Time accounts } & 972,361 & 1,578 & 0.22 & 980,658 & 1,956 & 0.27 \\ \text { Public funds } & 417,089 & 157 & 0.05 & 428,244 & 454 & 0.14 \\ \begin{array}{lll}\text { Total interest-bearing deposits } & 12,688,132 & 8,119\end{array} & 0.09 & 11,445,654 & 11,412 & 0.13 \\ \begin{array}{ll}\text { Total deposits }\end{array} & 21,499,962\end{array}\right)$

| Shareholders' Equity | $2,665,574$ |  |  | $2,440,845$ |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Total Liabilities and Shareholders' | $\$ 25,151,317$ |  |  | $\$ 22,458,980$ |  |  |  |
| Equity |  | $\$ 595,310$ |  |  | $\$ 525,890$ |  |  |
| Net interest income |  | 3.38 | $\%$ |  | 3.34 | $\%$ |  |
| Net interest spread |  | 3.43 | $\%$ |  | 3.42 | $\%$ |  |

For these computations: (i) average balances are presented on a daily average basis, (ii) information is shown on a taxable-equivalent basis assuming a $35 \%$ tax rate, (iii) average loans include loans on non-accrual status, and (iv) average securities include unrealized gains and losses on securities available for sale while yields are based on average amortized cost.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk
The disclosures set forth in this item are qualified by the section captioned "Forward-Looking Statements and Factors that Could Affect Future Results" included in Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.
Refer to the discussion of market risks included in Item 7A. Quantitative and Qualitative Disclosures About Market Risk in the 2013 Form 10-K. There has been no significant change in the types of market risks faced by the Corporation since December 31, 2013.
The Corporation utilizes an earnings simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model measures the impact on net interest income relative to a flat-rate case scenario of hypothetical fluctuations in interest rates over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. The impact of interest rate derivatives, such as interest rate swaps, caps and floors, is also included in the model. Other interest rate-related risks such as prepayment, basis and option risk are also considered.
For modeling purposes, as of September 30, 2014, the model simulations projected that 100 and 200 basis point ratable increases in interest rates would result in positive variances in net interest income of $0.1 \%$ and $0.5 \%$, respectively, relative to the flat-rate case over the next 12 months, while a decrease in interest rates of 25 basis points would result in a negative variance in net interest income of $3.1 \%$ relative to the flat-rate case over the next 12 months. The September 30, 2014 model simulations were impacted by the assumption, for modeling purposes, that the Corporation will begin to pay interest on demand deposits (those not already receiving an earnings credit rate) in the fourth quarter of 2014, as further discussed below. As of September 30, 2013, the model simulations projected that a 100 basis point increase in interest rates would result in a negative variance in net interest income of $0.1 \%$ and a 200 basis point increase in interest rates would result in a positive variance in net interest income of $1.1 \%$, relative to the flat-rate case over the next 12 months, while a decrease in interest rates of 25 basis points would result in a negative variance in net interest income of $2.7 \%$ relative to the flat-rate case over the next 12 months. The September 30, 2013 model simulations were impacted by the assumption, for modeling purposes, that the Corporation would begin to pay interest on demand deposits in the fourth quarter of 2013. The likelihood of a decrease in interest rates beyond 25 basis points as of September 30, 2014 and 2013 was considered to be remote given prevailing interest rate levels.
The model simulations as of September 30, 2014 indicate that the Corporation's balance sheet is slightly less asset sensitive in comparison to September 30, 2013. The decreased asset sensitivity is primarily due to an increase in the relative proportion of interest earning assets invested in fixed rate securities and a decrease in the relative proportion of interest earning assets invested in variable rate interest-bearing deposits, which generally reprice as market interest rates change. The growth in the Corporation's balance sheet was partly funded by significant deposit growth during 2013 and during the first nine months of 2014. Additionally, during the second quarter of 2014, the Corporation acquired WNB Bancshares, Inc. (See Note 2 - Mergers and Acquisitions included in the notes to consolidated financial statements elsewhere in this report). In connection with the acquisition, the Corporation acquired cash and cash equivalents totaling $\$ 879.7$ million and loans totaling $\$ 670.6$ million. The Corporation also acquired deposits totaling $\$ 1.6$ billion. The acquisition of WNB did not significantly impact the Corporation's sensitivity to interest rate changes relative to it's exposure prior to the acquisition.
As mentioned above, financial regulatory reform legislation entitled the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act") repealed the federal prohibition on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Although the ultimate impact of this legislation on the Corporation has not yet been determined, the Corporation may begin to incur interest costs associated with demand deposits in the future as market conditions warrant. If this were to occur, the Corporation's balance sheet would likely become less asset sensitive and possibly liability sensitive. Because the interest rate that will ultimately be paid on these demand deposits depends upon a variety of factors, some of which are beyond the Corporation's control, the Corporation assumed an aggressive
pricing structure for the purposes of the model simulations discussed above with interest payments beginning in the fourth quarter of 2014. Should the actual interest rate paid on demand deposits be less than the rate assumed in the model simulations, or should the interest rate paid for demand deposits become an administered rate with less direct correlation to movements in general market interest rates, the Corporation's balance sheet could be more asset sensitive than the model simulations might otherwise indicate.
As of September 30, 2014, the effects of a 200 basis point increase and a 25 basis point decrease in interest rates on the Corporation's derivative holdings would not result in a significant variance in the Corporation's net interest income.

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The effects of hypothetical fluctuations in interest rates on the Corporation's securities classified as "trading" under ASC Topic 320, "Investments-Debt and Equity Securities," are not significant, and, as such, separate quantitative disclosure is not presented.
Item 4. Controls and Procedures
As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Corporation's management, with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report. No change in the Corporation's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during the last fiscal quarter that materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

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Part II. Other Information
Item 1. Legal Proceedings
The Corporation and its subsidiaries are subject to various claims and legal actions that have arisen in the course of conducting business. Management does not expect the ultimate disposition of these matters to have a material adverse impact on the Corporation's financial statements.
Item 1A. Risk Factors
There has been no material change in the risk factors disclosed under Item 1A. of the Corporation's 2013 Form 10-K.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
The following table provides information with respect to purchases made by or on behalf of the Corporation or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Corporation's common stock during the three months ended September 30, 2014. Dollar amounts in thousands.

Period
Total Number of Average Price
Shares Purchased Paid Per Share

Maximum
Number of Shares
Total Number of (or Approximate Shares Purchased Dollar Value) as Part of Publicly That May Yet Be Announced Plan Purchased Under the Plan at the End of the Period
July 1, 2014 to July 31, 2014
August 1, 2014 to August 31, 2014
September 1, 2014 to September 30, 2014
Total
Item 3. Defaults Upon Senior Securities
None.
Item 4. Mine Safety Disclosures
None.
Item 5. Other Information
None.
Item 6. Exhibits
(a) Exhibits

Exhibit
Number
Description
31.1 Rule 13a-14(a) Certification of the Corporation's Chief Executive Officer
31.2 Rule 13a-14(a) Certification of the Corporation's Chief Financial Officer
32.1+ Section 1350 Certification of the Corporation's Chief Executive Officer
32.2+ Section 1350 Certification of the Corporation's Chief Financial Officer

101 Interactive Data File
This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or +otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

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## 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.

Date: October 29, 2014
Cullen/Frost Bankers, Inc.
(Registrant)
By: /s/ Phillip D. Green
Phillip D. Green
Group Executive Vice President and Chief Financial Officer
(Duly Authorized Officer, Principal
Financial
Officer and Principal Accounting Officer)

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