

CULLEN/FROST BANKERS, INC.

Form 10-Q

July 26, 2018

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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: June 30, 2018

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 74-1751768

(I.R.S.

(State or other jurisdiction of Employer

incorporation or organization) 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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer ¨

Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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 July 19, 2018 there were 63,907,784 shares of the registrant’s Common Stock, \$.01 par value, outstanding.

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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)

	June 30, 2018	December 31, 2017
Assets:		
Cash and due from banks	\$ 509,191	\$ 545,542
Interest-bearing deposits	2,476,587	4,347,538
Federal funds sold and resell agreements	329,692	159,967
Total cash and cash equivalents	3,315,470	5,053,047
Securities held to maturity, at amortized cost	1,236,511	1,432,098
Securities available for sale, at estimated fair value	10,717,743	10,489,009
Trading account securities	21,334	21,098
Loans, net of unearned discounts	13,711,762	13,145,665
Less: Allowance for loan losses	(150,226)	(155,364)
Net loans	13,561,536	12,990,301
Premises and equipment, net	539,861	520,958
Goodwill	654,952	654,952
Other intangible assets, net	4,316	5,073
Cash surrender value of life insurance policies	181,756	180,477
Accrued interest receivable and other assets	453,735	400,867
Total assets	\$ 30,687,214	\$ 31,747,880
Liabilities:		
Deposits:		
Non-interest-bearing demand deposits	\$ 10,525,998	\$ 11,197,093
Interest-bearing deposits	15,470,501	15,675,296
Total deposits	25,996,499	26,872,389
Federal funds purchased and repurchase agreements	977,470	1,147,824
Junior subordinated deferrable interest debentures, net of unamortized issuance costs	136,213	136,184
Subordinated notes, net of unamortized issuance costs	98,630	98,552
Accrued interest payable and other liabilities	168,890	195,068
Total liabilities	27,377,702	28,450,017
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 June 30, 2018 and December 31, 2017	144,486	144,486
Common stock, par value \$0.01 per share; 210,000,000 shares authorized; 64,236,306 shares issued at both June 30, 2018 and December 31, 2017	642	642
Additional paid-in capital	960,121	953,361
Retained earnings	2,297,099	2,187,069
Accumulated other comprehensive income, net of tax	(63,319)	79,512
Treasury stock, at cost; 332,722 shares at June 30, 2018 and 760,720 shares at December 31, 2017	(29,517)	(67,207)
Total shareholders' equity	3,309,512	3,297,863
Total liabilities and shareholders' equity	\$ 30,687,214	\$ 31,747,880

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		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Interest income:				
Loans, including fees	\$164,133	\$131,073	\$315,335	\$253,673
Securities:				
Taxable	21,188	23,527	41,746	48,829
Tax-exempt	57,298	55,435	114,009	112,382
Interest-bearing deposits	13,917	9,076	28,011	15,912
Federal funds sold and resell agreements	1,415	163	2,176	270
Total interest income	257,951	219,274	501,277	431,066
Interest expense:				
Deposits	17,575	2,173	28,213	4,041
Federal funds purchased and repurchase agreements	631	187	1,265	326
Junior subordinated deferrable interest debentures	1,311	962	2,453	1,870
Other long-term borrowings	1,164	1,164	2,328	1,532
Total interest expense	20,681	4,486	34,259	7,769
Net interest income	237,270	214,788	467,018	423,297
Provision for loan losses	8,251	8,426	15,196	16,378
Net interest income after provision for loan losses	229,019	206,362	451,822	406,919
Non-interest income:				
Trust and investment management fees	29,121	27,727	58,708	54,197
Service charges on deposit accounts	21,142	21,198	41,985	41,967
Insurance commissions and fees	10,556	9,728	26,536	23,549
Interchange and debit card transaction fees	3,446	5,692	6,604	11,266
Other charges, commissions and fees	9,273	9,898	18,280	19,490
Net gain (loss) on securities transactions	(60)	(50)	(79)	(50)
Other	11,588	6,887	24,477	14,361
Total non-interest income	85,066	81,080	176,511	164,780
Non-interest expense:				
Salaries and wages	85,204	80,995	171,887	163,507
Employee benefits	17,907	18,198	39,902	39,823
Net occupancy	19,455	19,153	39,195	38,390
Technology, furniture and equipment	20,459	18,250	40,138	36,240
Deposit insurance	4,605	5,570	9,484	10,485
Intangible amortization	369	438	757	896
Other	40,909	45,447	84,156	86,625
Total non-interest expense	188,908	188,051	385,519	375,966
Income before income taxes	125,177	99,391	242,814	195,733
Income taxes	13,836	13,838	24,993	25,239
Net income	111,341	85,553	217,821	170,494
Preferred stock dividends	2,015	2,015	4,031	4,031
Net income available to common shareholders	\$109,326	\$83,538	\$213,790	\$166,463
Earnings per common share:				
Basic	\$1.70	\$1.30	\$3.33	\$2.59

Diluted	1.68	1.29	3.30	2.57
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See Notes to Consolidated Financial Statements.

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Cullen/Frost Bankers, Inc.

Consolidated Statements of Comprehensive Income (Loss)

(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$111,341	\$85,553	\$217,821	\$170,494
Other comprehensive income (loss), before tax:				
Securities available for sale and transferred securities:				
Change in net unrealized gain/loss during the period	(11,884)	90,390	(190,788)	124,201
Change in net unrealized gain on securities transferred to held to maturity	(2,041)	(3,860)	(4,660)	(10,146)
Reclassification adjustment for net (gains) losses included in net income	60	50	79	50
Total securities available for sale and transferred securities	(13,865)	86,580	(195,369)	114,105
Defined-benefit post-retirement benefit plans:				
Change in the net actuarial gain/loss	—	—	—	—
Reclassification adjustment for net amortization of actuarial gain/loss included in net income as a component of net periodic cost (benefit)	1,251	1,358	2,501	2,715
Total defined-benefit post-retirement benefit plans	1,251	1,358	2,501	2,715
Other comprehensive income (loss), before tax	(12,614)	87,938	(192,868)	116,820
Deferred tax expense (benefit)	(2,649)	30,778	(40,502)	40,887
Other comprehensive income (loss), net of tax	(9,965)	57,160	(152,366)	75,933
Comprehensive income (loss)	\$101,376	\$142,713	\$65,455	\$246,427

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)

	Six Months Ended	
	June 30,	
	2018	2017
Total shareholders' equity at beginning of period	\$3,297,863	\$3,002,528
Cumulative effect of accounting change	(2,285)	—
Total shareholders' equity at beginning of period, as adjusted	3,295,578	3,002,528
Net income	217,821	170,494
Other comprehensive income (loss)	(152,366)	75,933
Stock option exercises/stock unit conversions (428,599 shares in 2018 and 752,075 shares in 2017)	25,448	44,149
Stock compensation expense recognized in earnings	6,760	6,291
Purchase of treasury stock (601 shares in 2018 and 469 shares in 2017)	(70)	(42)
Cash dividends – preferred stock (approximately \$0.67 per share in both 2018 and in 2017)	(4,031)	(4,031)
Cash dividends – common stock (\$1.24 per share in 2018 and \$1.11 per share in 2017)	(79,628)	(71,393)
Total shareholders' equity at end of period	\$3,309,512	\$3,223,929

See Notes to Consolidated Financial Statements.

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

	Six Months Ended	
	June 30,	
	2018	2017
Operating Activities:		
Net income	\$217,821	\$170,494
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	15,196	16,378
Deferred tax expense (benefit)	22,886	(4,173)
Accretion of loan discounts	(6,904)	(7,403)
Securities premium amortization (discount accretion), net	48,936	43,652
Net (gain) loss on securities transactions	79	50
Depreciation and amortization	24,581	24,055
Net (gain) loss on sale/write-down of assets/foreclosed assets	(5,453)	(1,383)
Stock-based compensation	6,760	6,291
Net tax benefit from stock-based compensation	3,160	5,579
Earnings on life insurance policies	(1,663)	(1,565)
Net change in:		
Trading account securities	(2,263)	(7,120)
Accrued interest receivable and other assets	(42,959)	(20,116)
Accrued interest payable and other liabilities	(26,176)	(36,277)
Net cash from operating activities	254,001	188,462
Investing Activities:		
Securities held to maturity:		
Purchases	(1,500)	—
Sales	—	—
Maturities, calls and principal repayments	183,140	634,874
Securities available for sale:		
Purchases	(11,453,662)	(8,825,545)
Sales	10,890,388	8,247,439
Maturities, calls and principal repayments	108,316	164,182
Proceeds from sale of loans	18,918	—
Net change in loans	(601,101)	(549,408)
Benefits received on life insurance policies	384	462
Proceeds from sales of premises and equipment	12,844	1,550
Purchases of premises and equipment	(45,766)	(14,481)
Proceeds from sales of repossessed properties	986	345
Net cash from investing activities	(887,053)	(340,582)
Financing Activities:		
Net change in deposits	(875,890)	(198,002)
Net change in short-term borrowings	(170,354)	(52,125)
Proceeds from issuance of subordinated notes	—	98,434
Principal payments on subordinated notes	—	(100,000)
Proceeds from stock option exercises	25,448	44,149
Purchase of treasury stock	(70)	(42)

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Cash dividends paid on preferred stock	(4,031)	(4,031)
Cash dividends paid on common stock	(79,628)	(71,393)
Net cash from financing activities	(1,104,525)	(283,010)
Net change in cash and cash equivalents	(1,737,577)	(435,130)
Cash and cash equivalents at beginning of period	5,053,047	4,141,445
Cash and cash equivalents at end of period	\$3,315,470	\$3,706,315

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. The terms “Cullen/Frost,” “the Corporation,” “we,” “us” and “our” mean Cullen/Frost Bankers, Inc. and its subsidiaries, when appropriate. In addition to general commercial and consumer banking, other products and services offered include trust and investment management, insurance, brokerage, mutual funds, leasing, treasury management, capital markets advisory 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. All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and financial reporting policies we follow 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 our 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 our consolidated financial statements, and notes thereto, for the year ended December 31, 2017, included in our Annual Report on Form 10-K filed with the SEC on February 7, 2018 (the “2017 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 and 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:

	Six Months Ended June 30,	
	2018	2017
Cash paid for interest	\$31,962	\$6,666
Cash paid for income taxes	3,888	22,801
Significant non-cash transactions:		
Unsettled purchases/sales of securities	2,186	80,586
Loans foreclosed and transferred to other real estate owned and foreclosed assets	2,656	—

Accounting Changes, Reclassifications and Restatements. Certain items in prior financial statements have been reclassified to conform to the current presentation. In addition, we adopted ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" as of January 1, 2018. In accordance with ASU 2018-02, we elected to reclassify certain income tax effects related to the change in the U.S. statutory federal income tax rate under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017, from accumulated other comprehensive income to retained earnings. Such amounts, which totaled \$9.5 million, related to a net actuarial loss on defined benefit post-retirement plans and unrealized gains on securities available for sale and securities transferred to held to maturity. See Note 14 - Other Comprehensive Income. The effects of the Tax Cuts and Jobs Act on deferred taxes related to amounts initially

recorded in accumulated other comprehensive income are provisional. As we finalize the accounting for the tax effects of the Tax Cuts and Jobs Act, additional reclassification adjustments may be recorded in future periods. See Note 13 - Income Taxes. Notwithstanding this election made in accordance with ASU 2018-02, our policy is to release such income tax effects only when the entire portfolio to which the underlying transactions relate is liquidated, sold or extinguished.

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We also adopted ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" as of January 1, 2018. Using a modified retrospective transition approach for contracts that were not complete as of our adoption, we recognized a cumulative effect reduction to beginning retained earnings totaling \$2.3 million. The amount was related to certain revenue streams within trust and investment management fees. Additionally, based on our underlying contracts, ASU 2014-09 requires us to report network costs associated with debit card and ATM transactions netted against the related fee income from such transactions. Previously, such network costs were reported as a component of other non-interest expense. For the three and six months ended June 30, 2018, gross interchange and debit card transaction fees totaled \$6.5 million and \$12.6 million, respectively, while related network costs totaled \$3.0 million and \$6.0 million, respectively. On a net basis, we reported \$3.4 million and \$6.6 million as interchange and debit card transaction fees in the accompanying Consolidated Statement of Income for the three and six months ended June 30, 2018, respectively. For the three and six months ended June 30, 2017, we reported interchange and debit card transaction fees totaling \$5.7 million and \$11.3 million, respectively, on a gross basis in the accompanying Consolidated Statement of Income while related network costs totaling \$2.9 million and \$6.1 million were reported as a component of other non-interest expense for the three and six months ended June 30, 2017, respectively. ASU 2014-09 also required us to change the way we recognize certain recurring revenue streams reported as components of trust and investment management fees, insurance commissions and fees and other categories of non-interest income, however, such changes were not significant to our financial statements for the six months ended June 30, 2018. Under ASU 2014-09, we adopted new policies related to revenue recognition. In general, for revenue not associated with financial instruments, guarantees and lease contracts, we apply the following steps when recognizing revenue from contracts with customers: (i) identify the contract, (ii) identify the performance obligations, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations and (v) recognize revenue when performance obligation is satisfied. Our contracts with customers are generally short term in nature, typically due within one year or less or cancellable by us or our customer upon a short notice period. Performance obligations for our customer contracts are generally satisfied at a single point in time, typically when the transaction is complete, or over time. For performance obligations satisfied over time, we primarily use the output method, directly measuring the value of the products/services transferred to the customer, to determine when performance obligations have been satisfied. We typically receive payment from customers and recognize revenue concurrent with the satisfaction of our performance obligations. In most cases, this occurs within a single financial reporting period. For payments received in advance of the satisfaction of performance obligations, revenue recognition is deferred until such time the performance obligations have been satisfied. In cases where we have not received payment despite satisfaction of our performance obligations, we accrue an estimate of the amount due in the period our performance obligations have been satisfied. For contracts with variable components, only amounts for which collection is probable are accrued. We generally act in a principal capacity, on our own behalf, in most of our contracts with customers. In such transactions, we recognize revenue and the related costs to provide our services on a gross basis in our financial statements. In some cases, we act in an agent capacity, deriving revenue through assisting other entities in transactions with our customers. In such transactions, we recognized revenue and the related costs to provide our services on a net basis in our financial statements. These transactions primarily relate to insurance and brokerage commissions and fees derived from our customers' use of various interchange and ATM/debit card networks.

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Note 2 - Securities

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

	June 30, 2018			December 31, 2017				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held to Maturity								
Residential mortgage-backed securities	\$3,317	\$9	\$73	\$3,253	\$3,610	\$15	\$38	\$3,587
States and political subdivisions	1,231,694	13,100	2,394	1,242,400	1,428,488	26,462	2,746	1,452,204
Other	1,500	—	10	1,490	—	—	—	—
Total	\$1,236,511	\$13,109	\$2,477	\$1,247,143	\$1,432,098	\$26,477	\$2,784	\$1,455,791
Available for Sale								
U.S. Treasury	\$3,454,387	\$—	\$44,306	\$3,410,081	\$3,453,391	\$7,494	\$15,732	\$3,445,153
Residential mortgage-backed securities	625,897	13,540	7,779	631,658	648,288	19,048	2,250	665,086
States and political subdivisions	6,626,495	71,701	64,807	6,633,389	6,185,711	167,293	16,795	6,336,209
Other	42,615	—	—	42,615	42,561	—	—	42,561
Total	\$10,749,394	\$85,241	\$116,892	\$10,717,743	\$10,329,951	\$193,835	\$34,777	\$10,489,009

All mortgage-backed securities included in the above table were issued by U.S. government agencies and corporations. At June 30, 2018, approximately 98.3% of the securities in our municipal bond portfolio were issued by political subdivisions or agencies within the State of Texas, of which approximately 67.9% are either guaranteed by the Texas Permanent School Fund, which has a “triple A” insurer financial strength rating, or are secured by U.S. Treasury securities via defeasance of the debt by the issuers. Securities with limited marketability and that do not have readily determinable fair values are carried at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar securities of the same issuer. These securities include stock in the Federal Reserve Bank and the Federal Home Loan Bank and are reported as other available for sale securities in the table above. 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 \$3.3 billion at June 30, 2018 and \$3.8 billion at December 31, 2017.

During the fourth quarter of 2012, we 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 remaining transferred securities included in accumulated other comprehensive income in the accompanying balance sheet as of June 30, 2018 totaled \$6.9 million (\$5.4 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.

Unrealized Losses. As of June 30, 2018, securities with unrealized losses, segregated by length of impairment, were as follows:

	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Held to Maturity						
Residential mortgage-backed securities	\$1,103	\$25	\$1,392	\$48	\$2,495	\$73

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States and political subdivisions	232,707	633	44,490	1,761	277,197	2,394
Other	1,490	10	—	—	1,490	10
Total	\$235,300	\$ 668	\$45,882	\$ 1,809	\$281,182	\$ 2,477
Available for Sale						
U.S. Treasury	\$2,841,825	\$ 34,887	\$568,256	\$ 9,419	\$3,410,081	\$44,306
Residential mortgage-backed securities	238,548	4,687	58,923	3,092	297,471	7,779
States and political subdivisions	1,907,610	25,535	813,864	39,272	2,721,474	64,807
Total	\$4,987,983	\$ 65,109	\$1,441,043	\$ 51,783	\$6,429,026	\$ 116,892

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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 our ability to retain our 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 we expect to receive full value for the securities. Furthermore, as of June 30, 2018, 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 we will not have to sell any such securities before a recovery of cost. Any unrealized losses are 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 securities 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 June 30, 2018, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in our consolidated income statement.

Contractual Maturities. The amortized cost and estimated fair value of securities, excluding trading securities, at June 30, 2018 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 Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 138,403	\$ 140,001	\$ 400,123	\$ 398,992
Due after one year through five years	134,389	136,874	3,739,862	3,705,611
Due after five years through ten years	448,447	450,758	480,038	481,384
Due after ten years	511,955	516,257	5,460,859	5,457,483
Residential mortgage-backed securities	3,317	3,253	625,897	631,658
Equity securities	—	—	42,615	42,615
Total	\$ 1,236,511	\$ 1,247,143	\$ 10,749,394	\$ 10,717,743

Sales of Securities. Sales of securities available for sale were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Proceeds from sales	\$ 7,905,521	\$ 8,247,439	\$ 10,890,388	\$ 8,247,439
Gross realized gains	3	—	3	—
Gross realized losses	(63) (50) (82) (50
Tax (expense) benefit of securities gains/losses	13	18	17	18

Premiums and Discounts. Premium amortization and discount accretion included in interest income on securities was as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Premium amortization	\$(26,689)	\$(24,119)	\$(52,723)	\$(48,147)
Discount accretion	2,010	2,105	3,787	4,495
Net (premium amortization) discount accretion	\$(24,679)	\$(22,014)	\$(48,936)	\$(43,652)

Trading Account Securities. Trading account securities, at estimated fair value, were as follows:

	June 30, 2018	December 31, 2017
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U.S. Treasury	\$20,755	\$ 19,210
States and political subdivisions	579	1,888
Total	\$21,334	\$ 21,098

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net gain on sales transactions	\$434	\$293	\$939	\$604
Net mark-to-market gains (losses)	23	(56)	(13)	(43)
Net gain (loss) on trading account securities	\$457	\$237	\$926	\$561

Note 3 - Loans

Loans were as follows:

	June 30, 2018	Percentage of Total	December 31, 2017	Percentage of Total
Commercial and industrial	\$5,043,272	36.8 %	\$4,792,388	36.4 %
Energy:				
Production	1,211,261	8.8	1,182,326	9.0
Service	163,013	1.2	171,795	1.3
Other	153,754	1.1	144,972	1.1
Total energy	1,528,028	11.1	1,499,093	11.4
Commercial real estate:				
Commercial mortgages	4,097,255	29.9	3,887,742	29.6
Construction	1,106,999	8.1	1,066,696	8.1
Land	305,585	2.2	331,986	2.5
Total commercial real estate	5,509,839	40.2	5,286,424	40.2
Consumer real estate:				
Home equity loans	352,243	2.6	355,342	2.7
Home equity lines of credit	321,795	2.3	291,950	2.2
Other	400,661	3.0	376,002	2.9
Total consumer real estate	1,074,699	7.9	1,023,294	7.8
Total real estate	6,584,538	48.1	6,309,718	48.0
Consumer and other	555,924	4.0	544,466	4.2
Total loans	\$13,711,762	100.0 %	\$13,145,665	100.0 %

Concentrations of Credit. Most of our 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 our loan portfolio consists of commercial and industrial and commercial real estate loans. As of June 30, 2018, there were no concentrations of loans related to any single industry in excess of 10% of total loans other than energy loans, which totaled 11.1% of total loans. Unfunded commitments to extend credit and standby letters of credit issued to customers in the energy industry totaled \$1.1 billion and \$47.6 million, respectively, as of June 30, 2018.

Foreign Loans. We have 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 June 30, 2018 or December 31, 2017.

Related Party Loans. In the ordinary course of business, we have granted loans to certain directors, executive officers and their affiliates (collectively referred to as "related parties"). Such loans totaled \$213.2 million at June 30, 2018 and \$166.4 million at December 31, 2017.

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Non-Accrual and Past Due Loans. Non-accrual loans, segregated by class of loans, were as follows:

	June 30, 2018	December 31, 2017
Commercial and industrial	\$ 17,306	\$ 46,186
Energy	79,963	94,302
Commercial real estate:		
Buildings, land and other	19,415	7,589
Construction	—	—
Consumer real estate	872	2,109
Consumer and other	1,625	128
Total	\$ 119,181	\$ 150,314

As of June 30, 2018, non-accrual loans reported in the table above included \$843 thousand related to loans that were restructured as “troubled debt restructurings” during 2018. See the section captioned “Troubled Debt Restructurings” elsewhere in this note.

Had non-accrual loans performed in accordance with their original contract terms, we would have recognized additional interest income, net of tax, of approximately \$1.4 million and \$2.9 million for the three and six months ended June 30, 2018, compared to \$798 thousand and \$1.6 million for the three and six months ended June 30, 2017. An age analysis of past due loans (including both accruing and non-accruing loans), segregated by class of loans, as of June 30, 2018 was as follows:

	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or More Days Past Due
Commercial and industrial	\$ 19,560	\$ 14,656	\$ 34,216	\$ 5,009,056	\$ 5,043,272	\$ 5,842
Energy	3,775	19,914	23,689	1,504,339	1,528,028	5,878
Commercial real estate:						
Buildings, land and other	14,208	23,300	37,508	4,365,332	4,402,840	9,055
Construction	615	—	615	1,106,384	1,106,999	—
Consumer real estate	6,399	1,959	8,358	1,066,341	1,074,699	1,617
Consumer and other	3,710	608	4,318	551,606	555,924	608
Total	\$ 48,267	\$ 60,437	\$ 108,704	\$ 13,603,058	\$ 13,711,762	\$ 23,000

Impaired Loans. Impaired loans are set forth in the following table. No interest income was recognized on impaired loans subsequent to their classification as impaired.

	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
June 30, 2018					
Commercial and industrial	\$ 23,510	\$ 3,710	\$ 11,671	\$ 15,381	\$ 7,667
Energy	90,744	19,461	60,228	79,689	14,371
Commercial real estate:					
Buildings, land and other	18,382	2,512	15,597	18,109	999
Construction	—	—	—	—	—
Consumer real estate	293	293	—	293	—
Consumer and other	1,625	—	1,625	1,625	1,625
Total	\$ 134,554	\$ 25,976	\$ 89,121	\$ 115,097	\$ 24,662
December 31, 2017					
Commercial and industrial	\$ 60,781	\$ 28,038	\$ 15,722	\$ 43,760	\$ 7,553
Energy	99,606	33,080	61,162	94,242	13,267

Commercial real estate:					
Buildings, land and other	10,795	6,394	—	6,394	—
Construction	—	—	—	—	—
Consumer real estate	1,214	1,214	—	1,214	—
Consumer and other	—	—	—	—	—
Total	\$ 172,396	\$ 68,726	\$ 76,884	\$ 145,610	\$ 20,820

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The average recorded investment in impaired loans was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Commercial and industrial	\$15,307	\$21,347	\$24,791	\$23,867
Energy	92,380	67,008	93,001	63,860
Commercial real estate:				
Buildings, land and other	13,867	5,966	11,376	6,266
Construction	—	—	—	—
Consumer real estate	860	1,376	978	1,135
Consumer and other	813	12	542	18
Total	\$123,227	\$95,709	\$130,688	\$95,146

Troubled Debt Restructurings. Troubled debt restructurings during the six months ended June 30, 2018 and June 30, 2017 are set forth in the following table.

	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	Balance at Restructure	Balance at Period-End	Balance at Restructure	Balance at Period-End
Commercial and industrial	\$2,203	\$ 843	\$784	\$ 643
Energy	13,708	—	12,959	12,458
	\$15,911	\$ 843	\$13,743	\$ 13,101

Loan modifications are typically related to extending amortization periods, converting loans to interest only for a limited period of time, deferral of interest payments, waiver of certain covenants, consolidating notes and/or reducing collateral or interest rates. The modifications during the reported periods did not significantly impact our determination of the allowance for loan losses.

Additional information related to restructured loans was as follows:

	June 30, 2018	June 30, 2017
Restructured loans past due in excess of 90 days at period-end:		
Number of loans	—	—
Dollar amount of loans	\$	—\$ —
Restructured loans on non-accrual status at period end	843	11,405
Charge-offs of restructured loans:		
Recognized in connection with restructuring	—	—
Recognized on previously restructured loans	1,650	9,951
Proceeds from sale of restructured loans	13,350	—

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of our 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.

We utilize a risk grading matrix to assign a risk grade to each of our commercial loans. Loans are graded on a scale of 1 to 14. A description of the general characteristics of the 14 risk grades is set forth in our 2017 Form 10-K. In monitoring credit quality trends in the context of assessing the appropriate level of the allowance for loan losses, we monitor 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 reassess the risk grade on at

least an annual basis. When a loan has a 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 risk grade of 10 or higher, a special assets officer monitors the loan on an on-going basis.

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The following tables present weighted-average risk grades for all commercial loans by class.

	June 30, 2018		December 31, 2017	
	Weighted		Weighted	
	Average	Loans	Average	Loans
	Risk Grade		Risk Grade	
Commercial and industrial:				
Risk grades 1-8	6.10	\$4,737,862	6.06	\$4,378,839
Risk grade 9	9.00	110,377	9.00	170,285
Risk grade 10	10.00	117,623	10.00	99,260
Risk grade 11	11.00	60,104	11.00	97,818
Risk grade 12	12.00	9,639	12.00	38,633
Risk grade 13	13.00	7,667	13.00	7,553
Total	6.33	\$5,043,272	6.41	\$4,792,388
Energy				
Risk grades 1-8	5.98	\$1,288,490	6.01	\$1,199,207
Risk grade 9	9.00	44,181	9.00	50,427
Risk grade 10	10.00	48,115	10.00	64,282
Risk grade 11	11.00	67,279	11.00	90,875
Risk grade 12	12.00	65,591	12.00	81,035
Risk grade 13	13.00	14,372	13.00	13,267
Total	6.74	\$1,528,028	6.97	\$1,499,093
Commercial real estate:				
Buildings, land and other				
Risk grades 1-8	6.77	\$4,071,883	6.75	\$3,868,659
Risk grade 9	9.00	130,689	9.00	151,487
Risk grade 10	10.00	101,505	10.00	129,391
Risk grade 11	11.00	79,348	11.00	62,602
Risk grade 12	12.00	18,416	12.00	7,589
Risk grade 13	13.00	999	13.00	—
Total	7.01	\$4,402,840	7.00	\$4,219,728
Construction				
Risk grades 1-8	7.13	\$1,077,422	7.11	\$1,019,635
Risk grade 9	9.00	10,873	9.00	18,042
Risk grade 10	10.00	17,237	10.00	23,393
Risk grade 11	11.00	1,467	11.00	5,626
Risk grade 12	12.00	—	12.00	—
Risk grade 13	13.00	—	13.00	—
Total	7.20	\$1,106,999	7.23	\$1,066,696

Net (charge-offs)/recoveries, segregated by class of loans, were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Commercial and industrial	\$(3,548)	\$(4,861)	\$(11,223)	\$(7,590)
Energy	(2,076)	(6,236)	(4,925)	(10,461)
Commercial real estate:				
Buildings, land and other	(402)	460	(321)	502
Construction	6	3	8	6

Consumer real estate	(164)	111	(690)	207
Consumer and other	(1,726)	(1,401)	(3,183)	(2,529)
Total	\$(7,910)	\$(11,924)	\$(20,334)	\$(19,865)

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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, the components of which are more fully described in our 2017 Form 10-K, totaled 129.7 at June 30, 2018 and 129.4 at December 31, 2017. 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 inherent 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. Our allowance for loan loss methodology, which is more fully described in our 2017 Form 10-K, 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. 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.

The following table presents details of the allowance for loan losses allocated to each portfolio segment as of June 30, 2018 and December 31, 2017 and detailed on the basis of the impairment evaluation methodology we used:

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
June 30, 2018						
Historical valuation allowances	\$ 25,233	\$12,117	\$ 20,072	\$ 2,555	\$ 6,779	\$66,756
Specific valuation allowances	7,667	14,371	999	—	1,625	24,662
General valuation allowances	9,671	6,807	4,036	1,474	(114)	21,874
Macroeconomic valuation allowances	15,142	4,018	13,811	2,307	1,656	36,934
Total	\$ 57,713	\$37,313	\$ 38,918	\$ 6,336	\$ 9,946	\$150,226
Allocated to loans:						
Individually evaluated	\$ 7,667	\$14,371	\$ 999	\$ —	\$ 1,625	\$24,662
Collectively evaluated	50,046	22,942	37,919	6,336	8,321	125,564
Total	\$ 57,713	\$37,313	\$ 38,918	\$ 6,336	\$ 9,946	\$150,226
December 31, 2017						
Historical valuation allowances	\$ 26,401	\$22,073	\$ 18,931	\$ 2,473	\$ 5,603	\$75,481
Specific valuation allowances	7,553	13,267	—	—	—	20,820
General valuation allowances	9,112	7,964	4,165	2,133	(91)	23,283
Macroeconomic valuation allowances	16,548	8,224	7,852	1,051	2,105	35,780
Total	\$ 59,614	\$51,528	\$ 30,948	\$ 5,657	\$ 7,617	\$155,364
Allocated to loans:						
Individually evaluated	\$ 7,553	\$13,267	\$ —	\$ —	\$ —	\$20,820
Collectively evaluated	52,061	38,261	30,948	5,657	7,617	134,544
Total	\$ 59,614	\$51,528	\$ 30,948	\$ 5,657	\$ 7,617	\$155,364

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Our recorded investment in loans as of June 30, 2018 and December 31, 2017 related to each balance in the allowance for loan losses by portfolio segment and detailed on the basis of the impairment methodology we used was as follows:

	Commercial and Industrial	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
June 30, 2018						
Individually evaluated	\$ 15,381	\$ 79,689	\$ 18,109	\$ 293	\$ 1,625	\$ 115,097
Collectively evaluated	5,027,891	1,448,339	5,491,730	1,074,406	554,299	13,596,665
Total	\$ 5,043,272	\$ 1,528,028	\$ 5,509,839	\$ 1,074,699	\$ 555,924	\$ 13,711,762
December 31, 2017						
Individually evaluated	\$ 43,760	\$ 94,242	\$ 6,394	\$ 1,214	\$ —	\$ 145,610
Collectively evaluated	4,748,628	1,404,851	5,280,030	1,022,080	544,466	13,000,055
Total	\$ 4,792,388	\$ 1,499,093	\$ 5,286,424	\$ 1,023,294	\$ 544,466	\$ 13,145,665

The following table details activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2018 and 2017. 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	Energy	Commercial Real Estate	Consumer Real Estate	Consumer and Other	Total
Three months ended:						
June 30, 2018						
Beginning balance	\$ 57,733	\$ 39,039	\$ 38,474	\$ 6,349	\$ 8,290	\$ 149,885
Provision for loan losses	3,528	350	840	151	3,382	8,251
Charge-offs	(4,153)	(2,689)	(614)	(482)	(3,994)	(11,932)
Recoveries	605	613	218	318	2,268	4,022
Net charge-offs	(3,548)	(2,076)	(396)	(164)	(1,726)	(7,910)
Ending balance	\$ 57,713	\$ 37,313	\$ 38,918	\$ 6,336	\$ 9,946	\$ 150,226
June 30, 2017						
Beginning balance	\$ 45,583	\$ 61,793	\$ 34,009	\$ 4,823	\$ 6,848	\$ 153,056
Provision for loan losses	8,184	(1,280)	(1,470)	601	2,391	8,426
Charge-offs	(5,579)	(6,317)	(14)	(2)	(3,623)	(15,535)
Recoveries	718	81	477	113	2,222	3,611
Net charge-offs	(4,861)	(6,236)	463	111	(1,401)	(11,924)
Ending balance	\$ 48,906	\$ 54,277	\$ 33,002	\$ 5,535	\$ 7,838	\$ 149,558
Six months ended:						
June 30, 2018						
Beginning balance	\$ 59,614	\$ 51,528	\$ 30,948	\$ 5,657	\$ 7,617	\$ 155,364
Provision for loan losses	9,322	(9,290)	8,283	1,369	5,512	15,196
Charge-offs	(13,405)	(5,539)	(619)	(1,201)	(7,966)	(28,730)
Recoveries	2,182	614	306	511	4,783	8,396
Net charge-offs	(11,223)	(4,925)	(313)	(690)	(3,183)	(20,334)
Ending balance	\$ 57,713	\$ 37,313	\$ 38,918	\$ 6,336	\$ 9,946	\$ 150,226
June 30, 2017						
Beginning balance	\$ 52,915	\$ 60,653	\$ 30,213	\$ 4,238	\$ 5,026	\$ 153,045
Provision for loan losses	3,581	4,085	2,281	1,090	5,341	16,378
Charge-offs	(9,106)	(10,595)	(14)	(13)	(7,171)	(26,899)
Recoveries	1,516	134	522	220	4,642	7,034
Net charge-offs	(7,590)	(10,461)	508	207	(2,529)	(19,865)

Ending balance	\$ 48,906	\$54,277	\$ 33,002	\$ 5,535	\$ 7,838	\$149,558
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Note 4 - Goodwill and Other Intangible Assets

Goodwill and other intangible assets are presented in the table below.

	June 30, 2018	December 31, 2017
Goodwill	\$654,952	\$ 654,952
Other intangible assets:		
Core deposits	\$3,466	\$ 4,044
Customer relationships	819	986
Non-compete agreements	31	43
	\$4,316	\$ 5,073

The estimated aggregate future amortization expense for intangible assets remaining as of June 30, 2018 is as follows:

Remainder of 2018	667
2019	1,167
2020	918
2021	697
2022	481
Thereafter	386
	\$4,316

Note 5 - Deposits

Deposits were as follows:

	June 30, 2018	Percentage of Total	December 31, 2017	Percentage of Total
Non-interest-bearing demand deposits:				
Commercial and individual	\$9,976,325	38.4 %	\$10,412,882	38.8 %
Correspondent banks	198,314	0.8	222,648	0.8
Public funds	351,359	1.3	561,563	2.1
Total non-interest-bearing demand deposits	10,525,998	40.5	11,197,093	41.7
Interest-bearing deposits:				
Private accounts:				
Savings and interest checking	6,692,025	25.7	6,788,766	25.2
Money market accounts	7,609,681	29.3	7,624,471	28.4
Time accounts of \$100,000 or more	464,134	1.8	453,668	1.7
Time accounts under \$100,000	324,195	1.2	324,636	1.2
Total private accounts	15,090,035	58.0	15,191,541	56.5
Public funds:				
Savings and interest checking	301,225	1.2	410,140	1.5
Money market accounts	65,002	0.2	59,008	0.2
Time accounts of \$100,000 or more	13,649	0.1	14,301	0.1
Time accounts under \$100,000	590	—	306	—
Total public funds	380,466	1.5	483,755	1.8
Total interest-bearing deposits	15,470,501	59.5	15,675,296	58.3
Total deposits	\$25,996,499	100.0 %	\$26,872,389	100.0 %

The following table presents additional information about our deposits:

	June 30, 2018	December 31, 2017
Deposits from foreign sources (primarily Mexico)	\$ 739,213	\$ 716,339
Deposits not covered by deposit insurance	12,198,682	13,281,040

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Note 6 - Commitments and Contingencies

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we enter into various transactions, which, in accordance with generally accepted accounting principles are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. As more fully discussed in our 2017 Form 10-K, 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. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

Financial instruments with off-balance-sheet risk were as follows:

	June 30, 2018	December 31, 2017
Commitments to extend credit	\$8,081,645	\$7,949,400
Standby letters of credit	240,232	236,595
Deferred standby letter of credit fees	1,741	1,843

Lease Commitments. We lease certain office facilities and office equipment under operating leases. Rent expense for all operating leases totaled \$8.1 million and \$16.3 million during the three and six months ended June 30, 2018 and \$7.5 million and \$15.3 million during the three and six months ended June 30, 2017. There has been no significant change in our expected future minimum lease payments since December 31, 2017. See the 2017 Form 10-K for information regarding these commitments.

Litigation. We 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 our financial statements.

Note 7 - Capital and Regulatory Matters

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.

Cullen/Frost's and Frost Bank's Common Equity Tier 1 capital includes common stock and related paid-in capital, net of treasury stock, and retained earnings. In connection with the adoption of the Basel III Capital Rules, we elected to opt-out of the requirement to include most components of accumulated other comprehensive income in Common Equity Tier 1. Common Equity Tier 1 for both Cullen/Frost and Frost Bank is reduced by, goodwill and other intangible assets, net of associated deferred tax liabilities, and subject to transition provisions. Frost Bank's Common Equity Tier 1 is also reduced by its equity investment in its financial subsidiary, Frost Insurance Agency ("FIA"). Tier 1 capital includes Common Equity Tier 1 capital and additional Tier 1 capital. For Cullen/Frost, additional Tier 1 capital at June 30, 2018 and December 31, 2017 includes \$144.5 million of 5.375% non-cumulative perpetual preferred stock. Frost Bank did not have any additional Tier 1 capital beyond Common Equity Tier 1 at June 30, 2018 or December 31, 2017.

Total capital includes Tier 1 capital and Tier 2 capital. Tier 2 capital for both Cullen/Frost and Frost Bank includes a permissible portion of the allowance for loan losses. Tier 2 capital for Cullen/Frost also includes \$100.0 million of qualified subordinated debt and \$133.0 million of trust preferred securities at both June 30, 2018 and December 31, 2017.

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The following tables present actual and required capital ratios as of June 30, 2018 and December 31, 2017 for Cullen/Frost and Frost Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of June 30, 2018 and December 31, 2017 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules. See the 2017 Form 10-K for a more detailed discussion of the Basel III Capital Rules.

	Actual		Minimum Capital Required - Basel III Phase-In Schedule		Minimum Capital Required - Basel III Fully Phased-In		Required to be Considered Well Capitalized	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
June 30, 2018								
Common Equity Tier 1 to Risk-Weighted Assets								
Cullen/Frost	\$2,581,196	12.69%	\$1,296,280	6.38%	\$1,423,366	7.00%	\$1,321,697	6.50%
Frost Bank	2,621,188	12.92	1,293,055	6.38	1,419,825	7.00	1,318,409	6.50
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,725,682	13.40	1,601,287	7.88	1,728,373	8.50	1,626,704	8.00
Frost Bank	2,621,188	12.92	1,597,304	7.88	1,724,074	8.50	1,622,658	8.00
Total Capital to Risk-Weighted Assets								
Cullen/Frost	3,109,408	15.29	2,007,963	9.88	2,135,049	10.50	2,033,380	10.00
Frost Bank	2,771,914	13.67	2,002,968	9.88	2,129,738	10.50	2,028,322	10.00
Leverage Ratio								
Cullen/Frost	2,725,682	9.02	1,208,770	4.00	1,208,770	4.00	1,510,963	5.00
Frost Bank	2,621,188	8.68	1,207,880	4.00	1,207,880	4.00	1,509,851	5.00
December 31, 2017								
Common Equity Tier 1 to Risk-Weighted Assets								
Cullen/Frost	\$2,426,048	12.42%	\$1,123,430	5.75%	\$1,367,583	7.00%	\$1,269,965	6.50%
Frost Bank	2,518,999	12.92	1,120,663	5.75	1,364,214	7.00	1,266,836	6.50
Tier 1 Capital to Risk-Weighted Assets								
Cullen/Frost	2,570,534	13.16	1,416,499	7.25	1,660,637	8.50	1,563,033	8.00
Frost Bank	2,518,999	12.92	1,413,010	7.25	1,656,546	8.50	1,559,183	8.00
Total Capital to Risk-Weighted Assets								
Cullen/Frost	2,959,326	15.15	1,807,257	9.25	2,051,375	10.50	1,953,792	10.00
Frost Bank	2,674,791	13.72	1,802,805	9.25	2,046,321	10.50	1,948,979	10.00
Leverage Ratio								
Cullen/Frost	2,570,534	8.46	1,215,227	4.00	1,215,186	4.00	1,519,034	5.00
Frost Bank	2,518,999	8.30	1,214,295	4.00	1,214,254	4.00	1,517,869	5.00

As of June 30, 2018, capital levels at Cullen/Frost and Frost Bank exceed all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis. Based on the ratios presented above, capital levels as of June 30, 2018 at Cullen/Frost and Frost Bank exceed the minimum levels necessary to be considered "well capitalized."

Cullen/Frost and Frost Bank are subject to the regulatory capital requirements administered by the Federal Reserve Board 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 our financial statements. Management believes, as of June 30, 2018, that Cullen/Frost and Frost Bank meet all capital adequacy requirements to which they are subject.

Stock Repurchase Plans. From time to time, our board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow us to proactively manage our capital position and return excess capital to shareholders. Shares purchased under such plans also provide us with shares of common stock necessary to satisfy obligations related to stock compensation awards. On October 24, 2017, our board of directors authorized a \$150.0 million stock repurchase program, allowing us to

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repurchase shares of our common stock over a two-year period from time to time at various prices in the open market or through private transactions. No shares were repurchased under this plan during 2018 or 2017. Under a prior plan, we repurchased 1,134,966 shares under the plan at a total cost of \$100.0 million during the third quarter of 2017.

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 June 30, 2018, Frost Bank could pay aggregate dividends of up to \$507.2 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 we have elected to defer interest on the debentures, we may not, with certain exceptions, declare or pay any dividends or distributions on our capital stock or purchase or acquire any of our capital stock.

Under the terms of our Series A Preferred Stock, in the event that we do not declare and pay dividends on our Series A Preferred Stock for the most recent dividend period, we may not, with certain exceptions, declare or pay dividends on, or purchase, redeem or otherwise acquire, shares of our common stock or any of our securities that rank junior to our Series A Preferred Stock.

Note 8 - 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. We utilize interest rate swaps, caps and floors to mitigate exposure to interest rate risk and to facilitate the needs of our customers. Our objectives for utilizing these derivative instruments are described in our 2017 Form 10-K.

The notional amounts and estimated fair values of interest rate derivative contracts are presented in the following table. The fair values of interest rate derivative contracts are estimated utilizing internal valuation models with observable market data inputs, or as determined by the Chicago Mercantile Exchange (“CME”) for centrally cleared derivative contracts. CME rules legally characterize variation margin payments for centrally cleared derivatives as settlements of the derivatives' exposure rather than collateral. As a result, the variation margin payment and the related derivative instruments are considered a single unit of account for accounting and financial reporting purposes.

Variation margin, as determined by the CME, is settled daily. As a result, derivative contracts that clear through the CME have an estimated fair value of zero as of June 30, 2018 and December 31, 2017.

	June 30, 2018		December 31, 2017	
	Notional	Estimated	Notional	Estimated
	Amount	Fair Value	Amount	Fair Value
Derivatives designated as hedges of fair value:				
Financial institution counterparties:				
Loan/lease interest rate swaps – assets	\$11,596	\$ 310	\$13,679	\$ 242
Loan/lease interest rate swaps – liabilities	4,561	(247)	11,147	(593)
Non-hedging interest rate derivatives:				
Financial institution counterparties:				
Loan/lease interest rate swaps – assets	706,088	4,832	430,449	1,418
Loan/lease interest rate swaps – liabilities	380,596	(6,307)	541,496	(12,820)
Loan/lease interest rate caps – assets	97,120	851	114,619	480
Customer counterparties:				

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Loan/lease interest rate swaps – assets	380,596	9,472	541,496	17,882
Loan/lease interest rate swaps – liabilities	706,088	(16,806)	430,449	(4,861)
Loan/lease interest rate caps – liabilities	97,120	(851)	114,619	(480)

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The weighted-average rates paid and received for interest rate swaps outstanding at June 30, 2018 were as follows:

	Weighted-Average	
	Interest	Interest
	Rate	Rate
	Paid	Received
Interest rate swaps:		
Fair value hedge loan/lease interest rate swaps	2.49 %	2.05 %
Non-hedging interest rate swaps – financial institution counterparties	4.09 %	3.67 %
Non-hedging interest rate swaps – customer counterparties	3.67 %	4.09 %

The weighted-average strike rate for outstanding interest rate caps was 3.01% at June 30, 2018.

Commodity Derivatives. We enter into commodity swaps and option contracts that are not designated as hedging instruments primarily to accommodate the business needs of our customers. Upon the origination of a commodity swap or option contract with a customer, we simultaneously enter 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. We obtain dealer quotations and use internal valuation models with observable market data inputs to value our commodity derivative positions.

	June 30, 2018		December 31, 2017	
	Notional	Notional	Notional	Notional
	Units	Amount	Amount	Amount
		Estimated	Estimated	Estimated
		Fair Value	Fair Value	Fair Value
Financial institution counterparties:				
Oil – assets	Barrels	585 \$ 1,520	253 \$ 193	
Oil – liabilities	Barrels	2,761 (30,963)	2,731 (13,448)	
Natural gas – assets	MMBTUs	6,080 548	5,927 1,399	
Natural gas – liabilities	MMBTUs	5,600 (612)	3,917 (326)	
Customer counterparties:				
Oil – assets	Barrels	2,761 30,952	2,731 13,709	
Oil – liabilities	Barrels	585 (1,518)	253 (187)	
Natural gas – assets	MMBTUs	5,697 623	3,917 340	
Natural gas – liabilities	MMBTUs	5,983 (538)	5,927 (1,366)	

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

	June 30, 2018		December 31, 2017	
	Notional	Notional	Notional	Notional
	Currency	Amount	Amount	Amount
		Estimated	Estimated	Estimated
		Fair Value	Fair Value	Fair Value
Financial institution counterparties:				
Forward contracts – assets	EUR	591 \$ 6	4,014 \$ 77	
Forward contracts – assets	GBP	— —	127 1	
Forward contracts – assets	AUD	57 1	— —	
Forward contracts – liabilities	EUR	906 (5)	4,846 (37)	
Forward contracts – liabilities	CAD	22,626 (208)	25,413 (142)	
Forward contracts – liabilities	GBP	1,095 (3)	1,178 (9)	

Customer counterparties:

Forward contracts – assets	EUR	400	1	3,867	58
Forward contracts – assets	CAD	22,575	262	25,282	279
Forward contracts – liabilities	EUR	—	—	4,041	(51)
Forward contracts – liabilities	GBP	—	—	127	—

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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/leases designated as hedging instruments in effective hedges of fair value are included in interest income on loans. 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 June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
Commercial loan/lease interest rate swaps:				
Amount of gain (loss) included in interest income on loans	\$31	\$(198)	\$(11)	\$(443)
Amount of (gain) loss included in other non-interest expense	(1)	(2)	(1)	(3)

As stated above, we enter into non-hedge related derivative positions primarily to accommodate the business needs of our customers. Upon the origination of a derivative contract with a customer, we simultaneously enter into an offsetting derivative contract with a third party financial institution. We recognize immediate income based upon the difference in the bid/ask spread of the underlying transactions with our customers and the third party. Because we act only as an intermediary for our customer, subsequent changes in the fair value of the underlying derivative contracts for the most part offset each other and do not significantly impact our results of operations.

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 June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
Non-hedging interest rate derivatives:				
Other non-interest income	\$702	\$607	\$2,190	\$977
Other non-interest expense	17	2	(4)	1
Non-hedging commodity derivatives:				
Other non-interest income	(54)	104	36	156
Non-hedging foreign currency derivatives:				
Other non-interest income	91	9	150	18

Counterparty Credit Risk. Our credit exposure relating to interest rate swaps, commodity swaps/options and foreign currency forward contracts with bank customers was approximately \$38.9 million at June 30, 2018. This credit exposure is partly mitigated as transactions with customers are generally secured by the collateral, if any, securing the underlying transaction being hedged. Our 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 \$747 thousand at June 30, 2018. This amount was primarily related to excess collateral we posted to counterparties. Collateral levels for upstream financial institution counterparties are monitored and adjusted as necessary. See Note 9 – Balance Sheet Offsetting and Repurchase Agreements for additional information regarding our credit exposure with upstream financial institution counterparties.

The aggregate fair value of securities we posted as collateral related to derivative contracts totaled \$6.2 million at June 30, 2018. At such date, we also had \$25.7 million in cash collateral on deposit with other financial institution counterparties.

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Note 9 - Balance Sheet Offsetting and Repurchase Agreements

Balance Sheet Offsetting. Certain financial instruments, including resell and repurchase agreements and derivatives, may be eligible for offset in the consolidated balance sheet and/or subject to master netting arrangements or similar agreements. Our 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, we do 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 June 30, 2018 is presented in the following tables.

	Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
June 30, 2018			
Financial assets:			
Derivatives:			
Loan/lease interest rate swaps and caps	\$ 5,993	\$	—\$ 5,993
Commodity swaps and options	2,068	—	2,068
Foreign currency forward contracts	7	—	7
Total derivatives	8,068	—	8,068
Resell agreements	9,642	—	9,642
Total	\$ 17,710	\$	—\$ 17,710
Financial liabilities:			
Derivatives:			
Loan/lease interest rate swaps	\$ 6,554	\$	—\$ 6,554
Commodity swaps and options	31,575	—	31,575
Foreign currency forward contracts	216	—	216
Total derivatives	38,345	—	38,345
Repurchase agreements	968,420	—	968,420
Total	\$ 1,006,765	\$	—\$ 1,006,765
		Gross Amounts Not Offset	
	Net Amount Recognized	Financial Instruments	Collateral Net Amount
June 30, 2018			
Financial assets:			
Derivatives:			
Counterparty A	\$ 1,234	\$(1,234)	\$—
Counterparty B	2,211	(2,211)	—
Counterparty C	77	(77)	—
Other counterparties	4,546	(1,448)	(2,873) 225
Total derivatives	8,068	(4,970)	(2,873) 225
Resell agreements	9,642	—	(9,642) —
Total	\$ 17,710	\$(4,970)	\$(12,515) \$ 225
Financial liabilities:			
Derivatives:			
Counterparty A	\$ 4,660	\$(1,234)	\$(3,426) \$—
Counterparty B	5,333	(2,211)	(2,358) 764
Counterparty C	1,195	(77)	(1,040) 78
Other counterparties	27,157	(1,448)	(24,532) 1,177

Total derivatives	38,345	(4,970)	(31,356)	2,019
Repurchase agreements	968,420	—	(968,420)	—
Total	\$ 1,006,765	\$(4,970)	\$(999,776)	\$ 2,019

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Information about financial instruments that are eligible for offset in the consolidated balance sheet as of December 31, 2017 is presented in the following tables.

	Gross Amount Recognized	Gross Amount Offset	Net Amount Recognized
December 31, 2017			
Financial assets:			
Derivatives:			
Loan/lease interest rate swaps and caps	\$ 2,140	\$	—\$ 2,140
Commodity swaps and options	1,592	—	1,592
Foreign currency forward contracts	78	—	78
Total derivatives	3,810	—	3,810
Resell agreements	9,642	—	9,642
Total	\$ 13,452	\$	—\$ 13,452
Financial liabilities:			
Derivatives:			
Loan/lease interest rate swaps	\$ 13,413	\$	—\$ 13,413
Commodity swaps and options	13,774	—	13,774
Foreign currency forward contracts	188	—	188
Total derivatives	27,375	—	27,375
Repurchase agreements	1,117,199	—	1,117,199
Total	\$ 1,144,574	\$	—\$ 1,144,574

	Net Amount Recognized	Gross Amounts Not Offset	Financial Instruments	Collateral	Net Amount
December 31, 2017					
Financial assets:					
Derivatives:					
Counterparty A	\$ 395	\$(395)	\$—		\$—
Counterparty B	1,028	(1,028)	—		—
Counterparty C	55	(55)	—		—
Other counterparties	2,332	(1,830)	(387)		115
Total derivatives	3,810	(3,308)	(387)		115
Resell agreements	9,642	—	(9,642)		—
Total	\$ 13,452	\$(3,308)	\$(10,029)		\$ 115
Financial liabilities:					
Derivatives:					
Counterparty A	\$ 7,397	\$(395)	\$(7,002)		\$—
Counterparty B	4,466	(1,028)	(3,101)		337
Counterparty C	1,520	(55)	(1,450)		15
Other counterparties	13,992	(1,830)	(11,215)		947
Total derivatives	27,375	(3,308)	(22,768)		1,299
Repurchase agreements	1,117,199	—	(1,117,199)		—
Total	\$ 1,144,574	\$(3,308)	\$(1,139,967)		\$ 1,299

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Repurchase Agreements. We utilize securities sold under agreements to repurchase to facilitate the needs of our customers and to facilitate secured short-term funding needs. Securities sold under agreements to repurchase are stated at the amount of cash received in connection with the transaction. We monitor collateral levels on a continuous basis. We may be required to provide additional collateral based on the fair value of the underlying securities. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

The remaining contractual maturity of repurchase agreements in the consolidated balance sheets as of June 30, 2018 and December 31, 2017 is presented in the following tables.

	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 Days	30-90 Days	Greater than 90 Days	Total
June 30, 2018					
Repurchase agreements:					
U.S. Treasury	\$956,963	\$ —	\$ —	\$ —	—\$956,963
Residential mortgage-backed securities	11,457	—	—	—	11,457
Total borrowings	\$968,420	\$ —	\$ —	\$ —	—\$968,420
Gross amount of recognized liabilities for repurchase agreements					\$968,420
Amounts related to agreements not included in offsetting disclosures above					\$—

December 31, 2017

Repurchase agreements:					
U.S. Treasury	\$1,036,891	\$ —	\$ —	\$ —	—\$1,036,891
Residential mortgage-backed securities	80,308	—	—	—	80,308
Total borrowings	\$1,117,199	\$ —	\$ —	\$ —	—\$1,117,199
Gross amount of recognized liabilities for repurchase agreements					\$1,117,199
Amounts related to agreements not included in offsetting disclosures above					\$—

Note 10 - Stock-Based Compensation

A combined summary of activity in our active stock plans is presented in the table. Performance stock units outstanding are presented assuming attainment of the maximum payout rate as set forth by the performance criteria. As of June 30, 2018, there were 1,409,473 shares remaining available for grant for future stock-based compensation awards.

	Director Deferred Stock Units Outstanding		Non-Vested Stock Awards/Stock Units Outstanding		Performance Stock Units Outstanding		Stock Options Outstanding	
	Number of Units	Weighted-Average Fair Value at Grant	Number of Shares/Units	Weighted-Average Fair Value at Grant	Number of Units	Weighted-Average Fair Value at Grant	Number of Shares	Weighted-Average Exercise Price
Balance, January 1, 2018	53,008	\$ 64.87	312,656	\$ 81.71	80,103	\$ 79.91	2,917,142	\$ 63.34
Authorized	—	—	—	—	—	—	—	—
Granted	6,576	109.58	—	—	—	—	—	—
Exercised/vested	(10,674)	63.68	(2,470)	78.92	—	—	(415,455)	61.25
Forfeited/expired	—	—	(4,424)	87.24	—	—	(43,875)	70.19
Balance, June 30, 2018	48,910	\$ 71.14	305,762	\$ 81.65	80,103	\$ 79.91	2,457,812	\$ 63.57

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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		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
New shares issued from available authorized shares	—	310,021	—	593,363
Issued from available treasury stock	110,489	—	428,599	158,712
Total	110,489	310,021	428,599	752,075

Proceeds from stock option exercises \$6,283 \$19,402 \$25,448 \$44,149

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. For most stock option awards, the service period generally matches the vesting period. For stock options granted to certain executive officers and for non-vested stock units granted to all participants, the service period does not extend past the date the participant reaches 65 years of age. Deferred stock units granted to non-employee directors generally have immediate vesting and the related expense is fully recognized on the date of grant. For performance stock units, the service period generally matches the three-year performance period specified by the award, however, the service period does not extend past the date the participant reaches 65 years of age. Expense recognized each period is dependent upon our estimate of the number of shares that will ultimately be issued.

Stock-based compensation expense and the related income tax benefit is presented in the following table.

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Stock options	\$1,019	\$1,573	\$2,104	\$3,360
Non-vested stock awards/stock units	1,371	901	2,839	1,934
Director deferred stock units	720	519	720	519
Performance stock units	475	195	1,097	478
Total	\$3,585	\$3,188	\$6,760	\$6,291
Income tax benefit	\$753	\$1,116	\$1,420	\$2,202

Unrecognized stock-based compensation expense at June 30, 2018 is presented in the table below. Unrecognized stock-based compensation expense related to performance stock units is presented assuming attainment of the maximum payout rate as set forth by the performance criteria.

Stock options	\$2,943
Non-vested stock awards/stock units	11,728
Performance stock units	4,033
Total	\$18,704

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Note 11 - Earnings Per Common Share

Earnings per common share is computed using the two-class method as more fully described in our 2017 Form 10-K. 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		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	\$ 111,341	\$ 85,553	\$ 217,821	\$ 170,494
Less: Preferred stock dividends	2,015	2,015	4,031	4,031
Net income available to common shareholders	109,326	83,538	213,790	166,463
Less: Earnings allocated to participating securities	726	436	1,431	871
Net earnings allocated to common stock	\$ 108,600	\$ 83,102	\$ 212,359	\$ 165,592
Distributed earnings allocated to common stock	\$ 42,791	\$ 36,545	\$ 79,096	\$ 71,020
Undistributed earnings allocated to common stock	65,809	46,557	133,263	94,572
Net earnings allocated to common stock	\$ 108,600	\$ 83,102	\$ 212,359	\$ 165,592
Weighted-average shares outstanding for basic earnings per common share	63,836,651	64,061,264	63,743,442	63,900,620
Dilutive effect of stock compensation	1,062,637	974,067	1,043,712	988,198
Weighted-average shares outstanding for diluted earnings per common share	64,899,288	65,035,331	64,787,154	64,888,818

Note 12 - Defined Benefit Plans

The components of the combined net periodic expense (benefit) for our defined benefit pension plans are presented in the table below.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Expected return on plan assets, net of expenses	\$(2,979)	\$(2,780)	\$(5,958)	\$(5,559)
Interest cost on projected benefit obligation	1,474	1,548	2,949	3,095
Net amortization and deferral	1,251	1,358	2,501	2,715
Net periodic expense (benefit)	\$(254)	\$ 126	\$(508)	\$ 251

Our non-qualified defined benefit pension plan is not funded. No contributions to the qualified defined benefit pension plan were made during the six months ended June 30, 2018. We do not expect to make any contributions to the qualified defined benefit plan during the remainder of 2018.

Note 13 - Income Taxes

Income tax expense was as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Current income tax expense	\$ 1,361	\$ 13,710	\$ 2,107	\$ 29,412
Deferred income tax expense (benefit)	12,475	128	22,886	(4,173)
Income tax expense, as reported	\$ 13,836	\$ 13,838	\$ 24,993	\$ 25,239
Effective tax rate	11.1	% 13.9	% 10.3	% 12.9

Net deferred tax assets totaled \$49.7 million at June 30, 2018 and \$31.7 million at December 31, 2017. No valuation allowance for deferred tax assets was recorded at June 30, 2018 as management believes it is more likely than not that all of the deferred tax assets will be realized against deferred tax liabilities and projected future taxable income.

The effective income tax rates differed from the U.S. statutory federal income tax rates of 21% during 2018 and 35% during 2017 primarily due to the effect of tax-exempt income from loans, securities and life insurance policies and the income tax effects

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associated with stock-based compensation. 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.

We file income tax returns in the U.S. federal jurisdiction. We are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2014.

Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act was enacted on December 22, 2017 as more fully discussed in the 2017 Form 10-K. Among other things, the new law established a new, flat corporate federal statutory income tax rate of 21%. As a result, we remeasured our deferred tax assets and liabilities based on the new tax rate and recognized a provisional net tax benefit related to the remeasurement totaling \$4.0 million. Notwithstanding the foregoing, we are still analyzing certain aspects of the new law and refining our calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. Nonetheless, there has been no change to the provisional net tax benefit we recorded during the fourth quarter of 2017.

Note 14 - 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. Reclassification adjustments related to defined-benefit post-retirement benefit plans are included in the computation of net periodic pension expense (see Note 12 – Defined Benefit Plans).

	Three Months Ended June 30, 2018			Three Months Ended June 30, 2017		
	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount
Securities available for sale and transferred securities:						
Change in net unrealized gain/loss during the period	\$(11,884)	\$(2,496)	\$(9,388)	\$90,390	\$31,636	\$58,754
Change in net unrealized gain on securities transferred to held to maturity	(2,041)	(429)	(1,612)	(3,860)	(1,351)	(2,509)
Reclassification adjustment for net (gains) losses included in net income	60	13	47	50	18	32
Total securities available for sale and transferred securities	(13,865)	(2,912)	(10,953)	86,580	30,303	56,277
Defined-benefit post-retirement benefit plans:						
Change in the net actuarial gain/loss	—	—	—	—	—	—
Reclassification adjustment for net amortization of actuarial gain/loss included in net income as a component of net periodic cost (benefit)	1,251	263	988	1,358	475	883
Total defined-benefit post-retirement benefit plans	1,251	263	988	1,358	475	883
Total other comprehensive income (loss)	\$(12,614)	\$(2,649)	\$(9,965)	\$87,938	\$30,778	\$57,160

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	Six Months Ended June 30, 2018			Six Months Ended June 30, 2017		
	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount	Before Tax Amount	Tax Expense, (Benefit)	Net of Tax Amount
Securities available for sale and transferred securities:						
Change in net unrealized gain/loss during the period	\$(190,788)	\$(40,066)	\$(150,722)	\$124,201	\$43,470	\$80,731
Change in net unrealized gain on securities transferred to held to maturity	(4,660)	(979)	(3,681)	(10,146)	(3,551)	(6,595)
Reclassification adjustment for net (gains) losses included in net income	79	17	62	50	18	32
Total securities available for sale and transferred securities	(195,369)	(41,028)	(154,341)	114,105	39,937	74,168
Defined-benefit post-retirement benefit plans:						
Change in the net actuarial gain/loss	—	—	—	—	—	—
Reclassification adjustment for net amortization of actuarial gain/loss included in net income as a component of net periodic cost (benefit)	2,501	526	1,975	2,715	950	1,765
Total defined-benefit post-retirement benefit plans	2,501	526	1,975	2,715	950	1,765
Total other comprehensive income (loss)	\$(192,868)	\$(40,502)	\$(152,366)	\$116,820	\$40,887	\$75,933
Activity in accumulated other comprehensive income (loss), net of tax, was as follows:						
				Securities Available For Sale	Defined Benefit Plans	Accumulated Other Comprehensive Income
Balance January 1, 2018				\$117,230	\$(37,718)	\$79,512
Other comprehensive income (loss) before reclassifications				(154,403)	—	(154,403)
Reclassification of amounts included in net income				62	1,975	2,037
Net other comprehensive income (loss) during period				(154,341)	1,975	(152,366)
Reclassification of certain income tax effects related to the change in the U.S. statutory federal income tax rate under the Tax Cuts and Jobs Act to retained earnings				17,557	(8,022)	9,535
Balance at June 30, 2018				\$(19,554)	\$(43,765)	\$(63,319)
Balance January 1, 2017				\$16,153	\$(40,776)	\$(24,623)
Other comprehensive income (loss) before reclassifications				74,136	—	74,136
Reclassification of amounts included in net income				32	1,765	1,797
Net other comprehensive income (loss) during period				74,168	1,765	75,933
Balance at June 30, 2017				\$90,321	\$(39,011)	\$51,310

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Note 15 – Operating Segments

We are managed under a matrix organizational structure whereby our two primary operating segments, Banking and Frost Wealth Advisors, overlap a regional reporting structure. See our 2017 Form 10-K for additional information regarding our operating segments. Summarized operating results by segment were as follows:

	Banking	Frost Wealth Advisors	Non-Banks	Consolidated
Revenues from (expenses to) external customers:				
Three months ended:				
June 30, 2018	\$290,433	\$34,526	\$ (2,623)	\$ 322,336
June 30, 2017	261,250	36,712	(2,094)	295,868
Six months ended:				
June 30, 2018	\$578,994	\$69,607	\$ (5,072)	\$ 643,529
June 30, 2017	520,161	71,300	(3,384)	588,077
Net income (loss):				
Three months ended:				
June 30, 2018	\$109,276	\$5,901	\$ (3,836)	\$ 111,341
June 30, 2017	81,529	6,279	(2,255)	85,553
Six months ended:				
June 30, 2018	\$212,917	\$11,535	\$ (6,631)	\$ 217,821
June 30, 2017	162,398	11,573	(3,477)	170,494

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Note 16 – 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, we utilize 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 three-level 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. See our 2017 Form 10-K for additional information regarding the fair value hierarchy and a description of our valuation techniques.

Financial Assets and Financial Liabilities. The table below summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017, segregated by the level of the valuation inputs within the fair value hierarchy of ASC Topic 820 utilized to measure fair value.

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
June 30, 2018				
Securities available for sale:				
U.S. Treasury	\$3,410,081	\$ —	—	—\$3,410,081
Residential mortgage-backed securities	—	631,658	—	631,658
States and political subdivisions	—	6,633,389	—	6,633,389
Other	—	42,615	—	42,615
Trading account securities:				
U.S. Treasury	20,755	—	—	20,755
States and political subdivisions	—	579	—	579
Derivative assets:				
Interest rate swaps, caps and floors	—	15,465	—	15,465
Commodity swaps and options	—	31,638	2,005	33,643
Foreign currency forward contracts	270	—	—	270
Derivative liabilities:				
Interest rate swaps, caps and floors	—	24,211	—	24,211
Commodity swaps and options	—	33,631	—	33,631
Foreign currency forward contracts	216	—	—	216
December 31, 2017				
Securities available for sale:				
U.S. Treasury	\$3,445,153	\$ —	—	—\$3,445,153
Residential mortgage-backed securities	—	665,086	—	665,086
States and political subdivisions	—	6,336,209	—	6,336,209
Other	—	42,561	—	42,561
Trading account securities:				
U.S. Treasury	19,210	—	—	19,210
States and political subdivisions	—	1,888	—	1,888
Derivative assets:				
Interest rate swaps, caps and floors	—	20,022	—	20,022
Commodity swaps and options	—	14,408	1,233	15,641
Foreign currency forward contracts	415	—	—	415
Derivative liabilities:				
Interest rate swaps, caps and floors	—	18,754	—	18,754
Commodity swaps and options	—	15,327	—	15,327
Foreign currency forward contracts	239	—	—	239

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Derivative assets, measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the reported periods consist of commodity swaps sold to loan customers. The significant unobservable (Level 3) inputs used in the fair value measurement of these commodity 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 3 - Loans) underlying the commodity 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 commodity 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. The weighted-average risk grade of loans underlying commodity swaps measured at fair value using significant unobservable (Level 3) inputs was 12.0 for both periods ended June 30, 2018 and December 31, 2017. The weighted-average loss severity in the event of default on the commodity swaps was 19.7% and 15.4% for the periods ended June 30, 2018 and December 31, 2017 respectively. 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. 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.

	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017
	Level 2	Level 3	Level 2 Level 3
Carrying value of impaired loans before allocations	\$14,359	\$52,048	\$21,686
Specific valuation allowance (allocations) reversals of prior allocations	(799)	(1,149)	(561)
Fair value	\$13,560	\$50,899	\$21,125

Non-Financial Assets and Non-Financial Liabilities. We do not have any non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Non-financial assets measured at fair value on a non-recurring basis during the 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 following table presents foreclosed assets that were remeasured and reported at fair value during the reported periods:

	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017
Foreclosed assets remeasured at initial recognition:			
Carrying value of foreclosed assets prior to remeasurement	\$2,656	\$—	
Charge-offs recognized in the allowance for loan losses	—	—	
Fair value	\$2,656	\$—	
Foreclosed assets remeasured subsequent to initial recognition:			
Carrying value of foreclosed assets prior to remeasurement	\$1,823	\$89	
Write-downs included in other non-interest expense	(473)	(16)	
Fair value	\$1,350	\$73	

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Financial Instruments Reported at Amortized Cost. The estimated fair values of financial instruments that are reported at amortized cost in our consolidated balance sheets, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value, were as follows:

	June 30, 2018		December 31, 2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Level 2 inputs:				
Cash and cash equivalents	\$3,315,470	\$3,315,470	\$5,053,047	\$5,053,047
Securities held to maturity	1,236,511	1,247,143	1,432,098	1,455,791
Cash surrender value of life insurance policies	181,756	181,756	180,477	180,477
Accrued interest receivable	173,394	173,394	167,508	167,508
Level 3 inputs:				
Loans, net	13,561,536	13,515,854	12,990,301	12,981,165
Financial liabilities:				
Level 2 inputs:				
Deposits	25,996,499	25,989,689	26,872,389	26,866,676
Federal funds purchased and repurchase agreements	977,470	977,470	1,147,824	1,147,824
Junior subordinated deferrable interest debentures	136,213	137,115	136,184	137,115
Subordinated notes payable and other borrowings	98,630	100,250	98,552	105,311
Accrued interest payable	5,655	5,655	3,358	3,358

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, we had no financial instruments measured at fair value under the fair value measurement option.

Note 17 - Accounting Standards Updates

Information about certain recently issued accounting standards updates is presented below. Also refer to Note 20 - Accounting Standards Updates in our 2017 Form 10-K for additional information related to previously issued accounting standards updates.

Accounting Standards Update (“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. We adopted ASU 2014-09 effective January 1, 2018. See Note 1 - Significant Accounting Policies for additional information.

ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-02 will be effective for us on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Notwithstanding the foregoing, in January 2018, the Financial Accounting Standards Board issued a proposal to provide an additional transition method

that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We are currently implementing a third-party vendor solution to assist us in the application of ASU 2016-02. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-02 until such time as we have implemented the solution, the adoption will result in an increase in right-of-use assets and lease liabilities recorded on our balance sheet.

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ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective on January 1, 2020. We are currently evaluating the potential impact of ASU 2016-13 on our financial statements. In that regard, we have formed a cross-functional working group, under the direction of our Chief Financial Officer and our Chief Risk Officer. The working group is comprised of individuals from various functional areas including credit, risk management, finance and information technology, among others. We are currently developing an implementation plan to include assessment of processes, portfolio segmentation, model development, system requirements and the identification of data and resource needs, among other things. We are also in the process of implementing a third-party vendor solution to assist us in the application of the ASU 2016-13. The adoption of the ASU 2016-13 could result in an increase in the allowance for loan losses as a result of changing from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. Furthermore, ASU 2016-13 will necessitate that we establish an allowance for expected credit losses for certain debt securities and other financial assets. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date.

ASU 2017-08, "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective for us on January 1, 2019, with early adoption permitted. While we are currently evaluating the potential impact of ASU 2017-08 on our financial statements, we expect that the impact of adoption will be significantly influenced by the composition of our securities portfolio as of the adoption date.

ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220) - Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." Under ASU 2018-02, entities may elect to reclassify certain income tax effects related to the change in the U.S. statutory federal income tax rate under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017, from accumulated other comprehensive income to retained earnings. ASU 2018-02 also requires certain accounting policy disclosures. We elected to adopt the provisions of ASU 2018-02 as of January 1, 2018 in advance of the required application date of January 1, 2019. See Note 1 - Significant Accounting Policies.