

FIRST FINANCIAL BANKSHARES INC
Form 10-K
February 19, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2015

Commission file number 0-7674

First Financial Bankshares, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Texas
(State or Other Jurisdiction of
Incorporation or Organization)

75-0944023
(I.R.S. Employer
Identification No.)

400 Pine Street, Abilene, Texas
(Address of Principal Executive Offices)

79601
(Zip Code)

Registrant's telephone number, including area code: (325) 627-7155

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common Stock, par value \$0.01 per share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

As of June 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's voting and non-voting common stock held by non-affiliates was \$2.12 billion.

As of February 19, 2016, there were 66,024,479 shares of common stock outstanding.

Documents Incorporated by Reference

Certain information called for by Part III is incorporated by reference to the proxy statement for our 2016 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2015.

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**CAUTIONARY STATEMENT REGARDING
FORWARD-LOOKING STATEMENTS**

This Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. When used in this Form 10-K, words such as anticipate, believe, estimate, expect, intend, predict, project, and similar expressions, as they relate to us or our management, identify forward-looking statements. These forward-looking statements are based on information currently available to our management. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including, but not limited, to those listed in Item 1A-Risk Factors and the following:

general economic conditions, including our local, state and national real estate markets and employment trends;

volatility and disruption in national and international financial markets;

government intervention in the U.S. financial system, including the effects of recent legislative, tax, accounting and regulatory actions and reforms, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Jumpstart Our Business Startups Act, the Consumer Financial Protection Bureau and the capital ratios of Basel III as adopted by the federal banking authorities;

political instability;

the ability of the Federal government to address the national economy and the fiscal cliff;

competition from other financial institutions and financial holding companies;

the effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System (the Federal Reserve Board);

changes in the demand for loans;

fluctuations in the value of collateral securing our loan portfolio and in the level of the allowance for loan losses;

the accuracy of our estimates of inherent loan losses;

the accuracy of our estimates and assumptions regarding the performance of our securities portfolio;

soundness of other financial institutions with which we have transactions;

inflation, interest rate, market and monetary fluctuations;

changes in consumer spending, borrowing and savings habits;

changes in commodity prices (e.g., oil and gas, cattle, and wind energy);

our ability to attract deposits;

changes in our liquidity position;

changes in the reliability of our vendors, internal control system or information systems;

cyber attacks on our technology information systems;

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our ability to attract and retain qualified employees;

acquisitions and integration of acquired businesses;

the possible impairment of goodwill associated with our acquisitions;

consequences of continued bank mergers and acquisitions in our market area, resulting in fewer but much larger and stronger competitors;

expansion of operations, including branch openings, new product offerings and expansion into new markets;

changes in our compensation and benefit plans; and

acts of God or of war or terrorism.

Such forward-looking statements reflect the current views of our management with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this paragraph. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise (except as required by law).

PART I

ITEM 1. BUSINESS

General

First Financial Bankshares, Inc., a Texas corporation (the Company), is a financial holding company registered under the Bank Holding Company Act of 1956, as amended, or BHCA. As such, we are supervised by the Federal Reserve Board, as well as several other bank regulators. We were formed as a bank holding company in 1956 under the original name F & M Operating Company, but our banking operations date back to 1890, when Farmers and Merchants National Bank opened for business in Abilene, Texas. In addition, on May 31, 2013, we acquired Orange Savings Bank, SSB and merged Orange Savings Bank, SSB with and into First Financial Bank, National Association, our subsidiary bank. On July 31, 2015, we acquired FBC Bancshares, Inc., and its wholly owned subsidiary, First Bank, N.A., Conroe, Texas and merged these entities with and into the Company and our subsidiary bank, respectively. We also completed an asset purchase of 4Trust Mortgage, Inc. on June 1, 2015 that significantly increased our residential mortgages/loan originations that are sold in the secondary market. On January 1, 2015, our technology subsidiary, First Technology Services, Inc., was contributed to our bank subsidiary, First Financial Bank, National Association, Abilene, Texas, and therefore became an indirect subsidiary of the Company. As of December 31, 2015, our subsidiaries are:

First Financial Bank, National Association, Abilene, Texas;

First Technology Services, Inc., Abilene, Texas, wholly owned subsidiary of First Financial Bank, National Association, Abilene, Texas;

First Financial Trust & Asset Management Company, National Association, Abilene, Texas;

First Financial Insurance Agency, Inc., Abilene, Texas; and

First Financial Investments, Inc., Abilene, Texas.

Through our subsidiaries, we conduct a full-service commercial banking business. Our banking centers are located primarily in Central, North Central, Southeast and West Texas. As of December 31, 2015, we had 70 financial centers across Texas, with eleven locations in Abilene, three locations in San Angelo and Weatherford, two locations in Cleburne, Conroe, Huntsville, Stephenville, and Granbury, and one location each in Acton, Albany,

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Aledo, Alvarado, Beaumont, Boyd, Bridgeport, Brock, Burleson, Cisco, Clyde, Cut and Shoot, Decatur, Eastland, Fort Worth, Glen Rose, Grapevine, Hereford, Keller, Magnolia, Mauriceville, Merkel, Midlothian, Mineral Wells, Montgomery, Moran, New Waverly, Newton, Odessa, Orange, Port Arthur, Ranger, Rising Star, Roby, Southlake, Sweetwater, Tomball, Trent, Trophy Club, Vidor, Waxahachie, Willis and Willow Park, all in Texas.

Even though we operate in a growing number of Texas markets, we continue to believe that decisions are best made at the local level. Although we consolidated our bank charters into one charter, we continue to regionally manage our operations with local advisory boards of directors, local bank region presidents and local decision-making. We have consolidated many of the backroom operations, such as investment securities, accounting, check processing, technology and employee benefits, which improves our efficiency and frees management of our bank regions to concentrate on serving the banking needs of their local communities. On December 1, 2015, we announced that we have combined, effective January 1, 2016, our Huntsville and Conroe Regions and our Abilene, Sweetwater and Eastland Regions. Also, the Company established a Fort Worth Region that previously was a branch of our Weatherford Region.

In the past, we have chosen to keep our Company focused on the State of Texas, one of the nation's largest, fastest-growing and most economically diverse states. With approximately 26.9 million residents, Texas has more people than any other state except California. The population of Texas grew 20.1% from 2004-2014 according to the U.S. Census Bureau. Many of the communities in which we operate are also experiencing positive growth as shown below:

Population Growth 2004-2014*

Bridgeport and Wise County	19.4%
Fort Worth and Tarrant County	21.4%
Cleburne and Johnson County	14.4%
Granbury and Hood County	19.6%
Weatherford, Willow Park, Aledo and Parker County	30.3%
Stephenville and Erath County	15.9%
Conroe and Montgomery County	47.0%

* Source: U. S. Census Bureau

These economies include dynamic centers of higher education, agriculture, wind energy and natural resources, retail, military, healthcare, tourism, retirement living, manufacturing and distribution.

We believe our community approach to doing business works best for us in small and mid-size markets, where we can play a prominent role in the economic, civic and cultural life of the community. Our goal is to serve these communities well and to experience growth as these markets continue to expand. In many instances, banking competition is less intense in smaller markets, making it easier for us to operate rationally and attract and retain high-caliber employees who prefer not only our community-banker concept but the high quality of life in smaller cities.

Over the years, we have grown in three ways: by growing internally, by opening new branch locations and by acquiring other banks. Since 1997, we have completed twelve bank acquisitions and have increased our total assets

from \$1.57 billion to \$6.67 billion as of December 31, 2015. We have also established a trust and asset management company and a technology services company. First Financial Trust and Asset Management Company, National Association operates as a subsidiary of First Financial Bankshares, Inc. and First Technology Services, Inc. operates as a subsidiary of First Financial Bank, National Association, Abilene, Texas. Looking ahead, we intend to continue to grow organically by better serving the needs of our customers and putting them first in all of our decisions. We continually look for new branch locations, so we can provide more convenient service to our customers, and we are actively pursuing acquisition opportunities by calling on banks that we are interested in possibly acquiring.

When targeting a bank for acquisition, the subject bank generally needs to be well managed and profitable, while being located in the type of community that fits our profile. We like growing communities with good amenities schools, infrastructure, commerce and lifestyle. We prefer non-metropolitan markets, either around Dallas/Fort Worth, Houston, San Antonio or Austin or along the Interstate 35, 45, 10 and 20 corridors in Texas. We might also consider the acquisition of banks in East Texas, the Texas Hill Country area or in states contiguous to Texas. Banks between \$300 million and \$1.0 billion in asset size fit our sweet spot for acquisition, but we would consider banks that are larger or smaller, or that are in other areas of Texas if we believe they would be a good fit for our Company.

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Information on our revenues, profits and losses and total assets appears in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Item 7 hereof.

First Financial Bankshares, Inc.

We provide management, technical resources and policy direction to our subsidiaries, which enable them to improve or expand their services while continuing their local activity and identity. Each of our subsidiaries operates under the day-to-day management of its own board of directors and officers, including advisory boards of directors for our bank regions. We provide resources and policy direction in, among other things, the following areas:

asset and liability management;

investments;

accounting;

budgeting;

training;

marketing;

planning;

risk management;

loan review;

loan analysis;

human resources;

insurance;

capitalization;

regulatory compliance; and

internal audit.

In particular, we assist our subsidiaries with, among other things, decisions concerning major capital expenditures, employee fringe benefits, including retirement plans and group medical coverage, dividend policies, and appointment of officers and directors, including advisory directors, and their compensation. We also perform, through corporate staff groups or by outsourcing to third parties, internal audits, compliance oversight and loan reviews of our subsidiaries. We provide advice and specialized services for our bank regions related to lending, investing, purchasing, advertising, public relations, and computer services.

We evaluate various potential financial institution acquisition opportunities and approve potential locations for new branch offices. We anticipate that funding for any acquisitions or expansions would be provided from our existing cash balances, available dividends from our subsidiaries, utilization of available lines of credit and future debt or equity offerings.

Services Offered by Our Subsidiaries

Our subsidiary bank, First Financial Bank, National Association, is a separate legal entity that operates under the day-to-day management of its board of directors and officers. Our multiple banking regions, which operate under our subsidiary bank, each have separate advisory boards that make recommendations and provide assistance to regional management of the bank regarding the operations of their respective region. Each of our bank regions provides general commercial banking services, which include accepting and holding checking, savings and time deposits, making loans, automated teller machines, drive-in and night deposit services, safe deposit facilities, remote deposit capture, internet banking, mobile banking, payroll cards, transmitting funds, and performing other customary commercial banking services. We also conduct full service trust activities through First Financial Trust & Asset

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Management Company, National Association, our trust company. Our trust company has nine locations which are located in Abilene, Fort Worth, Lubbock, Odessa, Beaumont, Hereford, San Angelo, Stephenville and Sweetwater, all in Texas. Through our trust company, we offer personal trust services, which include the administration of estates, testamentary trusts, revocable and irrevocable trusts and agency accounts. We also administer all types of retirement and employee benefit accounts, which include 401(k) profit sharing plans and IRAs. In addition, we provide securities brokerage services through arrangements with an unrelated third party in our Abilene, Cleburne, San Angelo, Southlake, Stephenville and Weatherford banking regions.

Competition

Commercial banking in Texas is highly competitive, and because we hold less than 1% of the state's deposits, we represent only a minor segment of the industry. To succeed in this industry, we believe that we must have the capability to compete effectively in the areas of (1) interest rates paid or charged; (2) scope of services offered; and (3) prices charged for such services. Our bank regions compete in their respective service areas against highly competitive banks, thrifts, savings and loan associations, small loan companies, credit unions, mortgage companies, insurance companies, and brokerage firms, all of which are engaged in providing financial products and services and some of which are larger than us in terms of capital, resources and personnel.

Our business does not depend on any single customer or any few customers, and the loss of any one would not have a materially adverse effect upon our business. Although we have a broad base of customers that are not related to us, our customers also occasionally include our officers and directors, as well as other entities with which we are affiliated. Through our bank regions we may make loans to our officers and directors, and entities with which we are affiliated, in the ordinary course of business. We make these loans on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. Loans to our directors, officers and their affiliates are also subject to numerous restrictions under federal and state banking laws, which we describe in greater detail below, under the heading *Supervision and Regulation* *Loans to Directors, Executive Officers and Principal Shareholders*.

Employees

Including all of our subsidiaries, we employed approximately 1,270 full-time equivalent employees at December 31, 2015. Our management believes that our employee relations have been and will continue to be good.

Supervision and Regulation

Both federal and state laws extensively regulate bank holding companies, financial holding companies and banks. These laws (and the regulations promulgated thereunder) are primarily intended to protect depositors and the deposit insurance fund (the *DIF*) of the Federal Deposit Insurance Corporation, or the FDIC. The following information describes particular laws and regulatory provisions relating to financial holding companies and banks. This discussion is qualified in its entirety by reference to the particular laws and regulatory provisions. A change in any of these laws or regulations may have a material effect on our business and the business of our subsidiaries.

Bank Holding Companies and Financial Holding Companies

Historically, the activities of bank holding companies were limited to the business of banking and activities closely related or incidental to banking. Bank holding companies were generally prohibited from acquiring control of any company that was not a bank and from engaging in any business other than the business of banking or managing and controlling banks. The Gramm-Leach-Bliley Act, which took effect on March 12, 2000, dismantled many

Depression-era restrictions against affiliations between banking, securities and insurance firms by permitting bank holding companies to engage in a broader range of financial activities, so long as certain safeguards are observed. Specifically, bank holding companies may elect to become financial holding companies that may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental to a financial activity. Thus, with the enactment of the Gramm-Leach-Bliley Act, banks, security firms and insurance companies find it easier to acquire or affiliate with each other and cross-sell financial products. The Gramm-Leach-Bliley Act permits a single financial services organization to offer a more complete array of financial products and services than historically was permitted.

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A financial holding company is essentially a bank holding company with significantly expanded powers. Under the Gramm-Leach-Bliley Act, in addition to traditional lending activities, the following activities are among those that are deemed financial in nature for financial holding companies: securities underwriting, dealing in or making a market in securities, sponsoring mutual funds and investment companies, insurance underwriting and agency activities, activities which the Federal Reserve Board determines to be closely related to banking, and certain merchant banking activities.

We elected to become a financial holding company in September 2001. As a financial holding company, we have very broad discretion to affiliate with securities firms and insurance companies, make merchant banking investments, and engage in other activities that the Federal Reserve Board has deemed financial in nature. In order to continue as a financial holding company, we must continue to be well-capitalized, well-managed and maintain compliance with the Community Reinvestment Act. Depending on the types of financial activities that we may elect to engage in, under the Gramm-Leach-Bliley Act's functional regulation principles, we may become subject to supervision by additional government agencies. The election to be treated as a financial holding company increases our ability to offer financial products and services that historically we were either unable to provide or were only able to provide on a limited basis. As a result, we will face increased competition in the markets for any new financial products and services that we may offer. Likewise, an increased amount of consolidation among banks and securities firms or banks and insurance firms could result in a growing number of large financial institutions that could compete aggressively with us.

Mergers and Acquisitions

We generally must obtain approval from the banking regulators before we can acquire other financial institutions. We may not engage in certain acquisitions if we are undercapitalized. Furthermore, the BHCA provides that the Federal Reserve Board cannot approve any acquisition, merger or consolidation that may substantially lessen competition in the banking industry, create a monopoly in any section of the country, or be a restraint of trade. However, the Federal Reserve Board may approve such a transaction if the convenience and needs of the community clearly outweigh any anti-competitive effects. Specifically, the Federal Reserve Board would consider, among other factors, the expected benefits to the public (greater convenience, increased competition, greater efficiency, etc.) against the risks of possible adverse effects (undue concentration of resources, decreased or unfair competition, conflicts of interest, unsound banking practices, etc.).

Under the BHCA, the Company must obtain the prior approval of the Federal Reserve Board, or acting under delegated authority, the Federal Reserve Bank of Dallas before (1) acquiring direct or indirect ownership or control of any class of voting securities of any bank or bank holding company if, after the acquisition, the Company would directly or indirectly own or control 5% or more of the class; (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging or consolidating with another bank holding company.

The Change in Bank Control Act of 1978, as amended, or the CIBCA, and the related regulations of the Federal Reserve Board require any person or groups of persons acting in concert (except for companies required to make application under the BHCA), to file a written notice with the Federal Reserve Board before the person or group acquires control of the Company. The CIBCA defines control as the direct or indirect power to vote 25% or more of any class of voting securities or to direct the management or policies of a bank holding company or an insured bank. A rebuttable presumption of control arises under the CIBCA where a person or group controls 10% or more, but less than 25%, of a class of the voting stock of a company or insured bank which is a reporting company under the Securities Exchange Act of 1934, as amended, such as the Company, or such ownership interest is greater than the ownership interest held by any other person or group.

Banks

Federal and state laws and regulations that govern banks have the effect of, among other things, regulating the scope of business, investments, cash reserves, the purpose and nature of loans, the maximum interest rate chargeable on loans, the amount of dividends declared, and required capitalization ratios.

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National Banking Associations. Banks organized as national banking associations under the National Bank Act are subject to regulation and examination by the Office of the Comptroller of the Currency, or OCC. Effective December 30, 2012, we consolidated our then eleven bank charters into one, that being our Abilene charter. As a result, the OCC now supervises, regulates and regularly examines the following subsidiaries:

First Financial Bank, National Association, Abilene, Texas;

First Financial Trust & Asset Management Company, National Association; and

First Technology Services, Inc. (a wholly owned subsidiary of First Financial Bank, National Association)

The OCC's supervision and regulation of banks is primarily intended to protect the interests of depositors. The National Bank Act:

requires each national banking association to maintain reserves against deposits;

restricts the nature and amount of loans that may be made and the interest that may be charged; and

restricts investments and other activities.

Deposit Insurance Coverage and Assessments

Our subsidiary bank is a member of the FDIC. Through the DIF, the FDIC provides deposit insurance protection that covers all deposit accounts in FDIC-insured depository institutions up to applicable limits (currently, \$250,000 per depositor).

Our subsidiary bank must pay assessments to the FDIC under a risk-based assessment system for this federal deposit insurance protection. FDIC-insured depository institutions that are members of the Bank Insurance Fund pay insurance premiums at rates based on their risk classification. Institutions assigned to higher risk classifications (i.e., institutions that pose a greater risk of loss to the DIF) pay assessments at higher rates than institutions assigned to lower risk classifications. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to bank regulators. As of December 31, 2015, the assessment rate for our subsidiary bank was at the lowest risk-based premium available, which was 5.00% of the assessment base per annum.

In addition, the FDIC can impose special assessments to cover shortages in the DIF. The FDIC required insured depository institutions to prepay on December 30, 2009 their estimated quarterly assessments for 2010, 2011 and 2012, including a three basis point increase in premium rates for 2011 and 2012. (The three basis point increase was later cancelled under the Restoration Plan described below.) The Company's prepayment amount on December 31, 2009 totaled \$11.60 million in the aggregate and was expensed based on quarterly assessment calculations. In June 2013, the unused portion of our prepaid assessment totaling \$3.72 million was refunded by FDIC to our subsidiary bank.

In October 2010, the FDIC adopted a new Restoration Plan for the DIF to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. Under the Restoration Plan, the FDIC did not institute the uniform three-basis point increase in assessment rates scheduled to take place on January 1, 2011 and maintained the current schedule of assessment rates for all depository institutions. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking, if required. The Dodd-Frank Act also eliminated the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. The Dodd-Frank Act requires the FDIC to offset the effect of increasing the reserve ratio on institutions with total consolidated assets of less than \$10 billion, such as the Company.

As required by the Dodd-Frank Act, the FDIC also revised the deposit insurance assessment system, effective April 1, 2011, to base assessments on the average total consolidated assets of insured depository institutions during the assessment period, less the average tangible equity of the institution during the assessment period as opposed to solely bank deposits at an institution. This base assessment change necessitated that the FDIC adjust the assessment rates to ensure that the revenue collected under the new assessment system will approximately equal that under the existing assessment system.

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Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, or FIRREA, an FDIC-insured depository institution can be held liable for any losses incurred by the FDIC in connection with (1) the default of one of its FDIC-insured subsidiaries or (2) any assistance provided by the FDIC to one of its FDIC-receivers, and in danger of default is defined generally as the existence of certain conditions indicating that a default is likely to occur in the absence of regulatory assistance.

The FDIC is also empowered to regulate interest rates paid by insured banks. Approval of the FDIC is also required before an insured bank retires any part of its common or preferred stock, or any capital notes or debentures.

Payment of Dividends

We are a legal entity separate and distinct from our banking and other subsidiaries. We receive most of our revenue from dividends paid to us by our bank and trust company subsidiaries. Described below are some of the laws and regulations that apply when either we or our subsidiaries pay or paid dividends.

The Federal Reserve Board, the OCC and the FDIC have issued policy statements that recommend that bank holding companies and insured banks should generally only pay dividends to the extent net income is sufficient to cover both cash dividends and a rate of earnings retention consistent with capital needs, asset quality and overall financial condition. Further, the Federal Reserve Board's policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries. In addition, the Federal Reserve Board has indicated that each bank holding company should carefully review its dividend policy, and has discouraged payment ratios that are at maximum allowable levels, which is the maximum dividend amount that may be issued and allow the company to still maintain its target Tier 1 capital ratio, unless both asset quality and capital are very strong.

To pay dividends, our subsidiaries must maintain adequate capital above regulatory guidelines. Under federal law, our subsidiary bank cannot pay a dividend if, after paying the dividend, the bank would be undercapitalized. In addition, if the FDIC believes that a bank under its jurisdiction is engaged in, or is about to engage in, an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), the FDIC may require, after notice and hearing, that such bank cease and desist from the unsafe practice. The FDIC and the OCC have each indicated paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice.

National banks are required by federal law to obtain the prior approval of the OCC in order to declare and pay dividends if the total of all dividends declared in any calendar year would exceed the total of (1) such bank's net profits (as defined and interpreted by regulation) for that year plus (2) its retained net profits (as defined and interpreted by regulation) for the preceding two calendar years, less any required transfers to surplus. In addition, these banks may only pay dividends to the extent that retained net profits (including the portion transferred to surplus) exceed bad debts (as defined by regulation).

Our subsidiaries paid aggregate dividends to us of \$51.20 million in 2015 and \$34.00 million in 2014. Under the dividend restrictions discussed above, as of December 31, 2015, our subsidiaries could have declared in the aggregate additional dividends of approximately \$129.31 million from retained net profits, without obtaining regulatory approvals.

Affiliate Transactions

The Federal Reserve Act, the FDIA and the rules adopted under these statutes restrict the extent to which we can borrow or otherwise obtain credit from, or engage in certain other transactions with, our subsidiaries. These laws regulate covered transactions between insured depository institutions and their subsidiaries, on the one hand, and their nondepository affiliates, on the other hand. The Dodd-Frank Act expanded the definition of affiliate to make any investment fund, including a mutual fund, for which a depository institution or its affiliates serve as investment advisor an affiliate of the depository institution. Covered transactions include a loan or extension of credit to a nondepository affiliate, a purchase of securities issued by such an affiliate, a purchase of assets from such an affiliate (unless otherwise exempted by the Federal Reserve Board), an acceptance of securities issued by such an affiliate as collateral for a loan, and an issuance of a guarantee, acceptance, or letter of credit for the benefit of such

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an affiliate. The Dodd-Frank Act extended the limitations to derivative transactions, repurchase agreements and securities lending and borrowing transactions that create credit exposure to an affiliate or an insider. The covered transactions that an insured depository institution and its subsidiaries are permitted to engage in with their nondepository affiliates are limited to the following amounts: (1) in the case of any one such affiliate, the aggregate amount of covered transactions cannot exceed ten percent of the capital stock and the surplus of the insured depository institution; and (2) in the case of all affiliates, the aggregate amount of covered transactions cannot exceed twenty percent of the capital stock and surplus of the insured depository institution. In addition, extensions of credit that constitute covered transactions must be collateralized in prescribed amounts. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services. Finally, when we and our subsidiaries conduct transactions internally among us, we are required to do so at arm's length.

Loans to Directors, Executive Officers and Principal Shareholders

The authority of our subsidiary bank to extend credit to our directors, executive officers and principal shareholders, including their immediate family members, corporations and other entities that they control, is subject to substantial restrictions and requirements under Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O promulgated thereunder, as well as the Sarbanes-Oxley Act of 2002. These statutes and regulations impose specific limits on the amount of loans our subsidiary bank may make to directors and other insiders, and specified approval procedures must be followed in making loans that exceed certain amounts. In addition, all loans our subsidiary bank makes to directors and other insiders must satisfy the following requirements:

the loans must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with persons not affiliated with us or our subsidiary bank;

the subsidiary bank must follow credit underwriting procedures at least as stringent as those applicable to comparable transactions with persons who are not affiliated with us or our subsidiary bank; and

the loans must not involve a greater than normal risk of non-payment or include other features not favorable to our subsidiary bank.

Furthermore, our subsidiary bank must periodically report all loans made to directors and other insiders to the bank regulators, and these loans are closely scrutinized by the regulators for compliance with Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O. Each loan to directors or other insiders must be pre-approved by the bank's board of directors with the interested director abstaining from voting.

Capital

Bank Holding Companies and Financial Holding Companies. The Federal Reserve Board has adopted risk-based capital guidelines for bank holding companies and financial holding companies. Under these guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a risk-weighted asset base. The ratio of total capital to risk weighted assets (including certain off-balance-sheet activities, such as standby letters of credit) must be a minimum of eight percent. At least half of the total capital is to be composed of common shareholders' equity,

minority interests in the equity accounts of consolidated subsidiaries and a limited amount of perpetual preferred stock, less goodwill, which is collectively referred to as Tier 1 Capital. The remainder of total capital may consist of subordinated debt, other preferred stock and a limited amount of loan loss reserves. These guidelines will change over the next several years as the new Basel III rules are implemented. See *Capital Adequacy Requirements under Basel III* below.

In addition, the Federal Reserve Board has established minimum leverage ratio guidelines for bank holding companies and financial holding companies. Bank holding companies and financial holding companies that meet certain specified criteria, including having the highest regulatory rating, must maintain a minimum Tier 1 Capital leverage ratio (Tier 1 Capital to average assets for the current quarter, less goodwill) of three percent. Bank holding companies and financial holding companies that do not have the highest regulatory rating will generally be required

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to maintain a higher Tier 1 Capital leverage ratio of three percent plus an additional cushion of 100 to 200 basis points. The guidelines also provide that bank holding companies and financial holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions. Such strong capital positions must be kept substantially above the minimum supervisory levels without significant reliance on intangible assets (e.g., goodwill and core deposit intangibles). As of December 31, 2015, our capital ratios were as follows: (1) Tier 1 Capital to Risk-Weighted Assets Ratio, 15.90%; (2) Total Capital to Risk-Weighted Assets Ratio, 16.97%; and (3) Tier 1 Capital Leverage Ratio, 9.96%. At December 31, 2015, we had a Common Equity Tier 1 to Risk-Weighted Assets Ratio of 15.90%.

Banks. The Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, established five capital tiers with respect to depository institutions: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. A depository institution's capital tier will depend upon where its capital levels are in relation to various relevant capital measures, including (1) risk-based capital measures, (2) a leverage ratio capital measure and (3) certain other factors. Regulations establishing the specific capital tiers provide that a well-capitalized institution will have a total risk-based capital ratio of ten percent or greater, a Tier 1 risk-based capital ratio of six percent or greater, and a Tier 1 leverage ratio of five percent or greater, and not be subject to any written regulatory enforcement agreement, order, capital directive or prompt corrective action derivative. For an institution to be adequately capitalized, it will have a total risk-based capital ratio of eight percent or greater, a Tier 1 risk-based capital ratio of four percent or greater, and a Tier 1 leverage ratio of four percent or greater (in some cases three percent). For an institution to be undercapitalized, it will have a total risk-based capital ratio that is less than eight percent, a Tier 1 risk-based capital ratio less than four percent or a Tier 1 leverage ratio less than four percent (or a leverage ratio less than three percent if the institution's composite rating is 1 in its most recent report of examination, subject to appropriate federal banking agency guidelines). For an institution to be significantly undercapitalized, it will have a total risk-based capital ratio less than six percent, a Tier 1 risk-based capital ratio less than three percent, or a Tier 1 leverage ratio less than three percent. For an institution to be critically undercapitalized, it will have a ratio of tangible equity to total assets equal to or less than two percent. FDICIA requires federal banking agencies to take prompt corrective action against depository institutions that do not meet minimum capital requirements. The various regulatory agencies, including the OCC, have adopted substantially similar regulations that define the five categories identified by FDICIA, using the total risk-based capital, Tier 1 risk based capital and Tier 1 leverage ratios as relevant capital measures. Under current regulations, our subsidiary bank was well capitalized as of December 31, 2015.

The Dodd-Frank Act requires the FDIC to establish minimum leverage and risk-based capital requirements to apply to insured depository institutions. The Dodd-Frank Act additionally requires capital requirements to be countercyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness practices.

FDICIA generally prohibits a depository institution from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized. An undercapitalized institution must develop a capital restoration plan and its parent holding company must guarantee that institution's compliance with such plan. The liability of the parent holding company under any such guarantee is limited to the lesser of five percent of the institution's assets at the time it became undercapitalized or the amount needed to bring the institution into compliance with all capital standards. Furthermore, in the event of the bankruptcy of the parent holding company, such guarantee would take priority over the parent's general unsecured creditors. If a depository institution fails to submit an acceptable capital restoration plan, it shall be treated as if it is significantly undercapitalized. Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks.

Critically undercapitalized institutions are subject to the appointment of a receiver or conservator. Finally, FDICIA

requires the various regulatory agencies to set forth certain standards that do not relate to capital. Such standards relate to the safety and soundness of operations and management and to asset quality and executive compensation, and permit regulatory action against a financial institution that does not meet such standards.

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If an insured bank fails to meet its capital guidelines, it may be subject to a variety of other enforcement remedies, including a prohibition on the taking of brokered deposits and the termination of deposit insurance by the FDIC. Bank regulators continue to indicate their desire to raise capital requirements beyond their current levels.

Capital Adequacy Requirements Under Basel III

On July 2, 2013, the Federal Reserve Board, and on July 9, 2013, the FDIC and OCC, adopted a final rule that implements the Basel III changes to the international regulatory capital framework, referred to as the Basel III Rules. The Basel III Rules apply to both depository institutions and (subject to certain exceptions not applicable to the Company) their holding companies. Although parts of the Basel III Rules apply only to large, complex financial institutions, substantial portions of the Basel III Rules apply to the Company and our subsidiary bank. The Basel III Rules include requirements contemplated by the Dodd-Frank Act as well as certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010.

The Basel III Rules include new risk-based and leverage capital ratio requirements which refine the definition of what constitutes capital for purposes of calculating those ratios. The minimum capital level requirements applicable to the Company and our subsidiary bank under the Basel III Rules are: (i) a new common equity Tier 1 risk-based capital ratio of 4.5%; (ii) a Tier 1 risk-based capital ratio of 6% (increased from 4%); (iii) a total risk-based capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. Common equity Tier 1 capital will consist of retained earnings and common stock instruments, subject to certain adjustments.

The Basel III Rules also establish a fully-phased capital conservation buffer of 2.5% above the new regulatory minimum risk-based capital requirements. The conservation buffer, when added to the capital requirements, results in the following minimum ratios: (i) a common equity Tier 1 risk-based capital ratio of 7.0%, (ii) a Tier 1 risk-based capital ratio of 8.5%, and (iii) a total risk-based capital ratio of 10.5%. The new capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution is subject to limitations on certain activities including payment of dividends, share repurchases and discretionary bonuses to executive officers if its capital level is below the buffer amount.

The Basel III Rules also revise the prompt corrective action framework, which is designed to place restrictions on insured depository institutions, including our subsidiary bank, if their capital levels do not meet certain thresholds. These revisions were effective January 1, 2015. The prompt corrective action rules were modified to include a common equity Tier 1 capital component and to increase certain other capital requirements for the various thresholds. For example, under the proposed prompt corrective action rules, insured depository institutions are required to meet the following capital levels in order to qualify as well capitalized: (i) a new common equity Tier 1 risk-based capital ratio of 6.5%; (ii) a Tier 1 risk-based capital ratio of 8% (increased from 6%); (iii) a total risk-based capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (unchanged from current rules).

The Basel III Rules set forth certain changes in the methods of calculating certain risk-weighted assets, which in turn affect the calculation of risk based ratios. Under the Basel III Rules, higher or more sensitive risk weights are assigned to various categories of assets, including, certain credit facilities that finance the acquisition, development or construction of real property, certain exposures or credits that are 90 days past due or on nonaccrual, foreign exposures and certain corporate exposures. In addition, the Basel III Rules include (i) alternative standards of credit worthiness consistent with the Dodd-Frank Act; (ii) greater recognition of collateral and guarantees; and (iii) revised capital treatment for derivatives and repo-style transactions.

In addition, the final rule includes certain exemptions to address concerns about the regulatory burden on community banks. For example, banking organizations with less than \$15 billion in consolidated assets as of December 31, 2009 are permitted to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock issued and included in Tier 1 capital prior to May 19, 2010 on a permanent basis, without any phase out. Community banks were required to make this election by their March 31, 2015 quarterly financial filings with the appropriate federal regulator to opt-out of the requirement to include most accumulated other comprehensive income (AOCI) components in the calculation of CET1 capital and, in effect, retain the AOCI treatment under the

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current capital rules. The Company made in its March 31, 2015 quarterly filing, a one-time, permanent election to continue to exclude accumulated other comprehensive income from capital. If the Company would not have made this election, unrealized gains and losses would have been included in the calculation of its regulatory capital. Overall, the rule provides some important concessions for smaller, less complex financial institutions.

The Basel III Rules generally became effective beginning January 1, 2015. The conservation buffer began to be phased in beginning in January 2016 and will take full effect on January 1, 2019. Certain calculations under the Basel III Rules also have phase-in periods. The Company has complied with the final Basel III Rules since January 1, 2015.

Our Support of Our Subsidiaries

Under Federal Reserve Board policy, we are expected to commit resources to act as a source of strength to support each of our subsidiaries. The Dodd-Frank Act codified this policy as a statutory requirement. This support may be required at times when, absent such Federal Reserve Board policy, we would not otherwise be required to provide it. In addition, any loans we make to our subsidiaries would be subordinate in right of payment to deposits and to other indebtedness of our subsidiaries. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and be subject to a priority of payment.

Under the Federal Deposit Insurance Act, in the event of a loss suffered or anticipated by the FDIC (either as a result of the default of a banking subsidiary or related to FDIC assistance provided to a subsidiary in danger of default) our other subsidiaries may be assessed for the FDIC's loss.

Safe and Sound Banking Practices.

Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board's Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the bank holding company's consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their nonbanking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$1.0 million for each day the activity continues.

Interstate Banking and Branching

Effective June 1, 1997, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended the Federal Deposit Insurance Act and certain other statutes to permit state and national banks with different home states to merge across state lines, with approval of the appropriate federal banking agency, unless the home state of a participating bank had passed legislation prior to May 31, 1997 expressly prohibiting interstate mergers. Under the Riegle-Neal Act amendments, once a state or national bank has established branches in a state, that bank may establish and acquire additional branches at any location in the state at which any bank involved in the interstate merger transaction could

have established or acquired branches under applicable federal or state law. If a state opts out of interstate branching within the specified time period, no bank in any other state may establish a branch in the state which has opted out, whether through an acquisition or de novo.

However, under the Dodd-Frank Act, the national branching requirements have been relaxed and national banks and state banks are able to establish branches in any state if that state would permit the establishment of the branch by a state bank chartered in that state.

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The Federal Deposit Insurance Act, or FDIA, requires that the FDIC review (1) any merger or consolidation by or with an insured bank, or (2) any establishment of branches by an insured bank. Additionally, the Banking Department accepts applications for interstate merger and branching transactions, subject to certain limitations on ages of the banks to be acquired and the total amount of deposits within the state a bank or financial holding company may control. Since our primary service area is Texas, we do not expect that the ability to operate in other states will have any material impact on our growth strategy. We may, however, face increased competition from out-of-state banks that branch or make acquisitions in our primary markets in Texas.

Community Reinvestment Act of 1977

The Community Reinvestment Act of 1977, or CRA, subjects a bank to regulatory assessment to determine if the institution meets the credit needs of its entire community, including low- and moderate-income neighborhoods served by the bank, and to take that determination into account in its evaluation of any application made by such bank for, among other things, approval of the acquisition or establishment of a branch or other depository facility, an office relocation, a merger, or the acquisition of shares of capital stock of another financial institution. The regulatory authority prepares a written evaluation of an institution's record of meeting the credit needs of its entire community and assigns a rating. These ratings are Outstanding, Satisfactory, Needs Improvement and Substantial Non-Compliance. Institutions with ratings lower than Satisfactory may be restricted from engaging in the aforementioned activities. We believe our subsidiary bank has taken and takes significant actions to comply with the CRA, and received a satisfactory rating in its most recent review by federal regulators with respect to its compliance with the CRA.

Monitoring and Reporting Suspicious Activity

Under the Bank Secrecy Act, or BSA, we are required to monitor and report unusual or suspicious account activity that might signify money laundering, tax evasion or other criminal activities, as well as transactions involving the transfer or withdrawal of amounts in excess of prescribed limits. The BSA is sometimes referred to as an anti-money laundering law (AML). Several AML acts, including provisions in Title III of the USA PATRIOT Act of 2001, have been enacted up to the present to amend the BSA. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures and controls generally require financial institutions to take reasonable steps:

to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;

to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;

to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and

to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, financial institutions are also required to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

the development of internal policies, procedures, and controls;

the designation of a compliance officer;

an ongoing employee training program; and

an independent audit function to test the programs.

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In addition, under the USA PATRIOT Act, the Secretary of the U.S. Department of the Treasury, or Treasury, has adopted rules addressing a number of related issues, including increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to violate the privacy provisions of the Gramm-Leach-Bliley Act that are discussed below. Finally, under the regulations of the Office of Foreign Asset Control, or OFAC, we are required to monitor and block transactions with certain specially designated nationals who OFAC has determined pose a risk to U.S. national security.

Incentive Compensation

In June 2010, the Federal Reserve Board, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

The Federal Reserve Board will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not large, complex banking organizations. These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

In addition, Section 956 of the Dodd-Frank Act required certain regulators (including the FDIC, SEC and Federal Reserve Board) to adopt requirements or guidelines prohibiting excessive compensation. On April 14, 2011, these regulators published a joint proposed rulemaking to implement Section 956 of the Dodd-Frank Act for depository institutions, their holding companies and various other financial institutions with \$1 billion or more in assets. The proposed rule would (i) prohibit incentive-based compensation arrangements for covered persons that would encourage inappropriate risks by providing excess compensation; (ii) prohibit incentive-based compensation arrangements for covered persons that would expose the institution to inappropriate risks by providing compensation that could lead to a material financial loss; (iii) require policies and procedures for incentive-based compensation arrangements that are commensurate with the size and complexity of the institutions; and (iv) require annual reports on incentive compensation structures to the institution's appropriate federal regulator. The comment period to the proposed rule ended on March 31, 2011. As of the date of this document, the final rule has not yet been published by these regulators.

In addition, the Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called golden parachute payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The new legislation also authorizes the Securities and Exchange Commission (SEC) to promulgate rules that would allow stockholders to nominate their own candidates

using a company's proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of \$1.0 billion, regardless of whether the company is publicly traded or not. The Dodd-Frank Act gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Table of Contents*Consumer Laws and Regulations*

We are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the following list is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, The Fair and Accurate Credit Transactions Act, The Real Estate Settlement Procedures Act and the Fair Housing Act, among others. These laws and regulations, among other things, prohibit discrimination on the basis of race, gender or other designated characteristics and mandate various disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. These and other laws also limit finance charges or other fees or charges earned in our activities. We must comply with the applicable provisions of these consumer protection laws and regulations as part of our ongoing customer relations.

Consumer Financial Protection Bureau

The Dodd-Frank Act creates a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. The Dodd-Frank Act permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits the state attorney general to enforce compliance with both the state and federal laws and regulations.

The CFPB has already finalized rules relating to, among other things, remittance transfers under the Electronic Fund Transfer Act, which requires companies to provide consumers with certain disclosures before the consumer pays for a remittance transfer. These new rules became effective in October 2013. The CFPB has also amended certain rules under Regulation C relating to home mortgage disclosure to reflect a change in the asset-size exemption threshold for depository institutions based on the annual percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers. In addition, on January 10, 2013, the CFPB released its final Ability-to-Repay/Qualified Mortgage rules, which amended the Truth in Lending Act (Regulation Z). Regulation Z prohibits a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to repay the loan. The final amended rule implemented sections 1411 and 1412 of the Dodd-Frank Act, which generally require creditors to make a reasonable, good faith determination of a consumer's ability to repay any consumer credit transaction secured by a dwelling (excluding an open-end credit plan, timeshare plan, reverse mortgage, or temporary loan) and establishes certain protections from liability under this requirement for qualified mortgages. The final rule also implemented section 1414 of the Dodd-Frank Act, which limits prepayment penalties. Finally, the final rule requires creditors to retain evidence of compliance with the rule for three years after a covered loan is consummated. This rule became effective January 10, 2014.

Technology Risk Management and Consumer Privacy

State and federal banking regulators have issued various policy statements emphasizing the importance of technology risk management and supervision in evaluating the safety and soundness of depository institutions with respect to

banks that contract with outside vendors to provide data processing and core banking functions. The use of technology-related products, services, delivery channels and processes exposes a bank to various risks, particularly operational, privacy, security, strategic, reputation and compliance risk. Banks are generally expected to prudently manage technology-related risks as part of their comprehensive risk management policies by identifying, measuring, monitoring and controlling risks associated with the use of technology.

Under Section 501 of the Gramm-Leach-Bliley Act, the federal banking agencies have established appropriate standards for financial institutions regarding the implementation of safeguards to ensure the security and

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confidentiality of customer records and information, protection against any anticipated threats or hazards to the security or integrity of such records and protection against unauthorized access to or use of such records or information in a way that could result in substantial harm or inconvenience to a customer. Among other matters, the rules require each bank to implement a comprehensive written information security program that includes administrative, technical and physical safeguards relating to customer information.

Under the Gramm-Leach-Bliley Act, a financial institution must also provide its customers with a notice of privacy policies and practices. Section 502 prohibits a financial institution from disclosing nonpublic personal information about a customer to nonaffiliated third parties unless the institution satisfies various notice and opt-out requirements and the customer has not elected to opt out of the disclosure. Under Section 504, the agencies are authorized to issue regulations as necessary to implement notice requirements and restrictions on a financial institution's ability to disclose nonpublic personal information about customers to nonaffiliated third parties. Under the final rule the regulators adopted, all banks must develop initial and annual privacy notices which describe in general terms the bank's information sharing practices. Banks that share nonpublic personal information about customers with nonaffiliated third parties must also provide customers with an opt-out notice and a reasonable period of time for the customer to opt out of any such disclosure (with certain exceptions). Limitations are placed on the extent to which a bank can disclose an account number or access code for credit card, deposit or transaction accounts to any nonaffiliated third party for use in marketing.

Concentrated Commercial Real Estate Lending Regulations

The federal banking agencies, including the FDIC, have promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and non-farm residential properties and loans for construction, land development, and other land represent 300% or more of total capital and the bank's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. Owner occupied loans are excluded from this second category. If a concentration is present, management must employ heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending.

UDAP and UDAAP

Recently, banking regulatory agencies have increasingly used a general consumer protection statute to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. The law of choice for enforcement against such business practices has been Section 5 of the Federal Trade Commission Act, referred to as the FTC Act, which is the primary federal law that prohibits unfair or deceptive acts or practices, referred to as UDAP, and unfair methods of competition in or affecting commerce. Unjustified consumer injury is the principal focus of the FTC Act. Prior to the Dodd-Frank Act, there was little formal guidance to provide insight to the parameters for compliance with UDAP laws and regulations. However, UDAP laws and regulations have been expanded under the Dodd-Frank Act to apply to unfair, deceptive or abusive acts or practices, referred to as UDAAP, which have been delegated to the CFPB for supervision. The CFPB has published its first Supervision and Examination Manual that addresses compliance with and the examination of UDAAP.

Monetary Policy

Banks are affected by the credit policies of monetary authorities, including the Federal Reserve Board, that affect the national supply of credit. The Federal Reserve Board regulates the supply of credit in order to influence general economic conditions, primarily through open market operations in United States government obligations, varying the discount rate on financial institution borrowings, varying reserve requirements against financial institution deposits, and restricting certain borrowings by financial institutions and their subsidiaries. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banks in the past and are expected to continue to do so in the future.

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Enforcement Powers of Federal Banking Agencies

The Federal Reserve and other state and federal banking agencies and regulators have broad enforcement powers, including the power to terminate deposit insurance, issue cease-and-desist orders, impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver. Our failure to comply with applicable laws, regulations and other regulatory pronouncements could subject us, as well as our officers and directors, to administrative sanctions and potentially substantial civil penalties.

Regulatory Reform and Legislation

From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and the operating environment of the Company in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on the financial condition or results of operations of the Company. A change in statutes, regulations or regulatory policies applicable to the Company or our subsidiaries could have a material effect on the Company's business, financial condition and results of operations.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act, which was enacted in July 2010, effected a fundamental restructuring of federal banking regulation. In addition to those provisions discussed above, among the Dodd-Frank Act provisions that have affected us are the following:

creation of a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms;

elimination of the federal statutory prohibition against the payment of interest on business checking accounts;

prohibition on state-chartered banks engaging in derivatives transactions unless the loans to one borrower of the state in which the bank is chartered takes into consideration credit exposure to derivative transactions. For this purpose, derivative transactions include any contract, agreement, swap, warrant, note or option that is based in whole or in part on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more commodity securities, currencies, interest or other rates, indices or other assets;

requirement that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by the issuer. On June 29, 2011, the Federal Reserve Board set the interchange rate cap at \$0.21 per transaction and 5 basis

points multiplied by the value of the transaction. While the restrictions on interchange fees do not apply to banks that, together with their affiliates, have assets of less than \$10 billion, the rule could affect the competitiveness of debit cards issued by smaller banks; and

restrictions under the Volcker Rule of the Company's ability to engage in proprietary trading and to invest in, sponsor and engage in certain types of transactions with certain private funds. The Company had until July 15, 2015 to fully conform to the Volcker Rules restrictions.

Many of the Dodd-Frank Act's provisions are still subject to the final rulemaking by federal banking agencies, and the implication of the Dodd-Frank Act for the Company's business will depend to a large extent on how such rules are adopted and implemented. The Company's management continues to review actively the provisions of the Dodd-Frank Act and assess its probable impact on its business, financial condition, and results of operations.

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Available Information

We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document we file at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our SEC filings are also available to the public at the SEC's web site at <http://www.sec.gov>. Our web site is <http://www.ffin.com>. You may also obtain copies of our annual, quarterly and special reports, proxy statements and certain other information filed with the SEC, as well as amendments thereto, free of charge from our web site. These documents are posted to our web site after we have filed them with the SEC. Our corporate governance guidelines, including our code of conduct applicable to all our employees, officers and directors, as well as the charters of our audit and nominating committees, are available at www.ffin.com. The foregoing information is also available in print to any shareholder who requests it. Except as explicitly provided, information on any web site is not incorporated into this Form 10-K or our other securities filings and is not a part of them.

ITEM 1A. RISK FACTORS

Our business, financial condition, operating results and cash flows can be impacted by a number of factors, including but not limited to those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results and other forward-looking statements that we make from time to time in our news releases, annual reports and other written communications, as well as oral forward-looking statements, and other statements made from time to time by our representatives.

Our business faces unpredictable economic conditions, which could have an adverse effect on us.

General economic conditions impact the banking industry. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we conduct our business. Our continued financial success depends somewhat on factors beyond our control, including:

general economic conditions, including national and local real estate markets and the price of oil and gas;

the supply of and demand for investable funds;

demand for loans and access to credit;

interest rates; and

federal, state and local laws affecting these matters.

Any substantial deterioration in any of the foregoing conditions could have a material adverse effect on our financial condition, results of operations and liquidity, which would likely adversely affect the market price of our common stock.

Our business is concentrated in Texas and a downturn in the economy of Texas may adversely affect our business.

Our network of bank regions is concentrated in Texas, primarily in the Central, North Central, Southeast and Western regions of the state. Most of our customers and revenue are derived from this area. These economies include dynamic centers of higher education, agriculture, energy and natural resources, retail, military, healthcare, tourism, retirement living, manufacturing and distribution. Because we generally do not derive revenue or customers from other parts of the state or nation, our business and operations are dependent on economic conditions in our Texas markets. Any significant decline in one or more segments of the local economies could adversely affect our business, revenue, operations and properties.

The significant decline and volatility in oil and gas prices has resulted in uncertainty about the Texas economy. While we consider our exposure to credits related to the oil and gas industry to not be significant, at approximately 2.9% of total loans as of December 31, 2015, should the price of oil and gas decline further and/or remain at the current low price for an extended period, the general economic conditions in our Texas markets could be negatively affected, which could have a material adverse affect on our business, financial condition and results of operations.

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In our business, we must effectively manage our credit risk.

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate us for the outstanding balance of the loan plus the costs to dispose of the collateral. We may experience significant loan losses, which could have a material adverse effect on our operating results and financial condition. Management makes various assumptions and judgments about the collectability of our loan portfolio, including the diversification by industry of our commercial loan portfolio, the amount of nonperforming loans and related collateral, the volume, growth and composition of our loan portfolio, the effects on the loan portfolio of current economic indicators and their probable impact on borrowers and the evaluation of our loan portfolio through our internal loan review process and other relevant factors.

We maintain an allowance for credit losses, which is an allowance established through a provision for loan losses charged to expense that represents management's best estimate of probable losses inherent in our loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than we have experienced to date. In determining the amount of the allowance, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance may not be sufficient and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Material additions to the allowance could materially decrease our net income.

In addition, banking regulators periodically review our allowance for credit losses and may require us to increase our provision for credit losses or recognize further charge-offs, based on judgments different than those of our management. Any increase in our allowance for credit losses or charge-offs as required by these regulatory agencies could have a material negative effect on our operating results, financial condition and liquidity.

Extended drought conditions, severe weather and natural disasters could significantly impact the Company's business.

Extended drought conditions, severe weather and natural disasters and other adverse external events could have a significant impact on the Company's ability to conduct business. In addition, such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of the collateral securing our loans, cause significant property damage, result in loss of revenue and/or cause the Company to incur additional expenses. The occurrence of any such event in the future could have a material adverse effect on the Company's business, which in turn, could have a material adverse effect on the Company's business, financial condition and result of operations.

Changes in economic conditions could cause an increase in delinquencies and non-performing assets, including loan charge-offs, which could depress our net income and growth.

Our loan portfolio includes many real estate secured loans, demand for which may decrease during economic downturns as a result of, among other things, an increase in unemployment, a decrease in real estate values and a slowdown in housing. If we see negative economic conditions develop in the United States as a whole or in the portions of Texas that we serve, we could experience higher delinquencies and loan charge-offs, which would reduce our net income and adversely affect our financial condition. Furthermore, to the extent that real estate collateral is obtained through foreclosure, the costs of holding and marketing the real estate collateral, as well as the ultimate values obtained from disposition, could reduce our earnings and adversely affect our financial condition.

The value of real estate collateral may fluctuate significantly resulting in an under-collateralized loan portfolio.

The market value of real estate, particularly real estate held for investment, can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. If the value of the real estate serving as collateral for our loan portfolio were to decline materially, a significant part of our loan

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portfolio could become under-collateralized. If the loans that are collateralized by real estate become troubled during a time when market conditions are declining or have declined, then, in the event of foreclosure, we may not be able to realize the amount of collateral that we anticipated at the time of originating the loan. This could have a material adverse effect on our provision for loan losses and our operating results and financial condition.

New lines of business or new products and services may subject the Company to additional risks.

From time to time, the Company may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or products and services the Company may invest significant time and resources. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. If we are unable to successfully manage these risks in the development and implementation of new lines of business or new products or services, it could have a material adverse effect on the Company's business, financial condition and result of operations.

We are subject to environmental liability risk associated with lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Environmental reviews of real property before initiating foreclosure actions may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition and results of operations.

We depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we must rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business, financial condition and results of operations.

The repeal of prohibitions on paying interest on demand deposits could increase our interest expense.

Effective July 2011, all federal prohibitions on financial institutions paying interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, some financial institutions have commenced and are considering offering interest on demand deposits to compete for customers. Our interest expense could increase and our net interest margin could decrease if we begin offering interest on demand deposits to maintain current customers or attract new customers, which could have a material adverse effect on our financial condition and results of operations.

We do business with other financial institutions that could experience financial difficulty.

We do business through the purchase and sale of Federal funds, check clearing and through the purchase and sale of loan participations with other financial institutions. Because these financial institutions have many risks, as do we, we could be adversely affected should one of these financial institutions experience significant financial difficulties or fail to comply with our agreements with them.

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If we are unable to continue to originate residential real estate loans and sell them into the secondary market for a profit, our earnings could decrease.

We derive a portion of our noninterest income from the origination of residential real estate loans and the subsequent sale of such loans into the secondary market. If we are unable to continue to originate and sell residential real estate loans at historical or greater levels, our residential real estate loan volume would decrease, which could decrease our earnings. A rising interest rate environment, general economic conditions or other factors beyond our control could adversely affect our ability to originate residential real estate loans. We also are experiencing an increase in regulations and compliance requirements related to mortgage loan originations necessitating technology upgrades and other changes. If new regulations continue to increase and we are unable to make technology upgrades, our ability to originate mortgage loans will be reduced or eliminated. Additionally, we sell a large portion of our residential real estate loans to third party investors, and rising interest rates could negatively affect our ability to generate suitable profits on the sale of such loans. If interest rates increase after we originate the loans, our ability to market those loans is impaired as the profitability on the loans decreases. These fluctuations can have an adverse effect on the revenue we generate from residential real estate loans and in certain instances, could result in a loss on the sale of the loans.

Further, for the mortgage loans we sell in the secondary market, the mortgage loan sales contracts contain indemnification clauses should the loans default, generally in the first sixty to ninety days, or if documentation is determined not to be in compliance with regulations. While the Company's historic losses as a result of these indemnities have been insignificant, we could be required to repurchase the mortgage loans or reimburse the purchaser of our loans for losses incurred. Both of these situations could have an adverse effect on the profitability of our mortgage loan activities and negatively impact our net income.

We may need to raise additional capital and such funds may not be available when needed.

We may need to raise additional capital in the future to provide us with sufficient capital resources to meet our commitments and business needs, particularly if our asset quality or earnings were to deteriorate significantly. Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital and financial markets at that time, which are outside of our control, and our financial performance. Economic conditions and the loss of confidence in financial institutions may increase our cost of funding and limit access to certain customary sources of capital, other financial institution borrowings and borrowings from the discount window of the Federal Reserve. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of other financial institutions, or counterparties participating in the capital markets, may adversely affect our costs and our ability to raise capital. An inability to raise additional capital on acceptable terms when needed could have a materially adverse effect on our financial condition and results of operations.

We may be subject to more stringent capital and liquidity requirements which would adversely affect our net income and future growth.

On July 2, 2013, the Federal Reserve Board, and on July 9, 2013, the FDIC and OCC, adopted a final rule that implements the Basel III changes to the international regulatory capital framework and revises the U.S. risk-based and leverage capital requirements for U.S. banking organizations to strengthen identified areas of weakness in capital rules and to address relevant provisions of the Dodd-Frank Act.

The final rule establishes a stricter regulatory capital framework that requires banking organizations to hold more and higher-quality capital to act as a financial cushion to absorb losses and help banking organizations better withstand periods of financial stress. The final rule increases capital ratios for all banking organizations and introduces a capital conservation buffer which is in addition to each capital ratio. If a banking organization dips into its capital

conservation buffer, it may be restricted in its ability to pay dividends and discretionary bonus payments to its executive officers. The final rule assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain available-for-sale securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. We exercised this opt-out right in our March 31, 2015 quarterly financial filing. Accordingly, accumulated other comprehensive income is excluded from our regulatory capital

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calculations. The final rule also includes changes in what constitutes regulatory capital, some of which are subject to a two-year transition period. These changes include the phasing-out of certain instruments such as qualifying capital. In addition, Tier 2 capital is no longer limited to the amount of Tier 1 capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common stock will be required to be deducted from capital, subject to a two-year transition period.

The final rule became effective for us on January 1, 2015. As of December 31, 2015, we met all of these new requirements, including the full capital conservation buffer.

Although we currently cannot predict the specific impact and long-term effects that Basel III will have on our Company and the banking industry more generally, the Company will be required to maintain higher regulatory capital levels which could impact our operations, net income and ability to grow. Furthermore, the Company's failure to comply with the minimum capital requirements could result in our regulators taking formal or informal actions against us which could restrict our future growth or operations.

The trust wealth management fees we receive may decrease as a result of poor investment performance, in either relative or absolute terms, which could decrease our revenues and net earnings.

Our trust company subsidiary derives its revenues primarily from investment management fees based on assets under management. Our ability to maintain or increase assets under management is subject to a number of factors, including investors' perception of our past performance, in either relative or absolute terms, market and economic conditions, including changes in oil and gas prices, and competition from investment management companies. Financial markets are affected by many factors, all of which are beyond our control, including general economic conditions, including changes in oil and gas prices; securities market conditions; the level and volatility of interest rates and equity prices; competitive conditions; liquidity of global markets; international and regional political conditions; regulatory and legislative developments; monetary and fiscal policy; investor sentiment; availability and cost of capital; technological changes and events; outcome of legal proceedings; changes in currency values; inflation; credit ratings; and the size, volume and timing of transactions. A decline in the fair value of the assets under management, caused by a decline in general economic conditions, would decrease our wealth management fee income.

Investment performance is one of the most important factors in retaining existing clients and competing for new wealth management clients. Poor investment performance could reduce our revenues and impair our growth in the following ways:

existing clients may withdraw funds from our wealth management business in favor of better performing products;

asset-based management fees could decline from a decrease in assets under management;

our ability to attract funds from existing and new clients might diminish; and

our wealth managers and investment advisors may depart, to join a competitor or otherwise.

Even when market conditions are generally favorable, our investment performance may be adversely affected by the investment style of our wealth management and investment advisors and the particular investments that they make. To the extent our future investment performance is perceived to be poor in either relative or absolute terms, the revenues and profitability of our wealth management business will likely be reduced and our ability to attract new clients will likely be impaired. As such, fluctuations in the equity and debt markets can have a direct impact upon our net earnings.

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Certain of our investment advisory and wealth management contracts are subject to termination on short notice, and termination of a significant number of investment advisory contracts could have a material adverse impact on our revenue.

Certain of our investment advisory and wealth management clients can terminate, with little or no notice, their relationships with us, reduce their aggregate assets under management, or shift their funds to other types of accounts with different rate structures for any number of reasons, including investment performance, changes in prevailing interest rates, inflation, changes in investment preferences of clients, changes in our reputation in the marketplace, change in management or control of clients, loss of key investment management personnel and financial market performance. We cannot be certain that our trust company subsidiary will be able to retain all of its clients. If its clients terminate their investment advisory and wealth management contracts, our trust company subsidiary, and consequently we, could lose a substantial portion of our revenues.

We are subject to possible claims and litigation pertaining to fiduciary responsibility.

From time to time, customers could make claims and take legal action pertaining to our performance of our fiduciary responsibilities. Whether customer claims and legal action related to our performance of our fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect our market perception of our products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Our business is subject to significant government regulation.

We operate in a highly regulated environment and are subject to supervision and regulation by a number of governmental regulatory agencies, including the Texas Department of Banking, the Federal Reserve Board, the OCC, and the FDIC. Regulations adopted by these agencies, which are generally intended to provide protection for depositors and customers rather than for the benefit of shareholders, govern a comprehensive range of matters relating to ownership and control of our shares, our acquisition of other companies and businesses, permissible activities for us to engage in, maintenance of adequate capital levels and other aspects of our operations. The bank regulatory agencies possess broad authority to prevent or remedy unsafe or unsound practices or violations of law.

The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes in light of the recent performance of and government intervention in the financial services sector. Other changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to reduced revenues, additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. Additionally, the banking regulations could prohibit and significantly delay the Company's acquisition of other financial institutions.

Included in the Dodd-Frank Act are, for example, changes related to interchange fees and overdraft services. While the changes for interchange fees that can be charged for electronic debit transactions by payment card issuers relate only to banks with assets greater than \$10 billion, concern exists that the regulations will also impact our Company. Beginning in the third quarter of 2010, we were prohibited from charging customers fees for paying

overdrafts on automated teller machine and debit card transactions, unless the consumer opts in. We continue to monitor the impact of these new regulations and other developments on our service charge revenue.

Our FDIC insurance assessments could increase substantially resulting in higher operating costs.

We have historically paid the lowest premium rate available due to our sound financial position. Should the number of bank failures increase, FDIC premiums could increase or additional special assessments could be imposed. These increased premiums would have an adverse effect on our net income and results of operations.

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We compete with many larger financial institutions which have substantially greater financial resources than we have.

Competition among financial institutions in Texas is intense. We compete with other bank holding companies, state and national commercial banks, savings and loan associations, consumer financial companies, credit unions, securities brokers, insurance companies, mortgage banking companies, money market mutual funds, asset-based non-bank lenders and other financial institutions. Many of these competitors have substantially greater financial resources, larger lending limits, larger branch networks and less regulatory oversight than we do, and are able to offer a broader range of products and services than we can. Failure to compete effectively for deposit, loan and other banking customers in our markets could cause us to lose market share, slow our growth rate and may have an adverse effect on our financial condition, results of operations and liquidity.

We are subject to interest rate risk.

Our profitability is dependent to a large extent on our net interest income, which is the difference between interest income we earn as a result of interest paid to us on loans and investments and interest we pay to third parties such as our depositors and those from whom we borrow funds. Like most financial institutions, we are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, and (iii) the average duration of the Company's securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and investments, our net interest income, and earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although we have implemented strategies which we believe reduce the potential effects of adverse changes in interest rates on our results of operations, these strategies may not always be successful. In addition, any substantial and prolonged increase in market interest rates could reduce our customers' desire to borrow money from us or adversely affect their ability to repay their outstanding loans by increasing their credit costs since most of our loans have adjustable interest rates that reset periodically. Any of these events could adversely affect our results of operations, financial condition and liquidity.

We are subject to liquidity risk.

The Company requires liquidity to meet our deposit and other obligations as they come due. The Company's access to funding sources in amounts adequate to finance its activities or on terms that are acceptable to it could be impaired by factors that affect it specifically or the financial services industry or the general economy. Factors that could reduce its access to liquidity sources include a downturn in the Texas market, difficult credit markets or adverse regulatory actions against the Company. The Company's access to deposits may also be affected by the liquidity needs of its depositors. In particular, a substantial majority of the Company's liabilities are demand, savings, interest checking and money market deposits, which are payable on demand or upon several days' notice, while by comparison, a substantial portion of its assets are loans, which cannot be called or sold in the same time frame. The Company may not be able to replace maturing deposits and advances as necessary in the future, especially if a large number of its depositors sought to withdraw their accounts, regardless of the reason. A failure to maintain adequate liquidity could have a material adverse effect on the Company's business, financial condition and result of operations.

The value of certain securities in our investment portfolio may be negatively affected by changes or disruptions in the market for these securities.

Our investment portfolio securities include obligations of, and mortgage-backed securities guaranteed by, government sponsored enterprises such as the Federal National Mortgage Association, referred to as Fannie Mae, the Government National Mortgage Association, referred to as Ginnie Mae, the Federal Home Loan Mortgage

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Corporation, referred to as Freddie Mac, and the Federal Home Loan Bank or otherwise backed by Federal Housing Administration or Veterans Administration guaranteed loans; however, volatility or illiquidity in financial markets may cause investment securities held within our investment portfolio to fall in value or become less liquid. The FRB's actions to increase the money supply (sometimes referred to as quantitative easing) may be curtailed or ended which may cause a decline in the value of securities held by the Company. Uncertainty surrounding the credit risk associated with mortgage collateral or guarantors may cause material discrepancies in valuation estimates obtained from third parties. Volatile market conditions may reduce valuations due to the perception of heightened credit and liquidity risks in addition to interest rate risk typically associated with these securities. There can be no assurance that declines in market value associated with these disruptions will not result in impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our results of operations, equity and capital ratios.

The downgrade of U.S. government securities by the credit rating agencies could have a material adverse effect on our operations, results of operations and financial condition.

The recent debates in Congress regarding the national debt ceiling, federal budget deficit concerns and overall weakness in the economy resulted in actual and threatened downgrades of United States government securities by the various major credit ratings agencies. While the federal banking agencies, including the Federal Reserve Board and the FDIC, have issued guidance indicating that, for risk-based capital purposes, the risk weights for United States Treasury securities and other securities issued or guaranteed by the United States government, government agencies and government-sponsored entities will not be affected by the downgrade, the downgrade of United States government securities by the credit agencies and the possible future downgrade of the federal government's credit rating could create further uncertainty in the United States and global financial markets and cause other events which, directly or indirectly, could adversely affect our operations, results of operations and financial condition.

First Financial Bankshares, Inc. relies on dividends from its subsidiaries for most of its revenue.

First Financial Bankshares, Inc. is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends paid by its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company's common stock and interest and principal on First Financial Bankshares, Inc. debt (if we had balances outstanding). Various federal and/or state laws and regulations limit the amount of dividends that our bank and trust subsidiaries may pay to First Financial Bankshares, Inc. In the event our subsidiaries are unable to pay dividends to First Financial Bankshares, Inc., First Financial Bankshares, Inc. may not be able to service debt, if any, or pay dividends on the Company's common stock. The inability to receive dividends from our subsidiaries could have a material adverse effect on the Company's business, financial condition, results of operations and liquidity.

To continue our growth, we are affected by our ability to identify and acquire other financial institutions.

We intend to continue our current growth strategy. This strategy includes opening new branches and acquiring other banks that serve customers or markets we find desirable. The market for acquisitions remains highly competitive, and we may be unable to find satisfactory acquisition candidates in the future that fit our acquisition and growth strategy. To the extent that we are unable to find suitable acquisition candidates, an important component of our growth strategy may be lost. Additionally, our completed acquisitions, or any future acquisitions, may not produce the revenue, earnings or synergies that we anticipated.

We may not be able to complete future acquisitions, may not be successful in realizing the benefits of any future acquisitions that are completed, or may choose not to pursue acquisition opportunities we might find beneficial.

A substantial part of our historical growth has been a result of acquisitions of other financial institutions, and we may, from time to time, evaluate and engage in the acquisition of other financial institutions. We must generally satisfy a number of conditions prior to completing any such transaction, including certain bank regulatory approvals. Bank regulators consider a number of factors with regard to all institutions involved in the transaction when determining whether to approve a proposed transaction, including, among others, the ratings and compliance history, anti-money laundering and Bank Secrecy Act compliance history, CRA examination results and the effect of the proposed transaction on the financial stability of the institutions involved and the market as a whole.

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The process for obtaining required regulatory approvals has become substantially more difficult, time-consuming and unpredictable as a result of the financial crisis. We may fail to pursue, evaluate or complete strategic and competitively significant business opportunities as a result of our inability, or our perceived inability, to obtain required regulatory approvals in a timely manner or at all.

Assuming we are able to successfully complete one or more transactions, we may not be able to successfully integrate and realize the expected synergies from any completed transaction in a timely manner or at all. In particular, we may be charged by federal and state regulators with regulatory and compliance failures at an acquired business prior to the date of the acquisition, and these failures by the acquired company may have negative consequences for us, including the imposition of formal or informal enforcement actions. Completion and integration of any transaction may also divert management's attention from other matters, result in additional costs and expenses, or adversely affect our relationships with our customers and employees, any of which may adversely affect our business or results of operations. As a result, our financial condition may be affected, and we may become more susceptible to general economic conditions and competitive pressures.

Use of our common stock for future acquisitions or to raise capital may be dilutive to existing stockholders.

When we determine that appropriate strategic opportunities exist, we may acquire other financial institutions and related businesses, subject to applicable regulatory requirements. We may use our common stock for such acquisitions. We may also seek to raise capital through selling additional common stock, although we have not historically done so. It is possible that the issuance of additional common stock in such acquisition or capital transactions may be dilutive to the interests of our existing shareholders.

Our accounting estimates and risk management processes rely on analytical and forecasting models.

The processes we use to estimate our allowance for loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates depends upon the use of analytical and forecasting models. In addition, these models are used to calculate fair value of our assets and liabilities when we acquire other financial institutions. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the models we use for determining our probable loan losses are inadequate, the allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value financial instruments is inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

The value of our goodwill and other intangible assets may decline in the future.

As of December 31, 2015, we had \$144.45 million of goodwill and other intangible assets. A significant decline in our financial condition, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our financial condition and results of operations.

We rely heavily on our management team, and the unexpected loss of key management or inability to recruit qualified personnel in the future may adversely affect our operations.

Our success to date has been strongly influenced by our ability to attract and to retain senior management experienced in banking in the markets we serve. Our ability to retain executive officers and the current management teams will continue to be important to the successful implementation of our strategies. We do not have employment agreements with these key employees other than executive agreements in the event of a change of control and a

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confidential information, non-solicitation and non-competition agreement related to our stock options. The unexpected loss of services of any key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on our business and financial results.

The Company's stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. The Company's stock price can fluctuate significantly in response to a variety of factors including, among other things:

actual or anticipated variations in quarterly results of operations;

recommendations by securities analysts;

operating and stock price performance of other companies that investors deem comparable to the Company;

new reports relating to trends, concerns and other issues in the financial services industry or Texas economy, including oil and gas prices;

perceptions in the marketplace regarding the Company and/or its competitors;

new technology used, or services offered, by competitors;

significant acquisitions or business combinations involving the Company or its competitors; and

changes in government regulations, including tax laws.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends could also cause the Company's stock price to decrease regardless of operational results.

The trading volume in our common stock is less than other larger financial institutions.

Although the Company's common stock is listed for trading on the Nasdaq Global Select Market, the trading volume in its common stock is less than that of other, larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Company's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Company has no control. Given the lower trading volume of the Company's common stock, significant sales of the Company's common stock, or the expectation

of these sales, could cause the Company's stock price to fall.

Breakdowns in our internal controls and procedures could have an adverse effect on us.

We believe our internal control system as currently documented and functioning is adequate to provide reasonable assurance over our internal controls. Nevertheless, because of the inherent limitation in administering a cost effective control system, misstatements due to error or fraud may occur and not be detected. Breakdowns in our internal controls and procedures could occur in the future, and any such breakdowns could have an adverse effect on us. See Item 9A Controls and Procedures for additional information.

We compete in an industry that continually experiences technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. In addition to improving the ability to serve customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend,

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in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for conveniences, as well as to create additional efficiencies in our operations. Many of our larger competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

System failure or cybersecurity breaches of our network security could subject us to increased operating costs as well as litigation and other potential losses.

The computer systems and network infrastructure we use could be vulnerable to unforeseen hardware and cybersecurity issues, including hacking and identity theft. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could have an adverse effect on our financial condition and results of operations. In addition, our operations are dependent upon our ability to protect the computer systems and network infrastructure utilized by us, including our Internet banking activities, against damage from physical break-ins, cybersecurity breaches and other disruptive problems caused by the Internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us, damage our reputation and inhibit current and potential customers from our Internet banking services. Each year, we add additional security measures to our computer systems and network infrastructure to mitigate the possibility of cybersecurity breaches including firewalls and penetration testing. We continue to investigate cost effective measures as well as insurance protection.

Furthermore, our customers could incorrectly blame the Company and terminate their accounts with the Company for a cyber-incident which occurred on their own system or with that of an unrelated third party. In addition, a security breach could also subject us to additional regulatory scrutiny and expose us to civil litigation and possible financial liability.

We are subject to claims and litigation pertaining to intellectual property.

We rely on technology companies to provide information technology products and services necessary to support our day-to-day operations. Technology companies frequently enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. In addition, patent holding companies seek to monetize patents they have purchased or otherwise obtained. Competitors of our vendors, or other individuals or companies, have from time to time claimed to hold intellectual property sold to us by its vendors. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, we may have to engage in litigation that could be expensive, time-consuming, disruptive to our operations, and distracting to management. If we are found to infringe one or more patents or other intellectual property rights, we may be required to pay substantial damages or royalties to a third-party. In certain cases, we may consider entering into licensing agreements for disputed intellectual property, although no assurance can be given that such licenses can be obtained on acceptable terms or that litigation will not occur. These licenses may also significantly increase our operating expenses. If legal matters related to intellectual property claims were resolved against us or settled, we could be required to make payments in amounts that could have a material adverse effect on our business, financial condition and results of operations.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this Risk Factors section and elsewhere in this Report. As a result, if you acquire our common stock, you may lose some or all of your investment.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal office is located in the First Financial Bank Building at 400 Pine Street in downtown Abilene, Texas. We lease four spaces in buildings owned by First Financial Bank, National Association, Abilene totaling approximately 8,300 square feet. Our subsidiaries collectively own 64 banking facilities, some of which are detached drive-ins, and also lease 11 banking facilities and 16 ATM locations. Our management considers all our existing locations to be well-suited for conducting the business of banking. We believe our existing facilities are adequate to meet our requirements and our subsidiaries' requirements for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

From time to time we and our subsidiaries are parties to lawsuits arising in the ordinary course of our banking business. However, there are no material pending legal proceedings to which we, our subsidiaries or our other direct and indirect subsidiaries, or any of their properties, are currently subject. Other than regular, routine examinations by state and federal banking authorities, there are no proceedings pending or known to be contemplated by any governmental authorities.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock, par value \$0.01 per share, is traded on the Nasdaq Global Select Market under the trading symbol FFIN. See Item 8 Financial Statements and Supplementary Data Quarterly Financial Data for the high, low and closing sales prices as reported by the Nasdaq Global Select Market for our common stock for the periods indicated.

Record Holders

As of February 1, 2016, we had approximately 1,100 shareholders of record.

Dividends

See Item 8 Financial Statements and Supplementary Data Quarterly Results of Operations for the frequency and amount of cash dividends paid by us. Also, see Item 1 Business Supervision and Regulation Payment of Dividends and Item 7 Management's Discussion and Analysis of the Financial Condition and Results of Operations Liquidity

Dividends for restrictions on our present or future ability to pay dividends, particularly those restrictions arising under federal and state banking laws.

Equity Compensation Plans

See Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters .

Table of Contents**PERFORMANCE GRAPH**

The following performance graph compares cumulative total shareholder returns for our common stock, the Russell 3000 Index, and the SNL Bank Index, which is a banking index prepared by SNL Financial LC and is comprised of banks with \$5 billion to \$10 billion in total assets, for a five-year period (December 31, 2010 to December 31, 2015). The performance graph assumes \$100 invested in our common stock at its closing price on December 31, 2010, and in each of the Russell 3000 Index and the SNL Bank Index on the same date. The performance graph also assumes the reinvestment of all dividends. The dates on the performance graph represent the last trading day of each year indicated. The amounts noted on the performance graph have been adjusted to give effect to all stock splits and stock dividends.

First Financial Bankshares, Inc.

<i>Index</i>	<i>Period Ending</i>					
	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15
First Financial Bankshares, Inc.	100.00	100.86	121.02	208.96	192.34	198.17
Russell 3000	100.00	101.03	117.61	157.07	176.79	177.64
SNL Bank \$5B-\$10B Index	100.00	99.24	116.73	180.10	185.52	211.33

Source : SNL Financial LC, Charlottesville, VA

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The selected financial data presented below as of and for the years ended December 31, 2015, 2014, 2013, 2012, and 2011, have been derived from our audited consolidated financial statements. The selected financial data should be read in conjunction with Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and accompanying notes presented elsewhere in this Form 10-K. The results of operations presented below are not necessarily indicative of the results of operations that may be achieved in the future. Management's Discussion and Analysis of Financial Condition and Results of Operations incorporates information required to be disclosed by the SEC's Industry Guide 3, Statistical Disclosure by Bank Holding Companies.

	Year Ended December 31,				
	2015	2014	2013	2012	2011
	(dollars in thousands, except per share data)				
Summary Income Statement Information:					
Interest income	\$ 221,623	\$ 198,539	\$ 176,369	\$ 159,796	\$ 160,021
Interest expense	4,088	4,181	4,088	5,112	8,024
Net interest income	217,535	194,358	172,281	154,684	151,997
Provision for loan losses	9,685	4,465	3,753	3,484	6,626
Noninterest income	73,432	66,624	62,052	57,209	51,438
Noninterest expense	149,464	137,925	126,012	109,049	104,624
Earnings before income taxes	131,818	118,592	104,568	99,360	92,185
Income tax expense	31,437	29,033	25,700	25,135	23,816
Net earnings	\$ 100,381	\$ 89,559	\$ 78,868	\$ 74,225	\$ 68,369
Per Share Data:					
Earnings per share, basic	\$ 1.55	\$ 1.40	\$ 1.24	\$ 1.18	\$ 1.09
Earnings per share, assuming dilution	1.54	1.39	1.24	1.18	1.09
Cash dividends declared	0.62	0.55	0.52	0.50	0.48
Book value at period-end	12.20	10.63	9.18	8.84	8.08
Earnings performance ratios:					
Return on average assets	1.61%	1.65%	1.64%	1.75%	1.78%
Return on average equity	13.60	14.00	13.75	13.85	14.44
Summary Balance Sheet Data (Period-end):					
Securities	\$ 2,734,177	\$ 2,416,297	\$ 2,058,407	\$ 1,820,096	\$ 1,844,998
Loans	3,350,593	2,937,991	2,689,448	2,088,623	1,786,544
Total assets	6,665,070	5,848,202	5,222,208	4,502,012	4,120,531
Deposits	5,190,169	4,750,255	4,135,075	3,632,584	3,334,798
Total liabilities	5,860,084	5,166,665	4,634,561	3,945,049	3,611,994
Total shareholders' equity	804,986	681,537	587,647	556,963	508,537
Asset quality ratios:					

Allowance for loan losses/period-end loans*	1.25%	1.25%	1.26%	1.67%	1.92%
Nonperforming assets/period-end loans plus foreclosed assets	0.89	0.74	1.16	1.22	1.64
Net charge offs/average loans	0.15	0.06	0.15	0.15	0.20
Capital ratios:					
Average shareholders equity/average assets	11.86%	11.78%	11.95%	12.62%	12.30%
Leverage ratio (1)	9.96	9.89	9.84	10.60	10.33
Tier 1 risk-based capital (2)	15.90	16.05	15.82	17.43	17.49
Total risk-based capital (3)	16.97	17.16	16.92	18.68	18.74
Common equity tier 1 capital (4)	15.90				
Dividend payout ratio	40.20	39.34	41.62	41.99	43.57

* The decrease in the allowance for loan losses percentage is due primarily to the impact of loans acquired through the Company's acquisition activities, which are initially recorded at fair value with an embedded credit adjustment and no allocated allowance for loan losses.

- (1) Calculated by dividing at period-end, shareholders' equity (before accumulated other comprehensive earnings/loss) less intangible assets by fourth quarter average assets less intangible assets.
- (2) Calculated by dividing at period-end, shareholders' equity (before accumulated other comprehensive earnings/loss) less intangible assets by risk-adjusted assets.

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- (3) Calculated by dividing at period-end, shareholders' equity (before accumulated other comprehensive earnings/loss) less intangible assets plus allowance for loan losses to the extent allowed under regulatory guidelines by risk-adjusted assets.
- (4) Calculated by dividing at period-end, shareholders' equity (before accumulated other comprehensive earnings/loss) less intangible assets by risk-adjusted assets.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains forward-looking statements that are subject to risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements as a result of certain factors, including but not limited to those listed in Item 1A Risk Factors and in the Cautionary Statement Regarding Forward-Looking Statements notice on page 1.

Introduction

As a financial holding company, we generate most of our revenue from interest on loans and investments, trust fees, and service charges. Our primary source of funding for our loans and investments are deposits held by our bank subsidiary, First Financial Bank, National Association, Abilene, Texas. Our largest expenses are salaries and related employee benefits. We measure our performance by calculating our return on average assets, return on average equity, our regulatory leverage and risk based capital ratios and our efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax equivalent basis and noninterest income.

The following discussion and analysis of the major elements of our consolidated balance sheets as of December 31, 2015 and 2014, and consolidated statements of earnings for the years 2013 through 2015 should be read in conjunction with our consolidated financial statements, accompanying notes, and selected financial data presented elsewhere in this Form 10-K.

Critical Accounting Policies

We prepare consolidated financial statements based on generally accepted accounting principles and customary practices in the banking industry. These policies, in certain areas, require us to make significant estimates and assumptions.

We deem a policy critical if (1) the accounting estimate required us to make assumptions about matters that are highly uncertain at the time we make the accounting estimate; and (2) different estimates that reasonably could have been used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, would have a material impact on the financial statements.

We deem our most critical accounting policies to be (1) our allowance for loan losses and our provision for loan losses and (2) our valuation of securities. We have other significant accounting policies and continue to evaluate the materiality of their impact on our consolidated financial statements, but we believe these other policies either do not generally require us to make estimates and judgments that are difficult or subjective, or it is less likely they would have a material impact on our reported results for a given period. A discussion of (1) our allowance for loan losses and our provision for loan losses and (2) our valuation of securities is included in Note 1 to our Consolidated Financial Statements beginning on page F-7.

Acquisitions and Asset Purchase

On February 9, 2013, we entered into an agreement and plan of merger to acquire Orange Savings Bank, SSB. On May 31, 2013, the transaction was completed, which we refer to herein as the Orange acquisition. Pursuant to the agreement, we paid \$39.20 million in cash and issued 840,000 shares of the Company's common stock in exchange for all of the outstanding shares of Orange Savings Bank, SSB. At closing, Orange Savings Bank, SSB was merged into First Financial Bank, National Association, Abilene, Texas, a wholly owned subsidiary of the Company. The total purchase price exceeded the estimated fair value of assets acquired by approximately \$23.02 million and the Company recorded such excess as goodwill.

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On April 1, 2015, we entered into an agreement and plan of reorganization to acquire FBC Bancshares, Inc. and its wholly owned bank subsidiary, First Bank, N.A., Conroe, Texas. On July 31, 2015, the transaction was completed, which we refer to herein as the Conroe acquisition. Pursuant to the agreement, we issued 1,755,374 shares of the Company's common stock in exchange for all of the outstanding shares of FBC Bancshares, Inc. At closing, FBC Bancshares, Inc. was merged into the Company and First Bank, N.A., Conroe, Texas, was merged into First Financial Bank, National Association, Abilene, Texas, a wholly owned subsidiary of the Company. The total purchase price exceeded the estimated fair value of assets acquired by approximately \$43.92 million and the Company recorded such excess as goodwill.

On April 8, 2015, the Company announced that it had entered into an asset purchase agreement with 4Trust Mortgage, Inc. for a cash purchase price of \$1.90 million. The asset purchase was finalized on June 1, 2015, which we refer to herein as the 4Trust asset purchase. The total asset purchase price exceeded the estimated fair value of assets purchased by approximately \$1.75 million and the Company recorded such excess as goodwill.

Stock Split

On April 22, 2014 the Company's Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend effective for shareholders of record on May 15, 2014 that was distributed on June 2, 2014. All share and per share amounts in this report have been restated to reflect this stock split. An amount equal to the par value of the additional common shares to be issued pursuant to the stock split was reflected as a transfer from retained earnings to common stock on the consolidated financial statements as of and for the year ended December 31, 2014.

Results of Operations

Performance Summary. Net earnings for 2015 were \$100.38 million, an increase of \$10.82 million, or 12.08%, over net earnings for 2014 of \$89.56 million. Net earnings for 2013 were \$78.87 million. The increases in net earnings for 2015 over 2014 and 2014 over 2013 were primarily attributable to growth in net interest income and noninterest income.

On a basic net earnings per share basis, net earnings were \$1.55 for 2015 as compared to \$1.40 for 2014 and \$1.24 for 2013. The return on average assets was 1.61% for 2015 as compared to 1.65% for 2014 and 1.64% for 2013. The return on average equity was 13.60% for 2015 as compared to 14.00% for 2014 and 13.75% for 2013.

Net Interest Income. Net interest income is the difference between interest income on earning assets and interest expense on liabilities incurred to fund those assets. Our earning assets consist primarily of loans and investment securities. Our liabilities to fund those assets consist primarily of noninterest-bearing and interest-bearing deposits. Tax-equivalent net interest income was \$240.48 million in 2015, as compared to \$213.49 million in 2014 and \$189.00 million in 2013. The increases in 2015 compared to 2014 and in 2014 compared to 2013 were largely attributable to increases in the volume of earning assets. Average earning assets were \$5.84 billion in 2015, as compared to \$5.08 billion in 2014 and \$4.48 billion in 2013. Average earning assets increased \$757.55 million in 2015, when compared to 2014, with increases in all categories of earning assets, except for short-term investments. Average earning assets increased \$602.51 million in 2014, when compared to 2013, with increases in all categories of earning assets, except for short-term investments. Average interest bearing liabilities were \$3.80 billion in 2015, as compared to \$3.30 billion in 2014 and \$2.91 billion in 2013. The yield on earning assets decreased 9 basis points in 2015, whereas the rate paid on interest-bearing liabilities decreased 2 basis point when compared to 2014, primarily due to the effects of lower interest rates. The yield on earning assets decreased 3 basis points in 2014, whereas the rate paid on interest-bearing liabilities decreased 1 basis point when compared to 2013, also primarily due to the effects of lower interest rates.

Table 1 allocates the change in tax-equivalent net interest income between the amount of change attributable to volume and to rate.

Table of Contents**Table 1 Changes in Interest Income and Interest Expense (in thousands):**

	2015 Compared to 2014			2014 Compared to 2013		
	Change Attributable to Volume	Change Attributable to Rate	Total Change	Change Attributable to Volume	Change Attributable to Rate	Total Change
Short-term investments	\$ (88)	\$ (74)	\$ (162)	\$ (32)	\$ (107)	\$ (139)
Taxable investment securities	4,777	(3,506)	1,271	2,938	(41)	2,897
Tax-exempt investment securities (1)	13,241	(2,491)	10,750	6,482	32	6,514
Loans (1) (2)	15,110	(73)	15,037	17,903	(2,598)	15,305
Interest income	33,040	(6,144)	26,896	27,291	(2,714)	24,577
Interest-bearing deposits	490	(731)	(241)	578	(404)	174
Short-term borrowings	95	53	148	(3)	(78)	(81)
Interest expense	585	(678)	(93)	575	(482)	93
Net interest income	\$ 32,455	\$ (5,466)	\$ 26,989	\$ 26,716	\$ (2,232)	\$ 24,484

(1) Computed on tax-equivalent basis assuming marginal tax rate of 35%.

(2) Non-accrual loans are included in loans.

The net interest margin in 2015 was 4.12%, a decrease of 8 basis points from 2014 which also decreased an additional 2 basis points from 2013. The decrease in our net interest margin in 2015 was largely the result of the extended period of historically low levels of short-term interest rates. The Federal funds rate remained at zero to 0.25% during 2013 through the majority of 2015. We have been able to somewhat mitigate the impact of low short-term interest rates by establishing minimum interest rates on certain of our loans, improving the pricing for loan risk, and reducing rates paid on interest bearing liabilities. Although the Federal Reserve slightly increased rates in late 2015 and continues to issue forward guidance plans to increase rates further in 2016 and future years, we expect interest rates to remain at lower levels, which will continue the downward pressure on our interest margin.

The net interest margin, which measures tax-equivalent net interest income as a percentage of average earning assets, is illustrated in Table 2 for the years 2013 through 2015.

Table 2 Average Balances and Average Yields and Rates (in thousands, except percentages):

	2015			2014			2013		
	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate	Average Balance	Income/Expense	Yield/Rate
Assets									
Short-term investments (1)	\$ 57,500	\$ 208	0.36%	\$ 75,093	\$ 370	0.49%	\$ 81,822	\$ 509	0.62%
	1,371,110	29,673	2.16	1,173,725	28,402	2.42	1,052,453	25,505	2.42

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Taxable investment securities (2)									
Tax-exempt investment securities (2)(3)									
Loans (3)(4)	1,318,531	61,407	4.66	1,045,304	50,657	4.85	911,472	44,143	4.84
	3,090,538	153,277	4.96	2,786,011	138,240	4.96	2,431,872	122,935	5.06
Total earning assets	5,837,679	\$ 244,565	4.19%	5,080,133	\$ 217,669	4.28%	4,477,619	\$ 193,092	4.31%
Cash and due from banks									
	148,369			144,029			129,222		
Bank premises and equipment, net									
	109,725			98,828			91,341		
Other assets									
	49,647			43,749			49,084		
Goodwill and other intangible assets, net									
	117,491			97,443			86,809		
Allowance for loan losses									
	(39,107)			(35,599)			(34,815)		
Total assets	\$ 6,223,804			\$ 5,428,583			\$ 4,799,260		
Liabilities and Shareholders Equity									
Interest-bearing deposits									
	\$ 3,272,150	\$ 3,642	0.11%	\$ 2,905,734	\$ 3,883	0.13%	\$ 2,513,674	\$ 3,709	0.15%
Short-term borrowings									
	524,365	446	0.08	397,738	298	0.07	400,545	379	0.09
Total interest-bearing liabilities									
	3,796,515	\$ 4,088	0.11%	3,303,472	\$ 4,181	0.13%	2,914,219	\$ 4,088	0.14%
Noninterest-bearing deposits									
	1,634,669			1,441,125			1,266,135		
Other liabilities									
	54,331			44,242			45,521		
Total liabilities	5,485,515			4,788,839			4,225,875		
Shareholders equity									
	738,289			639,744			573,385		
Total liabilities and shareholders equity	\$ 6,223,804			\$ 5,428,583			\$ 4,799,260		
Net interest income									
	\$ 240,477			\$ 213,488			\$ 189,004		
Rate Analysis:									
Interest income/earning assets									
			4.19%			4.28%			4.31%
Interest expense/earning assets									
			0.07			0.08			0.09

Net yield on
earning assets

4.12%

4.20%

4.22%

34

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- (1) Short-term investments are comprised of Fed Funds sold, interest bearing deposits in banks and interest bearing time deposits in banks.
- (2) Average balances include unrealized gains and losses on available-for-sale securities.
- (3) Computed on a tax-equivalent basis assuming a marginal tax rate of 35%.
- (4) Nonaccrual loans are included in loans.

Noninterest Income. Noninterest income for 2015 was \$73.43 million, an increase of \$6.81 million, or 10.22%, as compared to 2014. Increases in certain categories of noninterest income included (1) real estate mortgage fees of \$3.90 million, (2) ATM, interchange and credit card fees of \$2.43 million and (3) trust fees of \$486 thousand when compared to 2014. The increase in real estate mortgage fees primarily resulted from a stronger mortgage market and the 4Trust asset purchase on June 1, 2015. The increases in ATM, interchange and credit card fees are primarily a result of increases in the number of net new accounts and debit cards boosted by the Conroe acquisition on July 31, 2015. The increase in trust fees resulted from an increase in assets under management over the prior year offsetting the effect of the decline in oil and gas prices that reduced related trust fees by \$1.15 million in 2015 compared to 2014. The fair value of our trust assets managed, which are not reflected in our consolidated balance sheets, totaled \$3.87 billion at December 31, 2015 as compared to \$3.76 at December 31, 2014.

Offsetting the increases in 2015 was a loss on sale of assets of \$820 thousand and a decline in net gains on sale of foreclosed assets of \$366 thousand when compared to 2014.

Noninterest income for 2014 was \$66.62 million, an increase of \$4.57 million, or 7.37%, as compared to 2013. Increases in certain categories of noninterest income included (1) ATM, interchange and credit card fees of \$2.68 million, (2) trust fees of \$2.45 million and (3) net gain on sale of foreclosed assets of \$1.06 million. The increase in ATM, interchange and credit card fees were primarily a result of increases in the number of net new accounts and debit cards. The increase in trust fees were primarily due to the growth in assets under management over the prior year as well as higher fees generated from mineral management services. The fair value of our trust assets, which are not reflected in our consolidated balance sheets, totaled \$3.76 billion at December 31, 2014 compared to \$3.36 billion at December 31, 2013. The increase in net gain on sale of foreclosed assets was a result of several gains recognized on sales of foreclosed properties in our Orange and Weatherford regions.

Offsetting the increases in 2014 were decreases in real estate mortgage fees of \$545 thousand and service charges on deposit accounts of \$636 thousand. The decline in real estate mortgage fees was a result of the overall decline in the mortgage refinance market in 2014 when compared to 2013. The decline in service charges was a result of continued declines in NSF fees due to changes in overdraft regulations.

Table of Contents**Table 3 Noninterest Income (in thousands):**

	2015	Increase (Decrease)	2014	Increase (Decrease)	2013
Trust fees	\$ 19,252	\$ 486	\$ 18,766	\$ 2,449	\$ 16,317
Service charges on deposit accounts	17,171	261	16,910	(636)	17,546
ATM, interchange and credit card fees	21,860	2,433	19,427	2,677	16,750
Real estate mortgage operations	10,409	3,898	6,511	(545)	7,056
Net gain on sales of assets, net	(820)	(830)	10	(173)	183
Net gain on sale of available-for-sale securities	432	436	(4)	(151)	147
Net gain (loss) on sale of foreclosed assets	538	(366)	904	1,056	(152)
Other:					
Check printing fees	230	7	223	(6)	229
Safe deposit rental fees	524	(9)	533	30	503
Credit life and debt protection fees	663	449	214	(12)	226
Brokerage commissions	763	(108)	871	174	697
Interest on loan recoveries	1,050	449	601	133	468
Miscellaneous income	1,360	(298)	1,658	(424)	2,082
Total other	4,590	490	4,100	(105)	4,205
Total Noninterest Income	\$ 73,432	\$ 6,808	\$ 66,624	\$ 4,572	\$ 62,052

Noninterest Expense. Total noninterest expense for 2015 was \$149.46 million, an increase of \$11.54 million, or 8.37%, as compared to 2014. Noninterest expense for 2014 amounted to \$137.93 million, an increase of \$11.91 million, or 9.45%, as compared to 2013. An important measure in determining whether a banking company effectively manages noninterest expenses is the efficiency ratio, which is calculated by dividing noninterest expense by the sum of net interest income on a tax-equivalent basis and noninterest income. Lower ratios indicate better efficiency since more income is generated with a lower noninterest expense total. Our efficiency ratio for 2015 was 47.61%, as compared to 49.24% for 2014 and 50.19% for 2013.

Salaries and employee benefits for 2015 totaled \$81.00 million, an increase of \$10.54 million, or 14.96%, as compared to 2014. The increase was largely the result of the addition of employees in compliance-related areas, the addition of employees from the 4Trust asset purchase and Conroe acquisition, increases in healthcare claims and annual pay increases.

All other categories of noninterest expense for 2015 totaled \$68.47 million, an increase of \$996 thousand, or 1.48%, as compared to 2014. The increase in noninterest expense was largely attributable to increases in equipment expense of \$1.48 million, net occupancy expense of \$1.21 million, legal expense of \$1.13 million and software amortization and expense of \$696 thousand, largely resulting from the Company's 4Trust asset purchase and Conroe acquisition in 2015. Offsetting these increases in 2015 were declines in pension expense and the litigation settlement and expenses related to storm damage that were recognized in 2014 and discussed in more detail below.

Salaries and employee benefits for 2014 totaled \$70.46 million, an increase of \$3.93 million, or 5.90%, as compared to 2013. The principal causes of this increase were salary increases, additional employees to staff new branches and

compliance related areas and an increase in medical claims.

All other categories of noninterest expense for 2014 totaled \$67.47 million, an increase of \$7.99 million, or 13.43%, as compared to 2013. The increase in noninterest expense was largely attributable to the Company's recognition of a \$2.91 million expense from the partial settlement of its frozen defined benefit pension plan (see Note 12 to the Consolidated Financial Statements for more details) and the recognition of a \$2.39 million expense related to a litigation settlement and the deductible from damage sustained in a hail storm in Abilene. Other categories of noninterest expense with increases included ATM, interchange and credit card expenses, equipment expense and net occupancy expense.

Table of Contents**Table 4 Noninterest Expense (in thousands):**

	2015	Increase (Decrease)	2014	Increase (Decrease)	2013
Salaries	\$ 62,703	\$ 9,220	\$ 53,483	\$ 3,617	\$ 49,866
Medical	5,693	508	5,185	359	4,826
Profit sharing	5,455	131	5,324	(362)	5,686
Pension	17	(155)	172	(384)	556
401(k) match expense	2,043	344	1,699	139	1,560
Payroll taxes	4,382	498	3,884	260	3,624
Stock option expense	706	(3)	709	298	411
Total salaries and employee benefits	80,999	10,543	70,456	3,927	66,529
Loss from partial settlement of pension plan		(2,909)	2,909	2,909	
Net occupancy expense	10,314	1,214	9,100	1,005	8,095
Equipment expense	12,222	1,482	10,740	1,067	9,673
FDIC insurance premiums	3,153	428	2,725	307	2,418
ATM, interchange and credit card expenses	6,384	(486)	6,870	1,210	5,660
Professional and service fees	4,831	536	4,295	152	4,143
Printing, stationery and supplies	2,278	(359)	2,637	571	2,066
Amortization of intangible assets	561	286	275	78	197
Other:					
Data processing fees	400	91	309	60	249
Postage	1,705	35	1,670	136	1,534
Advertising	3,183	(407)	3,590	816	2,774
Correspondent bank service charges	925	38	887	(28)	915
Telephone	2,200	62	2,138	71	2,067
Public relations and business development	2,700	343	2,357	298	2,059
Directors fees	1,102	237	865	(2)	867
Audit and accounting fees	1,657	96	1,561	(158)	1,719
Legal fees	2,001	1,134	867	142	725
Regulatory exam fees	1,088	161	927	102	825
Travel	1,214	256	958	(35)	993
Courier expense	809	25	784	52	732
Operational and other losses	1,889	(1,792)	3,681	2,328	1,353
Other real estate	124	(346)	470	(55)	525
Software amortization and expense	2,122	696	1,426	(406)	1,832
Other miscellaneous expense	5,603	175	5,428	(2,634)	8,062
Total other	28,722	804	27,918	687	27,231
Total Noninterest Expense	\$ 149,464	\$ 11,539	\$ 137,925	\$ 11,913	\$ 126,012

Income Taxes. Income tax expense was \$31.44 million for 2015, as compared to \$29.03 million for 2014 and \$25.70 million for 2013. Our effective tax rates on pretax income were 23.85%, 24.48% and 24.58%, respectively, for the years 2015, 2014 and 2013. The effective tax rates differ from the statutory federal tax rate of 35.0% largely due to tax exempt interest income earned on certain investment securities and loans and the deductibility of dividends paid to our employee stock ownership plan.

Table of Contents**Balance Sheet Review**

Loans. Our portfolio is comprised of loans made to businesses, professionals, individuals, and farm and ranch operations located in the primary trade areas served by our subsidiary bank. Real estate loans represent loans primarily for 1-4 family residences and owner-occupied commercial real estate. The structure of loans in the real estate mortgage area generally provides re-pricing intervals to minimize the interest rate risk inherent in long-term fixed rate loans. As of December 31, 2015, total loans held for investment were \$3.32 billion, an increase of \$387.86 million, as compared to December 31, 2014. As compared to year-end 2014, real estate loans increased \$313.38 million, commercial loans increased \$56.21 million, agricultural loans decreased \$3.34 million and consumer loans increased \$21.62 million. The acquisition of First Bank accounted for \$248.38 million of the increase in loans. Loans averaged \$3.09 billion during 2015, an increase of \$304.53 million over the 2014 average balances.

Table 5 Composition of Loans (in thousands):

	December 31,				
	2015	2014	2013	2012	2011
Commercial	\$ 696,163	\$ 639,954	\$ 596,730	\$ 509,609	\$ 454,087
Agricultural	102,351	105,694	75,928	68,306	68,122
Real estate	2,136,233	1,822,854	1,678,514	1,226,823	1,041,396
Consumer	382,303	360,686	333,113	272,428	212,310
Total loans held-for-investment	\$ 3,317,050	\$ 2,929,188	\$ 2,684,285	\$ 2,077,166	\$ 1,775,915

As of December 31, 2015, our real estate loans represent approximately 64.40% of our loan portfolio and are comprised of (i) commercial real estate loans of 25.36%, generally owner occupied, (ii) 1-4 family residence loans of 44.63%, (iii) residential development and construction loans of 9.65%, which includes our custom and speculation home construction loans, (iv) commercial development and construction loans of 5.16% and (v) other loans, which includes ranches, hospitals and universities of 15.20%.

Loans held-for-sale totaled \$33.54 million and \$8.80 million at December 31, 2015 and 2014, respectively, which are valued using the lower of cost or market method.

The Company has certain lending policies and procedures in place that are designed to maximize loan income with an acceptable level of risk. Management reviews and approves these policies and procedures on an annual basis and makes changes as appropriate. Management receives and reviews monthly reports related to loan originations, quality, concentrations, delinquencies, nonperforming and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions, both by type of loan and geographic location.

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and effectively. Underwriting standards are designed to determine whether the borrower possesses sound business ethics and practices and to evaluate current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and, secondarily, on the underlying collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and include personal guarantees.

Agricultural loans are subject to underwriting standards and processes similar to commercial loans. These agricultural loans are based primarily on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Most agricultural loans are secured by the agriculture related assets being financed, such as farm land, cattle or equipment, and include personal guarantees.

Real estate loans are also subject to underwriting standards and processes similar to commercial and agricultural loans. These loans are underwritten primarily based on projected cash flows and, secondarily, as loans secured by real estate. The repayment of real estate loans is largely dependent on the successful operation of the business conducted on the property securing the loans or the business conducted on the property securing the loan. Real estate loans may be

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more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's real estate portfolio are generally diverse in terms of type and geographic location within Texas. This diversity helps reduce the exposure to adverse economic events that affect any single market or industry. Generally, real estate loans are owner occupied which further reduces the Company's risk.

Consumer loan underwriting utilizes methodical credit standards and analysis to supplement the Company's underwriting policies and procedures. The Company's loan policy addresses types of consumer loans that may be originated and the collateral, if secured, which must be perfected. The relatively smaller individual dollar amounts of consumer loans that are spread over numerous individual borrowers also minimize the Company's risk.

Table 6 Maturity Distribution and Interest Sensitivity of Loans at December 31, 2015 (in thousands):

The following tables summarize maturity and repricing information for the commercial and agricultural and the real estate-construction portion of our loan portfolio as of December 31, 2015:

	One Year or less	After One Year Through Five Years	After Five Years	Total
Commercial and agricultural	\$ 377,026	\$ 237,449	\$ 184,039	\$ 798,514
Real estate - construction	113,498	50,116	148,142	311,756

	Maturities After One Year
Loans with fixed interest rates	\$ 432,708
Loans with floating or adjustable interest rates	187,038

Asset Quality. The loan portfolio of our bank subsidiary is subject to periodic reviews by our centralized independent loan review group as well as periodic examinations by bank regulatory agencies. Loans are placed on nonaccrual status when, in the judgment of management, the collectability of principal or interest under the original terms becomes doubtful. Nonaccrual, past due 90 days or more and still accruing and restructured loans plus foreclosed assets, were \$29.77 million at December 31, 2015, as compared to \$21.72 million at December 31, 2014 and \$31.13 million at December 31, 2013. As a percent of loans and foreclosed assets, these assets were 0.89% at December 31, 2015, as compared to 0.74% at December 31, 2014 and 1.16% at December 31, 2013. As a percent of total assets, these assets were 0.45% at December 31, 2015, as compared to 0.37% at December 31, 2014 and 0.60% at December 31, 2013. We believe the level of these assets to be manageable and are not aware of any material classified credits not properly disclosed as nonperforming at December 31, 2015.

Table 7 Nonaccrual, Past Due 90 Days or More and Still Accruing, Restructured Loans and Foreclosed Assets (in thousands, except percentages):

At December 31,

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	2015	2014	2013	2012	2011
Nonaccrual loans*	\$ 28,601	\$ 20,194	\$ 27,926	\$ 21,800	\$ 19,975
Loans still accruing and past due 90 days or more	341	261	133	97	96
Troubled debt restructured loans**	199	226			
Nonperforming loans	29,141	20,681	28,059	21,897	20,071
Foreclosed assets	627	1,035	3,069	3,565	9,464
Total nonperforming assets	\$ 29,768	\$ 21,716	\$ 31,128	\$ 25,462	\$ 29,535
As a % of loans and foreclosed assets	0.89%	0.74%	1.16%	1.22%	1.64%
As a % of total assets	0.45	0.37	0.60	0.57	0.72

* Includes \$2.18 million, \$2.15 million and \$2.71 million, respectively, of purchased credit impaired loans as of December 31, 2015, 2014 and 2013. There were no purchased credit impaired loan balances in 2012 and 2011.

** Troubled debt restructured loans of \$6.11 million, \$9.07 million, \$13.30 million, \$14.36 million and \$6.55 million, respectively, whose interest collection, after considering economic and business conditions and collection efforts, is doubtful are included in non-accrual loans as of December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

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We record interest payments received on non-accrual loans as reductions of principal. Prior to the loans being placed on non-accrual, we recognized interest income on impaired loans as of December 31, 2015 of approximately \$780 thousand during the year ended December 31, 2015. If interest on these impaired loans had been recognized on a full accrual basis during the year ended December 31, 2015, such income would have approximated \$2.74 million.

See Note 3 to the Consolidated Financial Statements beginning on page F-16 for more information on these assets.

Provision and Allowance for Loan Losses. The allowance for loan losses is the amount we determine as of a specific date to be appropriate to absorb probable losses on existing loans in which full collectability is unlikely based on our review and evaluation of the loan portfolio. For a discussion of our methodology, see our accounting policies in Note 1 to the Consolidated Financial Statements beginning on page F-7. The provision for loan losses was \$9.69 million in 2015 as compared to \$4.47 million in 2014 and \$3.75 million in 2013. The continued provision for loan losses in 2015 and 2014 reflects the overall growth in loans and continuing levels of nonperforming and classified assets, including those related to the oil and gas industry. The Company's direct exposure to the oil and gas industry remained at approximately 2.9% of total loans at December 31, 2015, consistent with December 31, 2014 year-end levels. As a percent of average loans, net loan charge-offs were 0.15% during 2015, 0.06% during 2014 and 0.15% during 2013. The allowance for loan losses as a percent of loans was 1.25% as of December 31, 2015 as compared to 1.25% as of December 31, 2014 and 1.26% at December 31, 2013. Included in Tables 8 and 9 are further analysis of our allowance for loan losses.

Although we believe we use the best information available to make loan loss allowance determinations, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making our initial determinations. A downturn in the economy or lower employment could result in increased levels of nonaccrual, past due 90 days or more and still accruing, restructured loans, foreclosed assets, charge-offs, increased loan loss provisions and reductions in income. Additionally, as an integral part of their examination process, bank regulatory agencies periodically review the adequacy of our allowance for loan losses. The banking agencies could require additions to the loan loss allowance based on their judgment of information available to them at the time of their examinations of our bank subsidiary.

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	2015	2014	2013	2012	2011
Balance at January 1,	\$ 36,824	\$ 33,900	\$ 34,839	\$ 34,315	\$ 31,106
Charge-offs:					
Commercial	3,734	583	1,283	499	640
Agricultural	164	2	100	53	95
Real estate	441	1,075	1,970	2,951	3,682
Consumer	1,700	1,222	1,268	852	907
Total charge-offs	6,039	2,882	4,621	4,355	5,324
Recoveries:					
Commercial	344	346	402	281	610
Agricultural	55	18	39	54	33
Real estate	558	505	239	639	874
Consumer	450	472	337	421	390
Total recoveries	1,407	1,341	1,017	1,395	1,907
Net charge-offs	4,632	1,541	3,604	2,960	3,417
Transfer of off-balance sheet exposure to other liabilities			(1,088)		
Provision for loan losses	9,685	4,465	3,753	3,484	6,626
Balance at December 31,	\$ 41,877	\$ 36,824	\$ 33,900	\$ 34,839	\$ 34,315
Loans at year-end	\$ 3,350,593	\$ 2,937,991	\$ 2,689,448	\$ 2,088,623	\$ 1,786,544
Average loans	3,090,538	2,786,011	2,431,872	1,909,890	1,715,266
Net charge-offs/average loans	0.15%	0.06%	0.15%	0.15%	0.20%
Allowance for loan losses/year-end loans*	1.25	1.25	1.26	1.67	1.92
Allowance for loan losses/nonaccrual, past due 90 days still accruing and restructured loans	143.70	178.06	120.82	159.10	171.00

* Reflects the impact of loans acquired in the Orange acquisition in 2013 and the Conroe acquisition in 2015, which were initially recorded at fair value with no allocated allowance for loan losses.

Table 9 Allocation of Allowance for Loan Losses (in thousands):

	2015	2014	2013	2012	2011
	Allocation	Allocation	Allocation	Allocation	Allocation
	Amount	Amount	Amount	Amount	Amount
Commercial	\$ 12,644	\$ 7,990	\$ 6,440	\$ 7,343	\$ 9,664
Agricultural	1,191	527	383	1,541	1,482
Real estate	24,375	26,657	24,940	24,063	21,533
Consumer	3,667	1,650	2,137	1,892	1,636
Total	\$ 41,877	\$ 36,824	\$ 33,900	\$ 34,839	\$ 34,315

Percent of Loans in Each Category of Total Loans:

	2015	2014	2013	2012	2011
Commercial	20.99%	21.84%	22.23%	24.53%	26.37%
Agricultural	3.09	3.61	2.83	3.29	4.02
Real estate	64.40	62.23	62.53	59.06	57.66
Consumer	11.52	12.32	12.41	13.12	11.95

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Included in our loan portfolio are certain other loans not included in Table 7 that are deemed to be potential problem loans. Potential problem loans are those loans that are currently performing, but for which known information about trends, uncertainties or possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present repayment terms, possibly resulting in the transfer of such loans to nonperforming status. These potential problem loans totaled \$17.75 million as of December 31, 2015.

Interest-Bearing Deposits in Banks. The Company had interest-bearing deposits in banks of \$93.43 million, \$71.33 million and \$57.42 million at December 31, 2015, 2014, and 2013, respectively. At December 31, 2015, our interest-bearing deposits in banks included \$89.38 million maintained at the Federal Reserve Bank of Dallas, \$3.50 million invested in FDIC-insured certificates of deposit and \$554 thousand on deposit with the Federal Home Loan Bank of Dallas (FHLB). The average balance of interest-bearing deposits in banks was \$49.69 million, \$66.68 million and \$69.17 million in 2015, 2014 and 2013, respectively. The average yield on interest-bearing deposits in banks was 0.36%, 0.51% and 0.67% in 2015, 2014 and 2013, respectively.

Available-for-Sale and Held-to-Maturity Securities. At December 31, 2015, securities with a fair value of \$2.73 billion were classified as securities available-for-sale and securities with an amortized cost of \$278 thousand were classified as securities held-to-maturity. As compared to December 31, 2014, the available-for-sale portfolio at December 31, 2015, reflected (1) an increase of \$10.28 million in U.S. Treasury securities; (2) an increase of \$18.80 million in obligations of U.S. government sponsored enterprises and agencies; (3) an increase of \$283.50 million in obligations of states and political subdivisions; (4) a decrease of \$10.80 million in corporate bonds and other; and (5) an increase of \$16.27 million in mortgage-backed securities. As compared to December 31, 2013, the available-for-sale portfolio at December 31, 2014, reflected (1) an increase of \$520 thousand in U.S. Treasury securities; (2) a decrease of \$8.33 million in obligations of U.S. government sponsored enterprises and agencies; (3) an increase of \$176.36 million in obligations of states and political subdivisions; (4) a decrease of \$10.28 million in corporate bonds and other; and (5) an increase of \$16.27 million in mortgage-backed securities. Securities-available-for-sale included fair value adjustments of \$79.01 million, \$77.17 million and \$22.60 million at December 31, 2015, 2014, and 2013, respectively. We did not hold any collateralized mortgage obligations or structured notes as of December 31, 2015 that we consider to be high risk. Our mortgage related securities are backed by GNMA, FNMA or FHLMC or are collateralized by securities backed by these agencies.

See Table 10 and Note 2 to the Consolidated Financial Statements for additional disclosures relating to the maturities and fair values of the investment portfolio at December 31, 2015 and 2014.

Table 10 Maturities and Yields of Available-for-Sale Held at December 31, 2015 (in thousands, except percentages):

	One Year or Less		After One Year Through Five Years		Maturing After Five Years Through Ten Years		After Ten Years		Total		
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	
Available-for-Sale:											
U.S. Treasury securities	\$		%\$	10,795	1.12%	\$		%\$	%\$	10,795	1.12%
Obligations of U.S. government sponsored	33,600	1.18		114,954	1.27					148,554	1.25

enterprises and
agencies

Obligations of states and political subdivisions	71,179	4.30	603,833	5.17	771,407	4.84	4,708	7.79	1,451,127	4.96
Corporate bonds and other securities	34,307	1.87	53,648	3.04					87,955	2.58
Mortgage-backed securities	3,808	4.64	801,598	2.29	229,880	2.51	182	2.70	1,035,468	2.35
Total	\$ 142,894	2.99%	\$ 1,584,828	3.33%	\$ 1,001,287	4.31%	\$ 4,890	7.60%	\$ 2,733,899	3.68%

Amounts for held-to-maturity securities are not included herein due to insignificance.

All yields are computed on a tax-equivalent basis assuming a marginal tax rate of 35%. Yields on available-for-sale securities are based on amortized cost. Maturities of mortgage-backed securities are based on contractual maturities and could differ due to prepayments of underlying mortgages. Maturities of other securities are reported at the earlier of maturity date or call date.

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As of December 31, 2015, the investment portfolio had an overall tax equivalent yield of 3.68%, a weighted average life of 4.35 years and modified duration of 3.87 years.

Deposits. Deposits held by our subsidiary bank represent our primary source of funding. Total deposits were \$5.19 billion as of December 31, 2015, \$4.75 billion as compared to December 31, 2014 and \$4.14 billion as of December 31, 2013. Table 11 provides a breakdown of average deposits and rates paid over the past three years and the remaining maturity of time deposits of \$100,000 or more:

Table 11 Composition of Average Deposits and Remaining Maturity of Time Deposits of \$100,000 or More (in thousands, except percentages):

	2015		2014		2013	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing deposits	\$ 1,634,669		\$ 1,441,125		\$ 1,266,135	
Interest-bearing deposits						
Interest-bearing checking	1,622,331	0.09%	1,341,754	0.11%	1,094,897	0.11%
Savings and money market accounts	1,021,222	0.05	888,108	0.06	754,493	0.07
Time deposits under \$100,000	261,255	0.20	279,734	0.22	291,026	0.25
Time deposits of \$100,000 or more	367,342	0.31	396,138	0.32	373,258	0.34
Total interest-bearing deposits	3,272,150	0.11%	2,905,734	0.13%	2,513,674	0.15%
Total average deposits	\$ 4,906,819		\$ 4,346,859		\$ 3,779,809	

	As of December 31, 2015
Three months or less	\$ 116,272
Over three through six months	108,218
Over six through twelve months	101,162
Over twelve months	45,223
Total time deposits of \$100,000 or more	\$ 370,875

Short-Term Borrowings. Included in short-term borrowings were federal funds purchased, securities sold under repurchase agreements and advances from the FHLB of \$615.68 million, \$367.11 million and \$463.89 million at December 31, 2015, 2014 and 2013, respectively. Securities sold under repurchase agreements are generally with significant customers of the Company that require short-term liquidity for their funds for which we pledge certain securities that have a fair value equal to at least the amount of the short-term borrowing. The average balances of federal funds purchased, securities sold under repurchase agreements and advances from the FHLB were \$524.37 million, \$397.74 million and \$400.55 million in 2015, 2014 and 2013, respectively. The average rates paid on federal funds purchased, securities sold under repurchase agreements and advances from the FHLB were 0.08%, 0.07% and 0.09% for the years ended December 31, 2015, 2014 and 2013, respectively. The weighted average interest rate paid

on federal funds purchased, securities sold under repurchase agreements and advances from the FHLB was 0.17%, 0.04% and 0.10% at December 31, 2015, 2014 and 2013, respectively. The highest amount of federal funds purchased, securities sold under repurchase agreements and advances from the FHLB at any month end during 2015, 2014 and 2013 was \$647.72 million, \$497.31 million and \$532.39 million, respectively.

Capital Resources

We evaluate capital resources by our ability to maintain adequate regulatory capital ratios to do business in the banking industry. Issues related to capital resources arise primarily when we are growing at an accelerated rate but not retaining a significant amount of our profits or when we experience significant asset quality deterioration.

Total shareholders' equity was \$804.99 million, or 12.08% of total assets at December 31, 2015, as compared to \$681.54 million, or 11.65% of total assets, at December 31, 2014. During 2015, total shareholders' equity averaged \$738.29 million, or 11.86% of average assets, as compared to \$639.74 million, or 11.78% of average assets during 2014.

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Banking regulators measure capital adequacy by means of the risk-based capital ratios and leverage ratio. The risk-based capital rules provide for the weighting of assets and off-balance-sheet commitments and contingencies according to prescribed risk categories. Regulatory capital is then divided by risk-weighted assets to determine the risk-adjusted capital ratios. The leverage ratio is computed by dividing shareholders' equity less intangible assets by quarter-to-date average assets less intangible assets. As of December 31, 2015 and December 31, 2014, we had a total risk-based capital ratio of 16.97% and 17.16%, a Tier 1 capital to risk-weighted assets ratio of 15.90% and 16.05% and a Tier 1 leverage ratio of 9.96% and 9.89%, respectively. At December 31, 2015, we had a common equity Tier 1 to risk-weighted assets ratio of 15.90%. The regulatory capital ratios as of December 31, 2015 were calculated under Basel III rules and the regulatory capital ratios as of December 31, 2014 were calculated under Basel I rules. There is no threshold for well-capitalized status for bank holding companies.

We performed an assessment using the new regulatory capital ratios and determined that the Company meets the new requirements specified in the Basel III rules upon full adoption of such requirements.

Our subsidiary bank made the election to continue to exclude most accumulated other comprehensive income (AOCI) from capital in connection with its March 31, 2015 quarterly financial filing and, in effect, to retain the AOCI treatment under the prior capital rules.

Interest Rate Risk. Interest rate risk results when the maturity or repricing intervals of interest-earning assets and interest-bearing liabilities are different. Our exposure to interest rate risk is managed primarily through our strategy of selecting the types and terms of interest-earning assets and interest-bearing liabilities that generate favorable earnings while limiting the potential negative effects of changes in market interest rates. We use no off-balance-sheet financial instruments to manage interest rate risk.

Our subsidiary bank has an asset liability management committee that monitors interest rate risk and compliance with investment policies. The subsidiary bank utilizes an earnings simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next twelve months. The model measures the impact on net interest income relative to a base case scenario of hypothetical fluctuations in interest rates over the next twelve months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the re-pricing and maturity characteristics of the existing and projected balance sheet.

As of December 31, 2015, the model simulations projected that 100 and 200 basis point increases in interest rates would result in variances in net interest income of positive 0.11% and negative 0.18%, respectively, relative to the current financial statement structure over the next twelve months, while a decrease in interest rates of 50 basis points would result in a variance in a net interest income of negative 2.29% relative to the current financial statement structure over the next twelve months. We consider the likelihood of a decrease in interest rates beyond 50 basis points after December 31, 2015 remote given current interest rate levels. These are good faith estimates and assume that the composition of our interest sensitive assets and liabilities existing at each year-end will remain constant over the relevant twelve month measurement period and that changes in market interest rates are instantaneous and sustained across the yield curve regardless of duration of pricing characteristics on specific assets or liabilities. Also, this analysis does not contemplate any actions that we might undertake in response to changes in market interest rates. We believe these estimates are not necessarily indicative of what actually could occur in the event of immediate interest rate increases or decreases of this magnitude. As interest-bearing assets and liabilities re-price in different time frames and proportions to market interest rate movements, various assumptions must be made based on historical relationships of these variables in reaching any conclusion. Since these correlations are based on competitive and market conditions, we anticipate that our future results will likely be different from the foregoing estimates, and such differences could be material.

Should we be unable to maintain a reasonable balance of maturities and repricing of our interest-earning assets and our interest-bearing liabilities, we could be required to dispose of our assets in an unfavorable manner or pay a higher than market rate to fund our activities. Our asset liability committee oversees and monitors this risk.

Table of Contents**Liquidity**

Liquidity is our ability to meet cash demands as they arise. Such needs can develop from loan demand, deposit withdrawals or acquisition opportunities. Potential obligations resulting from the issuance of standby letters of credit and commitments to fund future borrowings to our loan customers are other factors affecting our liquidity needs. Many of these obligations and commitments are expected to expire without being drawn upon; therefore the total commitment amounts do not necessarily represent future cash requirements affecting our liquidity position. The potential need for liquidity arising from these types of financial instruments is represented by the contractual notional amount of the instrument, as detailed in Tables 12 and 13. Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. Liquid assets include cash, federal funds sold, and short-term investments in time deposits in banks. Liquidity is also provided by access to funding sources, which include core depositors and correspondent banks that maintain accounts with and sell federal funds to our subsidiary bank. Other sources of funds include our ability to borrow from short-term sources, such as purchasing federal funds from correspondent banks, sales of securities under agreements to repurchase and advances from the FHLB, which amounted to \$615.68 million at December 31, 2015, and an unfunded \$25.00 million revolving line of credit established with Frost Bank, a nonaffiliated bank, which matures on June 2017 (see next paragraph). Our subsidiary bank also has federal funds purchased lines of credit with two non-affiliated banks totaling \$130.00 million. At December 31, 2015, there were no amounts drawn on these lines of credit. Our subsidiary bank also has available a line of credit with the FHLB totaling \$933.30 million at December 31, 2015, secured by portions of our loan portfolio and certain investment securities. At December 31, 2015, \$299.02 million in advances was outstanding under this line of credit.

The Company renewed its loan agreement, effective June 30, 2015, with Frost Bank. Under the loan agreement, as renewed and amended, we are permitted to draw up to \$25.00 million on a revolving line of credit. Prior to June 30, 2017, interest is paid quarterly at *The Wall Street Journal* Prime Rate and the line of credit matures June 30, 2017. If a balance exists at June 30, 2017, the principal balance converts to a term facility payable quarterly over five years and interest is paid quarterly at our election at *The Wall Street Journal* Prime Rate plus 50 basis points or LIBOR plus 250 basis points. The line of credit is unsecured. Among other provisions in the credit agreement, we must satisfy certain financial covenants during the term of the loan agreement, including, without limitation, covenants that require us to maintain certain capital, tangible net worth, loan loss reserve, non-performing asset and cash flow coverage ratios. In addition, the credit agreement contains certain operational covenants, which among others, restricts the payment of dividends above 55% of consolidated net income, limits the incurrence of debt (excluding any amounts acquired in an acquisition) and prohibits the disposal of assets except in the ordinary course of business. Since 1995, we have historically declared dividends as a percentage of our consolidated net income in a range of 37% (low) in 1995 to 53% (high) in 2003 and 2006. The Company was in compliance with the financial and operational covenants at December 31, 2015. There was no outstanding balance under the line of credit as of December 31, 2015 or 2014.

In addition, we anticipate that any future acquisition of financial institutions, expansion of branch locations or offering of new products could also place a demand on our cash resources. Available cash and cash equivalents and securities at our parent company, which totaled \$90.47 million at December 31, 2015, investment securities which totaled \$12.06 million at December 31, 2015 which matures over 7 to 14 years, available dividends from our subsidiaries which totaled \$129.31 million at December 31, 2015, utilization of available lines of credit, and future debt or equity offerings are expected to be the source of funding for potential acquisitions or expansions.

Given the strong core deposit base and relatively low loan to deposit ratios maintained at our subsidiary bank, we consider our current liquidity position to be adequate to meet our short-term and long-term liquidity needs.

Table of Contents**Table 12 Contractual Obligations as of December 31, 2015 (in thousands):**

	Total Amounts	Payment Due by Period			
		Less than 1 year	More than 1 year but less than 3 years	More than 3 year but less than 5 years	Over 5 years
Deposits with stated maturity dates	\$ 620,852	\$ 534,970	\$ 60,756	\$ 25,126	\$
Pension obligation	9,143	797	1,717	1,804	4,825
Operating leases	2,177	1,055	769	334	19
Outsourcing service contracts	1,014	1,014			
Total Contractual Obligations	\$ 633,186	\$ 537,836	\$ 63,242	\$ 27,264	\$ 4,844

Amounts above for deposits do not include related accrued interest.

Off-Balance Sheet Arrangements. We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include unfunded lines of credit, commitments to extend credit and federal funds sold to correspondent banks and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

Our exposure to credit loss in the event of nonperformance by the counterparty to the financial instrument for unfunded lines of credit, commitments to extend credit and standby letters of credit is represented by the contractual notional amount of these instruments. We generally use the same credit policies in making commitments and conditional obligations as we do for on-balance-sheet instruments.

Unfunded lines of credit and commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. These commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, as we deem necessary upon extension of credit, is based on our credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments we issue to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The average collateral value held on letters of credit usually exceeds the contract amount.

Table 13 Commitments as of December 31, 2015 (in thousands):

	Total Notional Amounts Committed	Less than 1 year	More than 1 year but less than 3 years	More than 3 year but less than 5 years	Over 5 years
Unfunded lines of credit	\$ 461,000	\$ 423,522	\$ 15,121	\$ 10,915	\$ 11,442
Unfunded commitments to extend credit	172,433	83,591	10,701	23,610	54,531
Standby letters of credit	31,051	25,956	1,905	3,190	
Total Commercial Commitments	\$ 664,484	\$ 533,069	\$ 27,727	\$ 37,715	\$ 65,973

We believe we have no other off-balance sheet arrangements or transactions with unconsolidated, special purpose entities that would expose us to liability that is not reflected on the face of the financial statements.

Parent Company Funding. Our ability to fund various operating expenses, dividends, and cash acquisitions is generally dependent on our own earnings (without giving effect to our subsidiaries), cash reserves and funds derived from our subsidiaries. These funds historically have been produced by intercompany dividends and management

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fees that are limited to reimbursement of actual expenses. We anticipate that our recurring cash sources will continue to include dividends and management fees from our subsidiaries. At December 31, 2015, approximately \$129.31 million was available for the payment of intercompany dividends by the subsidiaries without the prior approval of regulatory agencies. Our subsidiaries paid aggregate dividends to us of \$51.20 million in 2015 and \$34.00 million in 2014.

Dividends. Our long-term dividend policy is to pay cash dividends to our shareholders of approximately 40% of annual net earnings while maintaining adequate capital to support growth. We are also restricted by a loan covenant within our line of credit agreement with Frost Bank to dividend no greater than 55% of net income, as defined in such loan agreement. The cash dividend payout ratios have amounted to 40.20%, 39.34% and 41.62% of net earnings, respectively, in 2015, 2014 and 2013. Given our current capital position, projected earnings and asset growth rates, we do not anticipate any significant change in our current dividend policy.

Our bank subsidiary, which is a national banking association and a member of the Federal Reserve System, is required by federal law to obtain the prior approval of the OCC to declare and pay dividends if the total of all dividends declared in any calendar year would exceed the total of (1) such bank's net profits (as defined and interpreted by regulation) for that year plus (2) its retained net profits (as defined and interpreted by regulation) for the preceding two calendar years, less any required transfers to surplus.

To pay dividends, we and our subsidiary bank must maintain adequate capital above regulatory guidelines. In addition, if the applicable regulatory authority believes that a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending on the financial condition of the bank, could include the payment of dividends), the authority may require, after notice and hearing, that such bank cease and desist from the unsafe practice. The Federal Reserve, the FDIC and the OCC have each indicated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice. The Federal Reserve, the OCC and the FDIC have issued policy statements that recommend that bank holding companies and insured banks should generally only pay dividends out of current operating earnings.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management considers interest rate risk to be a significant market risk for the Company. See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Capital Resources Interest Rate Risk for disclosure regarding this market risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and the report of our independent registered public accounting firm begin on page F-1.

Table of Contents**Quarterly Results of Operations (in thousands, except per share and common stock data):**

The following tables set forth certain unaudited historical quarterly financial data for each of the eight consecutive quarters in the fiscal years of 2015 and 2014. This information is derived from unaudited consolidated financial statements that include, in our opinion, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation when read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this Form 10-K.

	2015			
	4th	3rd	2nd	1st
	(dollars in thousands, except per share amounts)			
Summary Income Statement Information:				
Interest income	\$ 59,047	\$ 57,163	\$ 53,344	\$ 52,069
Interest expense	1,046	1,065	1,008	970
Net interest income	58,001	56,098	52,336	51,099
Provision for loan losses	4,177	2,664	1,554	1,290
Net interest income after provision for loan losses	53,824	53,434	50,782	49,809
Noninterest income	19,229	20,310	17,570	15,892
Net gain (loss) on securities transactions	51	136	239	5
Noninterest expense	40,342	39,973	35,204	33,943
Earnings before income taxes	32,762	33,907	33,387	31,763
Income tax expense	7,570	8,021	8,080	7,766
Net earnings	\$ 25,192	\$ 25,886	\$ 25,307	\$ 23,997
Per Share Data:				
Earnings per share, basic	\$ 0.38	\$ 0.40	\$ 0.39	\$ 0.37
Earnings per share, assuming dilution	0.38	0.40	0.39	0.37
Cash dividends declared	0.16	0.16	0.16	0.14
Book value at period-end	12.20	12.01	10.93	11.01
Common stock sales price:				
High	\$ 36.51	\$ 36.20	\$ 35.32	\$ 30.17
Low	29.56	29.21	27.16	24.46
Close	30.17	31.78	34.64	27.64

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	2014			
	4 th	3 rd	2 nd	1 st
	(dollars in thousands, except per share amounts)			
Summary Income Statement Information:				
Interest income	\$ 51,121	\$ 49,955	\$ 49,254	\$ 48,209
Interest expense	1,039	1,069	1,037	1,036