SOUTHSIDE BANCSHARES INC
Form 10-K
March 08, 2016

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

Form 10-K
(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From _______ to _______

Commission file number 0-12247
Southside Bancshares, Inc.
(Exact name of registrant as specified in its charter)

Texas	75-1848732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1201 S. Beckham Avenue, Tyler, Texas	75701
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (903) 531-7111

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

Title of each class	Name of each exchange on which registered
COMMON STOCK, $1.25 PAR VALUE	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 o No ý

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 o No ý

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2015 was $681,597,633.

As of March 7, 2016, 24,974,348 shares of common stock of Southside Bancshares, Inc. were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Registrant's proxy statement to be filed for the Annual Meeting of Shareholders to be held May 11, 2016 are incorporated by reference into Part III of this Annual Report on Form 10-K. Other than those portions of the proxy statement specifically incorporated by reference pursuant to Items 10-14 of Part III hereof, no other portions of the proxy statement shall be deemed so incorporated.

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IMPORTANT INFORMATION ABOUT THIS REPORT

In this report, the words “the Company,” “we,” “us,” and “our” refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries. The words “Southside” and “Southside Bancshares” refer to Southside Bancshares, Inc. The words “Southside Bank” and “the Bank” refer to Southside Bank. “FWBS” refers to Fort Worth Bancshares, Inc., a bank holding company acquired by Southside. “SFG” refers to SFG Finance, LLC (formerly Southside Financial Group, LLC) which was a wholly-owned subsidiary of the Bank as of July 15, 2011. SFG is consolidated in our financial statements and was dissolved in April 2015. “Omni” refers to OmniAmerican Bancorp, Inc., a bank holding company acquired by Southside on December 17, 2014. For additional information concerning the effect of the merger and the fair value of assets assumed in relation to the merger, see “Note 2 - Acquisition.”

In the second quarter of 2013, we closed our broker-dealer subsidiary, Southside Securities, Inc.

PART I

ITEM 1. BUSINESS

FORWARD-LOOKING INFORMATION

The disclosures set forth in this item are qualified by the section captioned “Cautionary Notice Regarding Forward-Looking Statements” in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Annual Report on Form 10-K and other cautionary statements set forth elsewhere in this report.

GENERAL

Southside Bancshares, Inc., incorporated in Texas in 1982, is a bank holding company for Southside Bank, a Texas state bank headquartered in Tyler, Texas that was formed in 1960. We operate through 60 banking centers, 18 of which are located in grocery stores, and 26 motor bank facilities.

At December 31, 2015, our total assets were $5.16 billion, total loans were $2.43 billion, deposits were $3.46 billion, and total equity was $444.1 million. For the years ended December 31, 2015 and 2014, our net income was $44.0 million and $20.8 million and diluted earnings per common share were $1.73 and $1.04, respectively. We have paid a cash dividend every year since 1970 (including dividends paid by Southside Bank prior to the incorporation of Southside Bancshares).

We are a community-focused financial institution that offers a full range of financial services to individuals, businesses, municipal entities, and nonprofit organizations in the communities that we serve. These services include consumer and commercial loans, deposit accounts, trust services, safe deposit services and brokerage services.

Our consumer loan services include 1-4 family residential loans, home equity loans, home improvement loans, automobile loans and other installment loans. Commercial loan services include short-term working capital loans for inventory and accounts receivable, short and medium-term loans for equipment or other business capital expansion, commercial real estate loans and municipal loans. We also offer construction loans for 1-4 family residential and commercial real estate.

We offer a variety of deposit accounts with a wide range of interest rates and terms, including savings, money market, interest and noninterest bearing checking accounts and certificates of deposit (“CDs”). Our trust services include investment management, administration and advisory services, primarily for individuals and, to a lesser extent, partnerships and corporations. At December 31, 2015, our trust department managed approximately $878.3 million of trust assets.

Our business strategy includes evaluating expansion opportunities through acquisitions of financial institutions in market areas that could complement our existing franchise. We generally seek merger partners that are culturally similar, have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. During 2014, we acquired OmniAmerican Bancorp, Inc., a bank holding company traded on the NASDAQ Global Market and the holding company for OmniAmerican Bank, a federal savings association, headquartered in Fort Worth, Texas. See "Note 2 - Acquisition" in the accompanying notes to consolidated financial statements included elsewhere in this report.

We and our subsidiaries are subject to comprehensive regulation, examination and supervision by the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Texas Department of Banking (the “TDB”) and the Federal Deposit Insurance Corporation (the “FDIC”) and are subject to numerous laws and regulations relating to internal controls, the extension of credit, making of loans to individuals, deposits, and all other facets of our

operations.

Our administrative offices are located at 1201 South Beckham Avenue, Tyler, Texas 75701, and our telephone number is 903-531-7111. Our website can be found at www.southside.com. Our public filings with the Securities and Exchange Commission

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(the "SEC") may be obtained free of charge on either our website, https://www.southside.com/about/investor-relations under the topic Documents, or the SEC's website, www.sec.gov, as soon as reasonably practicable after filing with the SEC.

RECENT DEVELOPMENTS

During April 2015, we dissolved SFG. During the year ended December 31, 2015, we closed one of our leased grocery store branches in Seven Points and branch locations in Ft. Worth and Forney, both of which were leased.

MARKET AREA

We are headquartered in Tyler, Texas. The Tyler metropolitan area has a population of approximately 210,000 and is located approximately 90 miles east of Dallas, Texas and 90 miles west of Shreveport, Louisiana.

We consider our primary market areas to be East Texas, the greater Fort Worth, Texas area and the greater Austin, Texas area. Our expectation is that our presence in all of the market areas we serve should grow in the future. In addition, we continue to explore new markets in which we believe we can expand successfully.

The principal economic activities in our market areas include retail, distribution, manufacturing, medical services, education, government and oil and gas industries. Additionally, the industry base includes conventions and tourism, as well as retirement relocation. These economic activities support a growing regional system of medical service, retail and education centers. Tyler, Longview, Fort Worth, Austin and Arlington are home to several nationally recognized health care systems that represent all major specialties.

Our 60 branches and 26 motor bank facilities are located in and around Tyler, Longview, Lindale, Gresham, Jacksonville, Bullard, Chandler, Hawkins, Palestine, Gun Barrel City, Athens, Whitehouse, Fort Worth, Arlington, Cleburne, Euless, Flower Mound, Granbury, Grapevine, Irving, Watauga, Weatherford and Austin. Our advertising is designed to target the market areas we serve. The type and amount of advertising in each market area is directly attributable to our market share in that market area combined with overall cost.

Additionally, our customers may access various banking services through a network of over 74 automated teller machines ("ATMs") and ATMs owned by others, through debit cards, and through our automated telephone, internet and electronic banking products. These products allow our customers to apply for loans from their computers, access account information and conduct various other transactions from their telephones, smart phones and computers.

THE BANKING INDUSTRY IN TEXAS

The banking industry is affected by general economic conditions such as interest rates, inflation, recession, unemployment and other factors beyond our control. During the last thirty years the Texas economy has continued to diversify, decreasing the overall impact of fluctuations in oil and gas prices; however, the oil and gas industry is still a significant component of the Texas economy. Since 2010, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. During a majority of that time economic growth and business activity in Texas exceeded the U.S. average. However in 2014, decisions by certain members of the Organization of Petroleum Exporting Countries ("OPEC") to maintain higher crude oil production levels, combined with increased production levels in the United States led to increased global oil supplies which has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2015, the price per barrel of crude oil was approximately $37 compared to approximately $98 as of December 31, 2013. A prolonged period of low oil prices could have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Texas. We cannot predict whether current economic conditions will improve, remain the same or decline.

COMPETITION

The activities we are engaged in are highly competitive. Financial institutions such as credit unions, consumer finance companies, insurance companies, brokerage companies and other financial institutions with varying degrees of regulatory restrictions compete vigorously for a share of the financial services market. During 2015, the number of financial institutions in our market areas increased, a trend that we expect will continue. Brokerage and insurance companies continue to become more competitive in the financial services arena and pose an ever-increasing challenge to banks. Legislative changes also greatly affect the level of competition we face. Federal legislation allows credit unions to use their expanded membership capabilities, combined with tax-free status, to compete more fiercely for traditional bank business. The tax-free status granted to credit unions provides them with a significant competitive advantage. Many of the largest banks operating in Texas, including some of the largest banks in the country, have offices in our market areas with capital resources, broader geographic markets, and legal lending limits substantially in excess of those available to us. We face competition from institutions that offer products and services we do not or cannot currently offer. Some institutions we compete with offer interest rate levels on loan and deposit products that we are unwilling to offer due to interest rate risk and overall profitability concerns. We expect the level of competition to continue to increase.

EMPLOYEES

At February 19, 2016, we employed approximately 683 full time equivalent persons. None of our employees are represented by any unions or similar groups, and we have not experienced any type of strike or labor dispute. We consider the relationship with our employees to be good.

SUPERVISION AND REGULATION

General

Banking is a complex, highly regulated industry. As a bank holding company under federal law, the Company is subject to regulation, supervision and examination by the Federal Reserve. In addition, under state law, as the parent company of a Texas-chartered state bank that is not a member of the Federal Reserve System, the Company is subject to supervision and examination by the TDB. As a Texas-chartered state bank, Southside Bank is subject to regulation, supervision and examination by the TDB, as its chartering authority, and by the FDIC, as its primary federal regulator and deposit insurer. This system of regulation and supervision applicable to us establishes a comprehensive framework for our operations and is intended primarily for the protection of bank depositors, the FDIC's Deposit Insurance Fund ("DIF") and the public, rather than our shareholders and creditors.

In addition to the system of regulation and supervision outlined above, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which is discussed in greater detail below, created the Consumer Financial Protection Bureau (the "Bureau"), a federal regulatory body with broad authority to regulate the offering and provision of consumer financial products. The Bureau officially came into being on July 21, 2011, and rulemaking authority for a range of consumer financial protection laws (such as the Truth in Lending Act, the Electronic Fund Transfer Act and the Real Estate Settlement Procedures Act, among others) transferred from the federal prudential banking regulators to the Bureau on that date. The Dodd-Frank Act gives the Bureau authority to supervise and examine depository institutions with more than $10 billion in assets for compliance with these federal consumer laws. The authority to supervise and examine depository institutions with $10 billion or less in assets for compliance with federal consumer laws will remain largely with those institutions' primary regulators. However, the Bureau may participate in examinations of these smaller institutions on a "sampling basis" and may refer potential enforcement actions against such institutions to their primary regulators. The Bureau will also have supervisory and examination authority over certain nonbank institutions that offer consumer financial products. The Dodd-Frank Act identifies a number of covered nonbank institutions, and also authorizes the Bureau to identify additional institutions that will be subject to its jurisdiction. Accordingly, the Bureau may participate in examinations of Southside Bank, and could supervise and examine other direct or indirect subsidiaries of the Company that offer consumer financial products.

The earnings of Southside Bank and, therefore, the earnings of the Company, are affected by general economic conditions, changes in federal and state laws and regulations and actions of various regulatory authorities, including those referenced above. Additional changes to the laws and regulations applicable to us are frequently proposed at

both the federal and state levels. As a result of the Dodd-Frank Act, which was enacted on July 21, 2010, the regulatory framework under which we operate has changed and will continue to change substantially over the next several years. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, addressing, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, interchange fees, derivatives, lending limits, mortgage lending practices, registration of investment advisors and changes among the bank regulatory agencies. Among the provisions that have impacted or are likely to affect the operations of the Company and Southside Bank are the following:

- Creation of the Bureau with centralized authority, including supervisory, examination and enforcement authority, for consumer protection in the banking industry;
- New limitations on federal preemption;
- New prohibitions and restrictions on the ability of a banking entity and nonbank financial company to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund;
- Application of new regulatory capital requirements, including changes to leverage and risk-based capital standards and changes to the components of permissible tiered capital;
- Requirement that holding companies and their subsidiary banks be well capitalized and well managed in order to engage in activities permitted for financial holding companies;
- Changes to the assessment base for deposit insurance premiums;
- Permanently raising the FDIC's standard maximum deposit insurance amount to $250,000;
- Repeal of the prohibition on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;
- Restrictions on compensation, including a prohibition on incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions and are deemed to be excessive, or that may lead to material losses;
- Requirement that sponsors of asset-backed securities retain a percentage of the credit risk underlying the securities; and
- Requirement that banking regulators remove references to and requirements of reliance upon credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness.

Some of these and other major changes could materially impact the profitability of our business, the value of assets we hold or the collateral available for our loans, require changes to business practices, or force us to discontinue businesses and expose us to additional costs, taxes, liabilities, enforcement actions and reputational risk. Many of these provisions became effective upon enactment of the Dodd-Frank Act, while others were subject to further study, rulemaking, and the discretion of regulatory bodies and have only recently taken effect or will take effect in the coming years. In light of these significant changes and the discretion afforded to federal regulators, we cannot fully predict the effect that compliance with the Dodd-Frank Act or any implementing regulations will have on the Company or Southside Bank's businesses or their ability to pursue future business opportunities. Additional regulations resulting from the Dodd-Frank Act may materially adversely affect the Company's business, financial condition or results of operations.

The likelihood, timing, and scope of any such change and the impact any such change may have on us are impossible to determine with any certainty. Also, additional changes to the laws and regulations applicable to us are frequently proposed at both the federal and state levels. We cannot predict whether new legislation or regulations will be enacted and, if enacted, the effect that it, or any regulations, would have on our business, financial condition or results of operations. Set forth below is a brief description of the significant federal and state laws and regulations to which we are currently subject. These descriptions do not purport to be complete and are qualified in their entirety by reference to the particular statutory or regulatory provision.

Holding Company Regulation

As a bank holding company regulated under the Bank Holding Company Act of 1956 ("BHCA"), as amended, the Company is registered with and subject to regulation, supervision and examination by the Federal Reserve. The Company is required to file annual and other reports with, and furnish information to, the Federal Reserve, which makes periodic inspections of the Company.

Permitted Activities. Under the BHCA, a bank holding company is generally permitted to engage in, or acquire direct or indirect control of more than five percent of the voting shares of any company engaged in, the following activities:

- banking or managing or controlling banks;
- furnishing services to or performing services for our subsidiaries; and
- any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking, including:

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- factoring accounts receivable;
- making, acquiring, brokering or servicing loans and usual related activities;
- leasing personal or real property;
- operating a nonbank depository institution, such as a savings association;
- performing trust company functions;
- conducting financial and investment advisory activities;
- conducting discount securities brokerage activities;
- underwriting and dealing in government obligations and money market instruments;
- providing specified management consulting and counseling activities;
- performing selected data processing services and support services;
- acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions;
- performing selected insurance underwriting activities;
- providing certain community development activities (such as making investments in projects designed primarily to promote community welfare); and
- issuing and selling money orders and similar consumer-type payment instruments.

The Federal Reserve has the authority to order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when the Federal Reserve has reasonable cause to believe that the bank holding company's continued ownership, activity or control constitutes a serious risk to the financial safety, soundness or stability of it or any of its bank subsidiaries.

Under the BHCA, a bank holding company meeting certain eligibility requirements may elect to become a "financial holding company," which is a form of bank holding company with authority to engage in additional activities. Specifically, a financial holding company and companies under its control may engage in activities that are "financial in nature," as defined by the Gramm-Leach-Bliley Act ("GLBA") and Federal Reserve interpretations, and therefore may engage in a broader range of activities than those permitted for bank holding companies and their subsidiaries. Financial activities specifically include insurance brokerage and underwriting, securities underwriting and dealing, merchant banking, investment advisory and lending activities. Financial holding companies and their subsidiaries also may engage in additional activities that are determined by the Federal Reserve, in consultation with the U.S. Department of the Treasury, to be "financial in nature or incidental to" a financial activity or are determined by the Federal Reserve unilaterally to be "complementary" to financial activities.

In order to offer broker-dealer services through our subsidiary, Southside Securities, Inc., on February 8, 2011, we filed with the Federal Reserve Bank of Dallas a declaration of financial holding company status and were granted financial holding company status on March 22, 2011. Election of financial holding company status is not automatic and it was granted based upon consideration of a number of factors, including that all of our depository institution subsidiaries satisfy the Federal Reserve's "well capitalized" and "well managed" standards and have at least a satisfactory rating under the Community Reinvestment Act ("CRA") (discussed below). Now that we have succeeded in attaining financial holding company status, that status could be impacted by the condition of Southside Bank and/or other factors. For example, if Southside Bank ceases to be "well capitalized" or "well managed" under applicable regulatory standards, the Federal Reserve may, among other things, place limitations on our ability to conduct broader financial activities or, if the deficiencies persist, require us to divest Southside Bank. In addition, if Southside Bank were to receive a rating of less than satisfactory under the CRA, we would be prohibited from engaging in any additional activities other than those permissible for bank holding companies that are not financial holding companies. If we undertake expanded financial activities (that are not permissible for a bank holding company) and we fail to continue to meet any of the prerequisites for "financial holding company" status, including those described above, the financial holding company would be required to enter into an agreement with the Federal Reserve to comply with all applicable capital and management requirements. If we do not return to compliance within 180 days, the Federal Reserve may order the financial holding company to divest its Bank or the Company may discontinue or divest investments in companies engaged in activities permissible only for a bank holding company that has elected to be treated as a financial holding company. We began engaging in broker-dealer activities through Southside Securities, Inc. on June

16, 2011. In early 2013, to further concentrate on our primary business of banking, a management decision was made to close Southside Securities, Inc. We ceased engaging in broker-dealer activities through Southside Securities, Inc. in the second quarter of 2013. However, our financial holding company status has been maintained.

Capital Adequacy. Each of the federal banking agencies, including the Federal Reserve and the FDIC, has issued substantially similar risk-based and leverage capital guidelines applicable to the banking organizations they supervise. As a result of new regulations, we were required to begin complying with higher minimum capital requirements as of January 1, 2015. The new capital rules ("Updated Capital Rules"), which are discussed below, implement certain provisions of the Dodd-Frank Act and a separate, international regulatory capital initiative known as "Basel III." These Updated Capital Rules also make important changes to the "prompt corrective action" framework discussed below in Bank Regulation - Prompt Corrective Action and Undercapitalization.

The agencies' prior risk-based guidelines, applicable to the Company before January 1, 2015, defined a three-tier capital framework. Risk-based capital ratios were calculated by dividing, as appropriate, total capital and Tier 1 capital by risk-weighted assets. Assets and off-balance sheet exposures were assigned to one of four categories of risk weights, based primarily on relative credit risk. Under these prior risk-based capital requirements, the Company and Southside Bank were each generally required to maintain a minimum ratio of total capital to risk-weighted assets of at least 8% and a minimum ratio of Tier 1 capital to risk-weighted assets of at least 4%. To the extent we engaged in trading activities, we were required to adjust our risk-based capital ratios to take into consideration market risks that may result from movements in market prices of covered trading positions in trading accounts, or from foreign exchange or commodity positions, whether or not in trading accounts, including changes in interest rates, equity prices, foreign exchange rates or commodity prices.

Each of the federal bank regulatory agencies, including the Federal Reserve and the FDIC, also had established minimum leverage capital requirements for the banking organizations they supervise. These requirements provided that banking organizations that met certain criteria, including excellent asset quality, high liquidity, low interest rate exposure and good earnings, and that had received the highest regulatory rating must maintain a ratio of Tier 1 capital to total adjusted average assets of at least 3%. Institutions not meeting these criteria, as well as institutions with supervisory, financial or operational weaknesses, were expected to maintain a minimum Tier 1 capital to total adjusted average assets ratio equal to 100 to 200 basis points above this stated minimum. Holding companies experiencing internal growth or making acquisitions were expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. The Federal Reserve also considered a "tangible Tier 1 capital leverage ratio" (deducting all intangibles) and other indicators of capital strength in evaluating proposals for expansion or new activity.

The Updated Capital Rules, which became applicable to the Company and the Bank on January 1, 2015, made substantial changes to these previous standards. Among other things, the new regulations (i) introduced a new capital requirement known as "Common Equity Tier 1" ("CET1"), (ii) stated that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain requirements, (iii) defined CET1 to require that most deductions and adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) revised the scope of the deductions and adjustments from capital as compared to regulations that previously applied to the Company and other banking organizations.

The Updated Capital Rules also established the following minimum capital ratios: 4.5 percent CET1 to risk-weighted assets; 6.0 percent Tier 1 capital to risk-weighted assets; 8.0 percent total capital to risk-weighted assets; and 4.0 percent Tier 1 leverage ratio to average consolidated assets. In addition, the Updated Capital Rules also introduced a minimum "capital conservation buffer" equal to 2.5% of an organization's total risk-weighted assets, which exists in addition to these new required minimum CET1, Tier 1, and total capital ratios. The "capital conservation buffer," which must consist entirely of CET1, is designed to absorb losses during periods of economic stress. The Updated Capital Rules provide for a number of deductions from and adjustments to CET1, which include the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Certain regulatory capital ratios of the Company and Southside Bank, as of December 31, 2015, are shown in the following table.

Capital Adequacy Ratios

	Regulatory Minimums	Regulatory Minimums to be Well Capitalized	Southside Bancshares, Inc.	Southside Bank
Common Equity Tier 1 risk-based capital ratio	4.50 %	6.50 %	12.71 %	14.36 %
Tier 1 risk-based capital ratio	6.00 %	8.00 %	14.56 %	14.36 %
Total risk-based capital ratio	8.00 %	10.00 %	15.27 %	15.07 %
Leverage ratio	4.00 %	5.00 %	8.61 %	8.49 %

Under the previous capital framework, the effects of accumulated other comprehensive income items included in shareholders' equity under U.S. generally accepted accounting principles ("GAAP ") were excluded for the purposes of determining capital ratios. However, the effects of certain accumulated other comprehensive items are not excluded under the Updated Capital Rules. The Updated Capital Rules permitted most banking organizations, including the Company and Southside Bank, to make a one-time permanent election on the institution's first call report filed after January 1, 2015 to continue to exclude these items, which Southside Bank did in its March 31, 2015 call report.

Under the Updated Capital Rules, certain hybrid securities, such as trust preferred securities, do not qualify as Tier 1 capital. However, for bank holding companies like us that had assets of less than $15 billion as of December 31, 2009, trust preferred securities issued prior to May 19, 2010 can be treated as Tier 1 capital to the extent that they do not exceed 25% of Tier 1 capital after the application of capital deductions and adjustments.

In addition, reflecting the importance that regulators place on managing capital and other risks, in May 2012 the banking agencies also issued guidance on stress testing for banking organizations with more than $10 billion in total consolidated assets. This guidance outlines four "high-level" principles for stress testing practices that should be a part of a banking organization's stress-testing framework. Specifically, the guidance calls for the framework to (i) include activities and exercises that are tailored to and sufficiently capture the banking organization's exposures, activities and risks; (ii) employ multiple conceptually sound stress testing activities and approaches; (iii) be forward-looking and flexible; and (iv) be clear, actionable, well-supported, and used in the decision-making process. Moreover, the federal bank regulators have issued a series of guidance and rulemakings applicable to "large banks." While many of these do not currently apply to us due to our asset size, these issuances could impact industry capital standards and practices in many, potentially unforeseeable, ways.

Source of Strength. Federal Reserve policy requires a bank holding company to act as a source of financial strength and to take measures to preserve and protect bank subsidiaries in situations where additional investments in a troubled bank may not otherwise be warranted. As a result, a bank holding company may be required to contribute additional capital to its subsidiaries in the form of capital notes or other instruments which qualify as capital under regulatory rules. Any loans from the holding company to its subsidiary banks likely will be unsecured and subordinated to the bank's depositors and perhaps to other creditors of the bank. Notably, the Dodd-Frank Act codified the Federal Reserve's "source of strength" policy; this statutory change became effective July 21, 2011. In addition to the foregoing requirements, the Dodd-Frank Act's provisions authorize the Federal Reserve and other federal banking regulators to require a company that directly or indirectly controls a bank to submit reports that are designed both to assess the ability of such company to comply with its "source of strength" obligations and to enforce the company's compliance with these obligations. As of December 31, 2015 the Federal Reserve and other federal banking regulators have not yet issued rules implementing this requirement.

In addition, if a bank holding company enters into bankruptcy or becomes subject to the orderly liquidation process established by the Dodd-Frank Act, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank would be assumed by the bankruptcy trustee or the FDIC, as appropriate, and entitled to a priority of payment. In addition, the FDIC provides that any insured depository institution generally will be liable for any loss incurred by the FDIC in connection with the default of, or any assistance provided by the FDIC to, a commonly controlled insured depository institution. Southside Bank is an FDIC-insured depository institution and thus subject to these requirements. See also Bank Regulation - Prompt Corrective Action and Undercapitalization.

Dividends. The principal source of our liquidity at the parent company level is dividends from Southside Bank. Southside Bank is subject to federal and state restrictions on its ability to pay dividends to the Company. We must pay essentially all of our operating expenses from funds we receive from Southside Bank. Therefore, shareholders may receive dividends from us only to the extent that funds are available after payment of our operating expenses. Consistent with its "source of strength" policy, the Federal Reserve discourages bank holding companies from paying dividends except out of operating earnings and prefers that dividends be paid only if, after the payment, the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition.

Among other things, the ability of banks and bank holding companies to pay dividends, and the contents of their respective dividend policies, could be impacted by a range of changes imposed by the Dodd-Frank Act, many of which will require implementing rules to become effective. See also Bank Regulation - Dividends for additional information.

Change in Control. Subject to certain exceptions, under the BHCA and the Change in Bank Control Act ("CBCA"), and the regulations promulgated thereunder, persons who intend to acquire direct or indirect control of a depository institution or a bank holding company are required to obtain the approval of the Federal Reserve prior to acquiring control. With respect to the Company, "control" is conclusively presumed to exist where an acquiring party directly or indirectly owns, controls or has the power to vote at least 25% of our voting securities. Under the Federal Reserve's CBCA regulations, a rebuttable presumption of control would arise with respect to an acquisition where, after the transaction, the acquiring party owns, controls or has the power

to vote at least 10% (but less than 25%) of our voting securities. In certain cases, a company may also be presumed to have control under the BHCA if it acquires five percent or more of any class of voting securities.

On September 22, 2008, the Federal Reserve issued a policy statement on minority equity investments in banks and bank holding companies, that permits investors to (1) acquire up to 33 percent of the total equity of a target bank or bank holding company, subject to certain conditions, including that the acquiring investor does not acquire 15 percent or more of any class of voting securities, and (2) designate at least one director, without triggering the various regulatory requirements associated with control.

Acquisitions. The BHCA provides that a bank holding company must obtain the prior approval of the Federal Reserve (i) for the acquisition of more than five percent of the voting stock in any bank or bank holding company, (ii) for the acquisition of substantially all the assets of any bank or bank holding company, or (iii) in order to merge or consolidate with another bank holding company.

Regulatory Examination. Federal and state banking agencies require the Company and Southside Bank to prepare annual reports on financial condition and to conduct an annual audit of financial affairs in compliance with minimum standards and procedures. Southside Bank, and in some cases the Company and any nonbank affiliates, must undergo regular on-site examinations by the appropriate regulatory agency, which will examine for adherence to a range of legal and regulatory compliance responsibilities. A bank regulator conducting an examination has complete access to the books and records of the examined institution, and the results of the examination are confidential. The cost of examinations may be assessed against the examined organization as the agency deems necessary or appropriate. The FDIC has developed a method for insured depository institutions to provide supplemental disclosure of the estimated fair value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition or any other report.

Enforcement Authority. The Federal Reserve has broad enforcement powers over bank holding companies and their nonbank subsidiaries, as well as “institution-affiliated parties,” including management, employees, agents, independent contractors and consultants, such as attorneys and accountants and others who participate in the conduct of the institution’s affairs, and has authority to prohibit activities that represent unsafe or unsound banking practices or constitute knowing or reckless violations of laws or regulations. These powers may be exercised through the issuance of cease and desist orders, civil money penalties or other actions. Civil money penalties can be as high as $1,000,000 for each day the activity continues and criminal penalties for some financial institution crimes may include imprisonment for 20 years. Regulators have flexibility to commence enforcement actions against institutions and institution-affiliated parties, and the FDIC has the authority to terminate deposit insurance. When issued by a banking agency, cease and desist and similar orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions determined to be appropriate by the ordering agency. The federal banking agencies also may remove a director or officer from an insured depository institution (or bar them from the industry) if a violation is willful or reckless.

Bank Regulation

Southside Bank is a Texas-chartered commercial bank, the deposits of which are insured up to the applicable limits by the DIF of the FDIC. Southside Bank is not a member of the Federal Reserve System. The Bank is subject to extensive regulation, examination and supervision by the TDB, as its chartering authority, and by the FDIC, as its primary federal regulator and deposit insurer. In addition, the Bureau could participate in examinations of the Bank (as described above) in the near term regarding the Bank’s offering of consumer financial products and services. The federal and state laws applicable to banks regulate, among other things, the scope of their business and investments, lending and deposit-taking activities, borrowings, maintenance of retained earnings and reserve accounts, distribution of earnings and payment of dividends.

Permitted Activities and Investments. Under the Federal Deposit Insurance Act (“FDIA”), the activities and investments of state nonmember banks are generally limited to those permissible for national banks, notwithstanding state law. With FDIC approval, a state nonmember bank may engage in activities not permissible for a national bank if the FDIC determines that the activity does not pose a significant risk to the DIF and that the bank meets its minimum

capital requirements. Similarly, under Texas law, a state bank may engage in those activities permissible for national banks domiciled in Texas. The TDB may permit a Texas state bank to engage in additional activities so long as the performance of the activity by the bank would not adversely affect the safety and soundness of the bank.

On December 10, 2013, federal regulators, including the Federal Reserve and the FDIC, issued final rules to implement Section 619 of the Dodd-Frank Act, known as the “Volcker Rule,” to prohibit insured depository institutions, such as Southside Bank, and their affiliates, such as the Company, from proprietary trading and acquiring certain interests in hedge or private equity funds. The final rules contain certain exemptions from the prohibition and permit the retention of certain ownership interests.

Insured depository institutions were generally required to conform their activities and investments to the requirements by July 21, 2015, though the conformance period for legacy investments in and relationships with a covered fund will end on July 21, 2016.

Brokered Deposits. Southside Bank also may be restricted in its ability to accept, renew or roll over brokered deposits, depending on its capital classification. Only "well-capitalized" banks are permitted to accept, renew or roll over brokered deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. Undercapitalized banks generally may not accept, renew or roll over brokered deposits.

Loans to One Borrower. Under Texas law, without the approval of the TDB and subject to certain limited exceptions, the maximum aggregate amount of loans that Southside Bank is permitted to make to any one borrower is 25% of Tier 1 capital.

Insider Loans. Under Regulation O of the Federal Reserve, as made applicable to state nonmember banks by section 18(j)(2) of the FDIA, Southside Bank is subject to quantitative restrictions on extensions of credit to its executive officers and directors, the executive officers and directors of the Company, any owner of 10% or more of its stock or the stock of Southside Bancshares, Inc. and certain entities affiliated with any such persons. In general, any such extensions of credit must (i) not exceed certain dollar limitations, (ii) be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (iii) not involve more than the normal risk of repayment or present other unfavorable features. Additional restrictions are imposed on extensions of credit to executive officers. Certain extensions of credit also require the approval of a bank's board of directors.

Deposit Insurance and Assessments. The deposits of Southside Bank are insured by the DIF of the FDIC, up to the applicable limits established by law and are subject to the deposit insurance premium assessments of the DIF. The Dodd-Frank Act amended the statutory regime governing the DIF. Among other things, the Dodd-Frank Act established a minimum designated reserve ratio ("DRR") of 1.35 percent of estimated insured deposits (which the FDIC has set at 2.0 percent each year since 2010), required that the fund reserve ratio reach 1.35 percent by September 30, 2020 and directed the FDIC to amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Specifically, the Dodd-Frank Act requires the assessment base to be an amount equal to the average consolidated total assets of the insured depository institution during the assessment period, minus the sum of the average tangible equity of the insured depository institution during the assessment period and an amount the FDIC determines is necessary to establish assessments consistent with the risk-based assessment system found in the FDIA. Furthermore, on February 7, 2011, the FDIC issued a final rule changing its assessment system from one based on domestic deposits to one based on the average consolidated total assets of a bank minus its average tangible equity during each quarter. This rule modified two adjustments added to the risk-based pricing system in 2009 (an unsecured debt adjustment and a brokered deposit adjustment), discontinued a third adjustment added in 2009 (the secured liability adjustment), and added an adjustment for long-term debt held by an insured depository institution where the debt is issued by another insured depository institution. Under these revisions to the DIF rules, the total base assessment rates will vary depending on the DIF reserve ratio. For example, for banks in the best risk category, the initial total base assessment rates will be between 2.5 and 9 basis points when the DIF reserve ratio is below 1.15 percent, between 1.5 and 7 basis points when the DIF reserve ratio is between 1.15 percent and 2 percent, between 1 and 6 basis points when the DIF reserve ratio is between 2 percent and 2.5 percent and between 0.5 and 5 basis points when the DIF reserve ratio is 2.5 percent or higher. On June 16, 2015, the FDIC issued a notice of proposed rulemaking that would refine the deposit insurance assessment system for small insured depository institutions that have been federally insured for at least five years. The proposed rule would revise the financial ratios method, update the financial measures used, and eliminate risk categories for such banks.

In addition, all FDIC-insured institutions are required to pay a pro rata portion of the interest due on bonds issued by the Financing Corporation ("FICO") to fund the closing and disposal of failed thrift institutions by the Resolution Trust Corporation. FICO assessment rates, which are calculated off the assessment base established by the Dodd-Frank Act, are set quarterly. The rate was .600 (annual) basis points for the first, second, and fourth quarters of 2015 and .580

(annual) basis points for the third quarter of 2015. It was 0.580 (annual) basis points for the first quarter of 2016. These assessments will continue until the FICO bonds mature in 2017 through 2019.

Capital Adequacy.

See Holding Company Regulation - Capital Adequacy.

Prompt Corrective Action and Undercapitalization. The Federal Deposit Insurance Corporation Improvement Act (the "FDICIA") established a system of prompt corrective action to resolve the problems of undercapitalized insured depository institutions. Under this system, the federal banking regulators are required to rate insured depository institutions on the basis of five capital categories as described below. The federal banking regulators are also required to take mandatory supervisory actions and are authorized to take other discretionary actions, with respect to insured depository institutions in the three undercapitalized categories, the severity of which will depend upon the capital category in which the insured depository institution is assigned. Generally, subject to a narrow exception, the FDICIA requires the banking regulator to appoint a receiver or conservator for an insured depository institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. The thresholds for each of these categories were recently revised pursuant to the Basel III Capital Rules, which are discussed above in "Holding Company Regulation - Capital Adequacy." These revised categories started to apply to Southside Bank on January 1, 2015.

Under the regulations, all insured depository institutions are assigned to one of the following capital categories:

- Well Capitalized - The insured depository institution exceeds the required minimum level for each relevant capital measure. Under the Updated Capital Rules, a well-capitalized insured depository institution is one (1) having a total risk-based capital ratio of 10 percent or greater, (2) having a Tier 1 risk-based capital ratio of 8 percent or greater, (3) having a CET1 capital ratio of 6.5 percent or greater, (4) having a leverage capital ratio of 5 percent or greater and (5) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.
- Adequately Capitalized - The insured depository institution meets the required minimum level for each relevant capital measure. Under the Updated Capital Rules, an adequately-capitalized depository institution is one having (1) a total risk based capital ratio of 8 percent or more, (2) a Tier 1 capital ratio of 6 percent or more, (3) a CET1 capital ratio of 4.5 percent or more, and (4) a leverage ratio of 4 percent or more.
- Undercapitalized - The insured depository institution fails to meet the required minimum level for any relevant capital measure. Under the Updated Capital Rules, an undercapitalized depository institution is one having (1) a total capital ratio of less than 8 percent, (2) a Tier 1 capital ratio of less than 6 percent, (3) a CET1 capital ratio of less than 4.5 percent, or (4) a leverage ratio of less than 4 percent.
- Significantly Undercapitalized - The insured depository institution is significantly below the required minimum level for any relevant capital measure. Under the Updated Capital Rules, a significantly undercapitalized institution is one having (1) a total risk-based capital ratio of less than 6 percent (2) a Tier 1 capital ratio of less than 4 percent, (3) a CET1 ratio of less than 3 percent or (4) a leverage capital ratio of less than 3 percent.
- Critically Undercapitalized - The insured depository institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution is one having a ratio of tangible equity to total assets that is equal to or less than 2 percent.

The prompt corrective action regulations permit the appropriate federal banking regulator to downgrade an institution to the next lower category if the regulator determines after notice and opportunity for hearing or response that (1) the institution is in an unsafe or unsound condition or (2) that the institution has received and not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings or liquidity in its most recent examination. Supervisory actions by the appropriate federal banking regulator depend upon an institution's classification within the five categories. Our management believes that we and our Bank subsidiary have the requisite capital levels to qualify as well-capitalized institutions under the FDICIA regulations.

If an institution fails to remain well capitalized, it will be subject to a variety of enforcement remedies that increase as the capital condition worsens. For instance, the 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 as a result. Undercapitalized depository institutions are subject to restrictions on borrowing from the Federal Reserve System. In addition, adequately-capitalized depository institutions may not accept brokered deposits absent a waiver from the FDIC and undercapitalized depository institutions may not accept brokered deposits, are subject to growth limitations and are required to submit capital

restoration plans for regulatory approval. A depository institution's holding company must guarantee any required capital restoration plan, up to an amount equal to the lesser of 5 percent of the depository institution's assets at the time it becomes undercapitalized or the amount of the capital deficiency when the institution fails to comply with the plan. Federal banking agencies may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. If a depository institution fails to submit an acceptable plan, it is 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 depository institutions are subject to appointment of a receiver or conservator.

In addition to the "prompt corrective action" directives, failure to meet capital guidelines may subject a banking organization to a variety of other enforcement remedies, including additional substantial restrictions on its operations and activities, termination of deposit insurance by the FDIC and, under certain conditions, the appointment of a conservator or receiver.

Standards for Safety and Soundness. The FDIA also requires the federal banking regulatory agencies to prescribe, by regulation or guideline, operational and managerial standards for all insured depository institutions relating to: (i) internal controls; (ii) information systems and internal audit systems; (iii) loan documentation; (iv) credit underwriting; (v) interest rate risk exposure; and (vi) asset quality. The agencies also must prescribe standards for asset quality, earnings, and stock valuation, as well as standards for compensation, fees and benefits. The federal banking agencies have adopted regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness ("Guidelines") to implement these required standards. The Guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Under the regulations, if the FDIC determines that Southside Bank fails to meet any standards prescribed by the Guidelines, it may require Southside Bank to submit an acceptable plan to achieve compliance, consistent with deadlines for the submission and review of such safety and soundness compliance plans. Notably, the Dodd-Frank Act contains separate requirements relating to compensation arrangements. Specifically, the Dodd-Frank Act requires federal banking regulators to issue regulations or guidelines to prohibit incentive-based compensation arrangements that encourage inappropriate risk taking by providing excessive compensation or that may lead to material loss at certain financial institutions with $1 billion or more in assets. A proposed rule was published in the Federal Register on April 14, 2011; however, regulators have yet to issue the final rule on the topic.

Dividends. All dividends paid by Southside Bank are paid to the Company, as the sole shareholder of Southside Bank. The ability of Southside Bank, as a Texas state bank, to pay dividends is restricted under federal and state law and regulations. As an initial matter, the FDICIA and the regulations of the FDIC generally prohibit an insured depository institution from making a capital distribution (including payment of dividend) if, thereafter, the institution would not be at least adequately capitalized. Under Texas law, Southside Bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. All dividends must be paid out of net profits then on hand, after deducting expenses, including losses and provisions for loan losses. Southside Bank's general dividend policy is to pay dividends at levels consistent with maintaining liquidity and preserving applicable capital ratios and servicing obligations. Southside Bank's dividend policies are subject to the discretion of its board of directors and will depend upon such factors as future earnings, financial conditions, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions. The exact amount of future dividends paid by Southside Bank will be a function of its general profitability (which cannot be accurately estimated or assured), applicable tax rates in effect from year to year and the discretion of its board of directors.

As described above under Holding Company Regulation - Dividends, the ability of banks and bank holding companies to pay dividends, and the contents of their respective dividend policies, could be impacted by a range of changes imposed by the Dodd-Frank Act, many of which will require implementing rules to become effective.

Transactions with Affiliates. Southside Bank is subject to sections 23A and 23B of the Federal Reserve Act ("FRA") and the Federal Reserve's Regulation W, as made applicable to state nonmember banks by section 18(j) of the FDIA. Sections 23A and 23B of the FRA restrict a bank's ability to engage in certain transactions with its affiliates. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies controlled by such parent bank holding company are generally affiliates of the bank.

Specifically, section 23A places limits on the amount of "covered transactions," which include loans or extensions of credit to, and investments in or certain other transactions with, affiliates. It also limits the amount of any advances to third parties that are collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited to 10 percent of the bank's capital and surplus for any one affiliate and 20 percent for all affiliates. Additionally, within the foregoing limitations, each covered transaction must meet specified collateral requirements ranging from 100 to 130 percent of the loan amount, depending on the type of collateral. Further, banks are prohibited from purchasing low quality assets from an affiliate. Section 608 of the Dodd-Frank Act broadened the definition of "covered transactions" to include derivative transactions and the borrowing or lending of securities if the transaction will cause a bank to have credit exposure to an affiliate. The revised definition also includes the acceptance of debt obligations of an affiliate as collateral for a loan or extension of credit to a third party. Furthermore, reverse repurchase transactions are viewed as extensions of credit (instead of asset purchases) and thus become subject to collateral requirements. The expanded definition of "covered transactions" took effect on July 21, 2012.

Section 23B, among other things, prohibits a bank from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with non-affiliated companies. Except for limitations on low quality asset purchases and transactions that are deemed to be unsafe or unsound, Regulation W generally excludes affiliated depository institutions from treatment as affiliates.

Anti-Tying Regulations. Under the BHCA and the Federal Reserve's regulations, a bank is prohibited from engaging in certain tying or reciprocity arrangements with its customers. In general, a bank may not extend credit, lease, sell property, or furnish any services or fix or vary the consideration for these products or services on the condition that either: (i) the customer obtain or provide some additional credit, property, or services from or to the bank, the bank holding company or subsidiaries thereof or (ii) the customer not obtain credit, property, or service from a competitor, except to the extent reasonable conditions are imposed to assure the soundness of the credit extended. A bank may, however, offer combined-balance products and may otherwise offer more favorable terms if a customer obtains two or more traditional bank products. Also, certain foreign transactions are exempt from the general rule.

Community Reinvestment Act. Under the CRA, Southside Bank has a continuing and affirmative obligation, consistent with safe and sound banking practices, to help meet the needs of our entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for banks nor does it limit a bank's discretion to develop the types of products and services that it believes are best suited to its particular community.

On a periodic basis, the FDIC is charged with preparing a written evaluation of our record of meeting the credit needs of the entire community and assigning a rating - outstanding, satisfactory, needs to improve or substantial noncompliance. Banks are rated based on their actual performance in meeting community credit needs. The FDIC will take that rating into account in its evaluation of any application made by the bank for, among other things, approval of the acquisition or establishment of a branch or other deposit facility, an office relocation, a merger or the acquisition of shares of capital stock of another financial institution. A bank's CRA rating may be used as the basis to deny or condition an application. In addition, as discussed above, a bank holding company may not become a financial holding company unless each of its subsidiary banks has a CRA rating of at least "satisfactory." As of January 1, 2014, the most recent exam date, Southside Bank has a CRA rating of "outstanding."

Branch Banking. Pursuant to the Texas Finance Code, all banks located in Texas are authorized to branch statewide. Accordingly, a bank located anywhere in Texas has the ability, subject to regulatory approval, to establish branch facilities near any of our facilities and within our market area. If other banks were to establish branch facilities near our facilities, it is uncertain whether these branch facilities would have a material adverse effect on our business.

The Dodd-Frank Act substantially amended the legal framework that had previously governed interstate branching activities. Formerly, under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, a bank's ability to branch into a particular state was largely dependent upon whether the state "opted in" to de novo interstate branching. Many states did not "opt in," which resulted in branching restrictions in those states. The Dodd-Frank Act removed the "opt-in" concept and permits banks to engage in de novo branching outside of their home states, provided that the laws of the target state permit banks chartered in that state to branch within that state. Accordingly, de novo interstate branching by Southside Bank is subject to these new standards. All branching in which Southside Bank may engage remains subject to regulatory approval and adherence to applicable legal and regulatory requirements.

Consumer Protection Regulation. The activities of Southside Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected or contracted for by the banks are subject to state usury laws and federal laws concerning interest rates. Loan operations are also subject to federal laws and regulations applicable to credit transactions, such as:

- the Truth In Lending Act and Regulation Z, governing disclosures of credit terms to consumer borrowers;
- the Home Mortgage Disclosure Act and Regulation C, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- the Equal Credit Opportunity Act and Regulation B, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- the Fair Credit Reporting Act and Regulation V, governing the use and provision of information to consumer reporting agencies;
- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- the guidance of the various federal agencies charged with the responsibility of implementing such federal laws.

Deposit and other operations also are subject to:

- the Truth in Savings Act and Regulation DD, governing disclosure of deposit account terms to consumers;
- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- the Electronic Fund Transfer Act and Regulation E, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of ATMs and other electronic banking services, which the Bureau has expanded to include a new compliance regime that governs consumer-initiated cross border electronic transfers.

Many of the foregoing laws and regulations have recently changed and are subject to further change resulting from the provisions in the Dodd-Frank Act and other developments. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks, in an effort to encourage lenders to verify a borrower's ability to repay. The Bureau issued a rule, which took effect on January 10, 2014, to implement this "ability-to-repay" requirement and provide lenders with protection from liability for "qualified mortgages," as required by the Dodd-Frank Act. The rule has impacted our residential mortgage lending practices, and the residential mortgage market generally. Most significantly, the new "qualified mortgage" standards generally limit the total points and fees that financial institutions and/or a broker may charge on conforming and jumbo loans to 3 percent of the total loan amount. Also, the Dodd-Frank Act, in conjunction with the Federal Reserve's final rule on loan originator compensation issued August 16, 2010 and effective April 1, 2011, prohibits certain compensation payments to loan originators and steering consumers to loans not in their interest because it will result in greater compensation for a loan originator. In addition, the Bureau recently issued additional rules pertaining to loan originator compensation, and that established qualification, registration and licensing requirements for loan originators. These standards will result in a myriad of new system, pricing, and compensation controls in order to ensure compliance and to decrease repurchase requests and foreclosure defenses. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability to repay standards. The final rule, which took effect on December 24, 2015 for residential mortgage-backed securitizations, generally requires the securitizer to retain not less than 5 percent of the credit risk.

Moreover, the Bureau has republished the transferred regulations in a new section of the Code of Federal Regulations and has requested comments regarding an effort to "streamline" these regulations. It is also anticipated that the Bureau will be making substantive changes to a number of consumer protection regulations and associated disclosures in the near term including significant changes to certain requirements related to lending. The Bureau has also established a series of mechanisms to collect, track and make public consumer complaints, including complaints against individual financial institutions and is using this, and other information it has gathered, in connection with a variety of initiatives to address issues in markets for consumer financial products and services. The Bureau also has broad authority to prohibit unfair, deceptive and abusive acts and practices ("UDAAP") and to investigate and penalize financial institutions that violate this prohibition.

We cannot predict the effect that being regulated by a new, additional regulatory authority focused on consumer financial protection, or any new implementing regulations or revisions to existing regulations that may result from the establishment of this new authority, will have on our businesses. Additional regulations resulting from the Dodd-Frank Act may materially adversely affect our business, financial condition or results of operations. In addition, Southside Bank also may be subject to certain state laws and regulations designed to protect consumers.

Commercial Real Estate Lending. Lending operations that involve concentration of commercial real estate loans are subject to enhanced scrutiny by federal banking regulators. The regulators have issued guidance with respect to the risks posed by commercial real estate lending concentrations. Real estate loans generally include land development, construction loans, land and lot loans to individuals, loans secured by multi-family property and nonfarm nonresidential real property where the primary source of repayment is derived from rental income associated with the property. The guidance prescribes the following guidelines for examiners to help identify institutions that are potentially exposed to concentration risk and may warrant greater supervisory scrutiny:

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- total reported loans for construction, land development and other land represent 100 percent or more of the institution’s total capital, or
- total commercial real estate loans represent 300 percent or more of the institution’s total capital and the outstanding balance of the institution’s commercial real estate loan portfolio has increased by 50 percent or more during the prior 36 months.

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In October 2009, the federal banking agencies issued additional guidance on real estate lending that emphasizes these considerations.

In addition, the Dodd-Frank Act contains provisions that may impact our business by reducing the amount of our commercial real estate lending and increasing the cost of borrowing, including rules relating to risk retention of securitized assets. Section 941 of the Dodd-Frank Act requires, among other things, a loan originator or a securitizer of asset-backed securities to retain a percentage of the credit risk of securitized assets. The banking agencies have jointly issued a final rule to implement these requirements, which will become effective on December 24, 2016 for classes of asset-backed securities other than residential mortgage-backed securitizations.

Anti-Money Laundering. Southside Bank is subject to the regulations of the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Department of the Treasury, which implement the Bank Secrecy Act, as amended by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA PATRIOT Act"). The USA PATRIOT Act gives the federal government the power to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. Title III of the USA PATRIOT Act includes measures intended to encourage information sharing among banks, regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including state-chartered banks like Southside Bank.

The USA PATRIOT Act and the related FinCEN regulations impose certain requirements with respect to financial institutions, including the following:

- establishment of anti-money laundering programs, including adoption of written procedures and an ongoing employee training program, designation of a compliance officer and auditing of the program;
- establishment of a program specifying procedures for obtaining information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time;
- establishment of enhanced due diligence policies, procedures and controls designed to detect and report money laundering, for financial institutions that administer, maintain or manage private bank accounts or correspondent accounts for non-U.S. persons;
- prohibitions on correspondent accounts for foreign shell banks and compliance with recordkeeping obligations with respect to correspondent accounts of foreign banks;
- filing of suspicious activities reports if a bank believes a customer may be violating U.S. laws and regulations; and
- requirements that bank regulators consider bank holding company or bank compliance in connection with merger or acquisition transactions.

Bank regulators routinely examine institutions for compliance with these obligations and have been active in imposing cease and desist and other regulatory orders and money penalty sanctions against institutions found to be violating these obligations. In addition, FinCEN issued a Notice of Proposed Rulemaking on August 4, 2014 that would require financial institutions to obtain beneficial ownership information for certain accounts, however, it has yet to issue a final rule on this topic.

The Federal Bureau of Investigation can send bank regulatory agencies lists of the names of persons suspected of involvement in terrorist activities. Southside Bank can be requested to search its records for any relationships or transactions with persons on those lists and required to report any identified relationships or transactions.

OFAC. The U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") is responsible for helping to insure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC publishes, and routinely updates, lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts, including the Specially Designated Nationals List. If we find a name on any transaction, account or wire transfer that is on an OFAC list, we must undertake certain specified activities, which could include blocking or freezing the account or transaction requested, and we must notify the appropriate authorities.

Privacy and Data Security. Under federal law, financial institutions are generally prohibited from disclosing consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and

has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to consumers annually. To the extent state laws are more protective of consumer privacy, financial institutions must comply with state law privacy provisions.

In addition, federal and state banking agencies have prescribed standards for maintaining the security and confidentiality of consumer information. Southside Bank is subject to such standards, as well as standards for notifying consumers in the event of a security breach. Under existing federal law, Southside Bank must disclose its privacy policy for collecting and protecting confidential customer information to consumers, permit consumers to “opt out” of having nonpublic customer information disclosed to non-affiliated third parties, with some exceptions, and allow customers to opt out of receiving marketing solicitations based on information about the customer received from another subsidiary. On October 28, 2014, the Bureau amended the annual privacy notice requirement to permit a financial institution to provide the annual privacy notice through posting the annual notice on its website if the financial institution meets certain conditions. On December 4, 2015, the GLBA was amended to provide additional circumstances under which a financial institution is not required to provide an annual notice. States may adopt more extensive privacy protections. Southside Bank is similarly required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Regulatory Examination.

See Holding Company Regulation - Regulatory Examination.

Enforcement Authority. Southside Bank and its “institution-affiliated parties,” including management, employees, agents, independent contractors and consultants, such as attorneys and accountants and others who participate in the conduct of the institution’s affairs, are subject to potential civil and criminal penalties for violations of law, regulations or written orders of a government agency. Violations can include failure to timely file required reports, filing false or misleading information or submitting inaccurate reports. Civil penalties may be as high as $1,000,000 a day for such violations, and criminal penalties for some financial institution crimes may include imprisonment for 20 years. Regulators have flexibility to commence enforcement actions against institutions and institution-affiliated parties, and the FDIC has the authority to terminate deposit insurance. When issued by a banking agency, cease and desist orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions determined to be appropriate by the ordering agency. The federal banking agencies also may remove a director or officer from an insured depository institution (or bar them from the industry) if a violation is willful or reckless.

Governmental Monetary Policies. The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowings, control of borrowings, open market operations, the imposition of and changes in reserve requirements against member banks, deposits and assets of foreign branches, the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates and the placing of limits on interest rates which member banks may pay on time and savings deposits are some of the instruments of monetary policy available to the Federal Reserve. These monetary policies influence to a significant extent the overall growth of all bank loans, investments and deposits and the interest rates charged on loans or paid on time and savings deposits. In response to the financial crisis, the Federal Reserve established several innovative programs to stabilize certain financial institutions and to ensure the availability of credit, which the Federal Reserve has begun to modify as a result of improving economic conditions. The nature of future monetary policies and the effect of such policies on Southside Bank’s future business and earnings, therefore, cannot be predicted accurately.

Evolving Legislation and Regulatory Action. Proposals for new statutes and regulations are frequently circulated at both the federal and state levels, and may include wide-ranging changes to the structures, regulations and competitive relationships of financial institutions. We cannot predict whether new legislation or regulations will be enacted and, if enacted, the effect that it, or any regulations, would have on our business, financial condition or results of operations.

Other Regulatory Matters. The Company and its affiliates are subject to oversight by the SEC, the NASDAQ Stock Market, various state securities regulators and other regulatory authorities. The Company and its subsidiaries have from time to time received requests for information from regulatory authorities in various states, including state attorneys general, securities regulators and other regulatory authorities, concerning their business practices. Such requests are considered incidental to the normal conduct of business.

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ITEM 1A. RISK FACTORS

Set forth below are the material risks and uncertainties that, if they were to occur, could materially and adversely affect our business, financial condition, results of operations and the trading price of our common stock. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our financial condition and business operations.

RISKS RELATED TO OUR BUSINESS

We are subject to an uneven economic environment that could adversely affect our financial condition and results of operations.

We continue to operate in a challenging and uncertain economic environment. In the last three to five years, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. There can be no assurance that economic conditions will continue to improve, and these conditions could worsen. In addition, declining oil prices, the implementation of the employer mandate under the Patient Protection and Affordable Care Act and the level of U.S. debt may have a destabilizing effect on our financial markets. Declines in real estate values, home sales volumes and financial stress on borrowers as a result of the uncertain economic environment, including unemployment and new job losses, could have an adverse effect on our borrowers or their customers, which could adversely affect our financial condition and results of operations. In addition, should we see a decline in national or regional economic conditions, the residual deterioration in local economic conditions in our markets could drive losses beyond those which are provided for in our allowance for loan losses and result in the following consequences:

- increases in loan delinquencies;
- increases in nonperforming assets and foreclosures;
- decreases in demand for our products and services, which could adversely affect our liquidity position;
- decreases in the value of the collateral securing our loans, especially real estate, which could reduce customers' borrowing power;
- decreases in the credit quality of our non-U.S. Government and non-U.S. agency investment securities, corporate and municipal securities;
- an adverse or unfavorable resolution of the Fannie Mae or Freddie Mac receivership; and
- decreases in the real estate values subject to ad-valorem taxes by municipalities that impact such municipalities' ability to repay their debt, which could adversely affect our municipal loans or debt securities.

Any of the foregoing could adversely affect our financial condition and results of operation.

We continue to face market volatility, which could adversely impact our results of operations and access to capital.

The capital and credit markets experienced volatility and disruption from 2008 to 2010. While volatility in, and disruption of, these markets no longer remain at unprecedented levels, any future escalated levels of market volatility and disruption could produce downward pressure on stock prices and credit capacity without regard to an issuer's underlying financial strength. If levels of market disruption and volatility worsen, there can be no assurance that we will not experience adverse effects, which may be material, on our ability to access capital and on our results of operations and financial condition, including our liquidity position.

We are subject to interest rate risk.

Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest earning assets such as loans and securities and interest expense paid on interest bearing liabilities such as deposits and borrowed funds. Interest rates 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 Board of Governors of the Federal Reserve System. Changes in monetary policy, interest rates, the yield curve, or market risk spreads, or a prolonged inverted yield curve 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:

- our ability to originate loans and obtain deposits;
- our ability to retain deposits in a rising rate environment;

- net interest rate spreads and net interest rate margins;

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- our ability to enter into instruments to hedge against interest rate risk;
- the fair value of our financial assets and liabilities; and
- the average duration of our loan and mortgage-backed 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 other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. See the section captioned "Net Interest Income" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion related to our management of interest rate risk.

We are subject to the risk that our U.S. agency mortgage-backed securities ("MBS") could prepay faster than we have projected.

We have and continue to purchase MBS at premiums due to the low interest rate environment. Our prepayment assumptions take into account Bloomberg consensus speeds, current trends and past experience. If actual prepayments exceed our projections, the amortization expense associated with these MBS will increase, thereby decreasing our net income. The increase in amortization expense and the corresponding decrease in net income could have a material adverse effect on our financial condition and results of operations.

We are subject to credit quality risks and our credit policies may not be sufficient to avoid losses.

We are subject to the risk of losses resulting from the failure of borrowers, guarantors and related parties to pay interest and principal amounts on their loans. Although we maintain well-defined credit policies and credit underwriting and monitoring and collection procedures, these policies and procedures may not prevent losses, particularly during periods in which the local, regional or national economy suffers a general decline. If borrowers fail to repay their loans, our financial condition and results of operations would be adversely affected.

Our interest rate risk, liquidity, fair value of securities and profitability are subject to risks associated with the successful management of our balance sheet strategy.

We implemented a balance sheet strategy for the purpose of enhancing overall profitability by maximizing the use of our capital. The effectiveness of our balance sheet strategy, and therefore our profitability, may be adversely affected by a number of factors, including reduced net interest margin and spread, adverse changes in the market liquidity and fair value of our investment securities and U.S. agency MBS, incorrect modeling results due to the unpredictable nature of MBS prepayments, the length of interest rate cycles and the slope of the interest rate yield curve. In addition, we may not be able to obtain wholesale funding to profitably and properly fund our balance sheet strategy. If our balance sheet strategy is flawed or poorly implemented, we may incur significant losses. See the section captioned "Balance Sheet Strategy" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

We have a high concentration of loans secured by real estate and a decline in the real estate market, for any reason, could result in losses and materially and adversely affect our business, financial condition, results of operations and future prospects.

A significant portion of our loan portfolio is dependent on real estate. In addition to the importance of the financial strength and cash flow characteristics of the borrower, loans are also often secured with real estate collateral. At December 31, 2015, approximately 71.1% of our loans have real estate as a primary or secondary component of collateral. The real estate in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. Beginning in the third quarter of 2007 and continuing until 2010, there were well-publicized developments in the credit markets, beginning with a decline in the sub-prime mortgage lending market, which later extended to the markets for collateralized mortgage obligations, MBS and the lending markets generally. This decline resulted in restrictions in the resale markets during 2011 and 2012 for non-conforming loans and has had an adverse effect on retail mortgage lending operations in many markets. Beginning in 2014, the price per barrel of crude oil began to decline significantly from a high during 2014 of over $100 to approximately $37 as of December 31, 2015. A prolonged period of low oil prices could have a negative

impact on energy-dominant states such as Texas, including real estate values. A further decline in the credit markets generally could adversely affect our financial condition and results of operations if we are unable to extend credit or sell loans in the secondary market. An adverse change in the economy affecting real estate values generally or in our primary markets specifically could significantly impair the value of collateral underlying certain of our loans and our ability to sell the collateral upon foreclosure. Furthermore, it is likely that, in a declining real estate market, we would be required to further increase our allowance for loan losses. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase our allowance for loan losses, our profitability and financial condition could be adversely impacted.

We have a high concentration of loans directly related to the medical community in our market areas. A negative change adversely impacting the medical community, for any reason, could result in losses and materially and adversely affect our business, financial condition, results of operations and future prospects.

A significant portion of our loan portfolio is dependent on the medical community. The primary source of repayment for loans in the medical community is cash flow from continuing operations. However, changes in the amount the government pays the medical community through the various government health insurance programs could adversely impact their profitability, which in turn could result in higher default rates by borrowers in the medical industry. Healthcare reform or increased regulation of the medical community could also negatively impact profitability and cash flow in the medical community. It is likely that, should there be any significant adverse impact to the medical community, our profitability and financial condition would also be adversely impacted.

Our allowance for probable loan losses may be insufficient.

We maintain an allowance for probable loan losses, which is a reserve established through a provision for probable loan losses charged to expense. This allowance represents management's best estimate of probable losses that may exist within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions; and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for probable loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates and assumptions regarding current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting the value of properties used as collateral for loans, problems affecting the credit of borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside our control, may require an increase in the allowance for probable loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for probable loan losses or the recognition of further loan charge-offs (in accordance with GAAP), based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for probable loan losses, we may need additional provisions to increase the allowance for probable loan losses. Any increases in the allowance for probable loan losses will result in a decrease in net income and capital, and may have a material adverse effect on our financial condition and results of operations. See the section captioned "Loan Loss Experience and Allowance for Loan Losses" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion related to our process for determining the appropriate level of the allowance for probable loan losses.

We may be adversely affected by declining crude oil prices.

Beginning in 2014, decisions by certain members of OPEC to maintain higher crude oil production levels combined with increased production levels in the United States led to increased global oil supplies which has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2015, energy loans comprised approximately 1.34% of our loan portfolio. Energy production and related industries represent a significant part of the economies in our primary markets. As of December 31, 2015, the price per barrel of crude oil was approximately $37 compared to approximately $98 as of December 31, 2013. If oil prices remain at these low levels for an extended period, we could experience weaker loan demand from the energy industry and increased losses within our energy portfolio. A prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Texas, which in turn could have a material adverse effect on our business, financial condition and results of operations.

If we fail to maintain an effective system of disclosure controls and procedures, including internal control over financial reporting,

we may not be able to accurately report our financial results or prevent fraud, which could have a material adverse effect on our

business, results of operation and financial condition. In addition, current and potential shareholders could lose confidence in
our financial reporting, which could harm the trading price of our common stock.

Management regularly reviews and updates our disclosure controls and procedures, including our internal control over financial reporting. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

Failure to achieve and maintain an effective internal control environment could result in us not being able to accurately report our financial results, prevent or detect fraud, or provide timely and reliable financial information pursuant to our reporting

obligations, which could have a material adverse effect on our business, financial condition, and results of operations. Further, it could cause our investors to lose confidence in the financial information we report, which could affect the trading price of our common stock.

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. 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 remediation 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. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews 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 financial condition and results of operations.

Our profitability depends significantly on economic conditions in the State of Texas.

Our success depends primarily on the general economic conditions of the State of Texas and the specific local markets in which we operate. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers primarily in the State of Texas and the local markets in which we operate. The local economic conditions in these areas have a significant impact on the demand for our products and services, as well as the ability of our customers to repay loans, the value of the collateral securing loans and the stability of our deposit funding sources. Moreover, virtually all of the securities in our municipal bond portfolio were issued by political subdivisions and agencies within the State of Texas. A significant decline in general economic conditions, caused by inflation, recession, crude oil prices, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, plant or business closings or downsizing, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on our financial condition and results of operations.

We operate in a highly competitive industry and market area.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets we operate. Additionally, various out-of-state banks have entered or have announced plans to enter the market areas in which we currently operate. We also face competition from many other types of financial institutions, including, without limitation, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes, continued consolidation and recent trends in the credit and mortgage lending markets. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for nonbanks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;

- customer satisfaction with our level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

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

From time to time, we may implement new delivery systems, such as internet banking, or offer new products and services within existing lines of business. In developing and marketing new delivery systems and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. 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. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.

We rely on dividends from our subsidiary for most of our revenue.

Southside Bancshares, Inc. is a separate and distinct legal entity from our subsidiaries. We receive substantially all of our revenue from dividends from our subsidiary, Southside Bank. These dividends are the principal source of funds to pay dividends on our common stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that Southside Bank, and certain nonbank subsidiaries may pay to us. Also, Southside Bancshares, Inc.'s right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event Southside Bank is unable to pay dividends to Southside Bancshares, Inc., we may not be able to service debt, pay obligations or pay dividends to our shareholders. The inability to receive dividends from Southside Bank could have a material adverse effect on Southside Bancshares, Inc.'s business, financial condition and results of operations. See the section captioned "Supervision and Regulation" in "Item 1. Business" and "Note 13 – Shareholders' Equity" to our consolidated financial statements included in this report.

Funding to provide liquidity may not be available to us on favorable terms or at all.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. The liquidity of Southside Bank is necessary to make loans and leases, and to repay deposit liabilities as they become due or are demanded by customers. Liquidity policies and limits are established by our board of directors. Management and our asset liability committee regularly monitor the overall liquidity position of Southside Bank and the Company to ensure that various alternative strategies exist to cover unanticipated events that could affect liquidity. Management and our asset liability committee also establish policies and monitor guidelines to diversify Southside Bank's funding sources to avoid concentrations in excess of board-approved policies in any one market source. Funding sources include federal funds purchased, securities sold under repurchase agreements, noncore deposits, and short- and long-term debt. Southside Bank is also a member of the Federal Home Loan Bank ("FHLB") System, which provides funding through advances to members that are collateralized with mortgage-related assets.

We maintain a portfolio of securities that can be used as a secondary source of liquidity. There are other sources of liquidity available to us should they be needed. These sources include sales or securitizations of loans, our ability to acquire additional national market, noncore deposits, additional collateralized borrowings such as FHLB advances, the issuance and sale of debt securities, and the issuance and sale of preferred or common securities in public or private transactions. Southside Bank also can borrow from the Federal Reserve's discount window.

We have historically had access to a number of alternative sources of liquidity, but if there is an increase in volatility in the credit and liquidity markets similar to 2008, there is no assurance that we will be able to obtain such liquidity on terms that are favorable to us, or at all. For example, the cost of out-of-market deposits may exceed the cost of deposits of similar maturity in our local market area, making them unattractive sources of funding; financial institutions may be unwilling to extend credit to banks because of concerns about the banking industry and the economy generally; and there may not be a viable market for raising equity capital.

If we were unable to access any of these funding sources when needed, we might be unable to meet customers' needs, which could adversely impact our financial condition, results of operations, cash flows and liquidity, and level of regulatory-qualifying capital.

Acquisitions and potential acquisitions may disrupt our business and dilute shareholder value.

We occasionally evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and fair values, and, therefore, some dilution of

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our tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits and synergies from an acquisition could have a material adverse effect on our 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 $98.1 million of goodwill and other intangible assets. A significant decline in our expected future cash flows, 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 business, financial condition and results of operations.

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

The process we use to estimate our probable 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 and other market measures on our financial condition and results of operations, depends upon the use of analytical and forecasting models. 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 of financial instruments are 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. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

We may not be able to attract and retain skilled personnel.

Our success depends, in large part, on our ability to attract and retain key personnel. Competition for the best personnel in most activities we engage in can be intense, and we may not be able to hire personnel or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our market, relationships in the communities we serve, years of industry experience and the difficulty of promptly finding qualified replacement personnel. Although we have employment agreements with certain of our executive officers, there is no guarantee that these officers will remain employed with the Company.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that we can prevent any such failures, interruptions, cyber security breaches or other security breaches or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We continually encounter technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. Our future success depends, 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, as well as to create additional efficiencies in our operations. Many of our 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 and even if we implement such products and services, we may incur substantial costs in doing so. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business, financial condition and results of operations.

Severe weather, natural disasters, climate change, acts of war or terrorism and other external events could significantly impact our business.

Severe weather, natural disasters, climate change, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. For example, because of our location and the location of the market areas we serve, severe weather is more likely than in other areas of the country. Although management has established disaster recovery policies and procedures, there can be no assurance of the effectiveness of such policies and procedures, and the occurrence of any such event could have a material adverse effect on our business, financial condition and results of operations.

RISKS ASSOCIATED WITH THE BANKING INDUSTRY

We are subject or may become subject to extensive government regulation and supervision.

Southside Bancshares, Inc., primarily through Southside Bank, and certain nonbank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect our lending practices, capital structure, investment practices and dividend policy and growth, among other things. The statutory and regulatory framework under which we operate has changed substantially as the result of the enactment of the Dodd-Frank Act. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, addressing, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, as implemented through the Bureau, interchange fees, derivatives, lending limits, mortgage lending practices, registration of investment advisors and changes among bank regulatory authorities. In addition, Congress and federal and state regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit deposit fees and other types of fees we charge, limit the types of financial services and products we may offer and/or increase the ability of nonbanks to offer competing financial services and products, among other things. While we cannot predict the impact of regulatory changes that may arise out of the current financial and economic environment, any regulatory changes or increased regulatory scrutiny could increase costs directly related to complying with new regulatory requirements. 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 our business, financial condition and results of operations. While our policies and procedures are designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned "Supervision and Regulation" in "Item 1. Business" and "Note 13 – Shareholders' Equity" to our consolidated financial statements included in this report.

We may become subject to increased regulatory capital requirements.

The capital requirements applicable to Southside Bancshares, Inc. and Southside Bank are subject to change as a result of the Dodd-Frank Act, the international regulatory capital initiative known as Basel III and any other future government actions. In particular, the Dodd-Frank Act eliminates Tier 1 capital treatment for most trust preferred securities after a three-year phase-in period that began January 1, 2013 for institutions that exceed $15 billion in assets. Furthermore, each of the federal banking agencies, including the Federal Reserve and the FDIC, has issued substantially similar risk-based and leverage capital guidelines applicable to the banking organizations they supervise. As a result of new regulations, we were required to begin complying with higher minimum capital requirements as of January 1, 2015. The Updated Capital Rules implement certain provisions of the Dodd-Frank Act and a separate, international regulatory capital initiative known as Basel III. These Updated Capital Rules also make important changes to the prompt corrective action framework. For additional discussion relating to capital adequacy refer to "Item 1. Business - Supervision and Regulation - Capital Adequacy." The Company believes it will be able to meet the new capital guidelines, however complying with any higher Updated Capital Rules mandated by the Dodd-Frank Act and Basel III may affect our operations, including our asset portfolios and financial performance.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties and inaccuracies in such information, including as a result of fraud, could adversely impact our business, financial condition and results of operations.

In deciding whether to extend credit or enter into other transactions, we rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may 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. Such information could turn out to be inaccurate, including as a result of fraud on behalf of our customers, counterparties or other third parties. In times of increased economic stress we are at increased risk of fraud losses. We cannot assure you that our underwriting and operational controls will prevent or detect such fraud or that we will not experience

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fraud losses or incur costs or other damage related to such fraud. Our customers may also experience fraud in their businesses which could adversely affect their ability to repay their loans or make use of our services. Our exposure and the exposure of our customers to fraud may increase our financial risk and reputation risk as it may result in unexpected loan losses that exceed those that have been provided for in our allowance for loan losses. Reliance on inaccurate or misleading information from our customers, counterparties and other third parties, including as a result of fraud, could have a material adverse impact on our business, financial condition and results of operations.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices insufficient to recover the full amount of the loan or derivative exposure due to us. There is no assurance that any such losses would not materially and adversely affect our results of operations or earnings.

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

From time to time, customers 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, defending claims is costly and diverts management’s attention, and 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 and 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, financial condition and results of operations.

RISKS ASSOCIATED WITH OUR COMMON STOCK

Our 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. Our 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 us;
- news reports relating to trends, concerns and other issues in the financial services industry;
- perceptions in the marketplace regarding us and/or our competitors;
- perceptions in the marketplace regarding the impact of the change in price per barrel of crude oil on the Texas economy;
- new technology used, or services offered, by competitors;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- changes in government regulations; and
-

geopolitical conditions such as acts or threats of terrorism or military conflicts.

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 our stock price to decrease regardless of operating results.

The trading volume in our common stock is less than that of other larger financial services companies.

Although our common stock is listed for trading on the NASDAQ Global Select Market, the trading volume is low, and you are not assured liquidity with respect to transactions in our common stock. 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 our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

The holders of our junior subordinated debentures have rights that are senior to those of our shareholders.

On September 4, 2003, we issued $20.6 million of floating rate junior subordinated debentures in connection with a $20.0 million trust preferred securities issuance by our subsidiary, Southside Statutory Trust III. These junior subordinated debentures mature in September 2033. On August 8 and 10, 2007, we issued $23.2 million and $12.9 million, respectively, of five-year fixed rate converting to floating rate thereafter, junior subordinated debentures in connection with $22.5 million and $12.5 million, respectively, trust preferred securities issuances by our subsidiaries Southside Statutory Trust IV and V, respectively. Trust IV matures October 2037 and Trust V matures September 2037. As part of the acquisition of FWBS on October 10, 2007, we assumed $3.6 million of floating rate junior subordinated debentures issued to Magnolia Trust Company I in connection with $3.5 million of trust preferred securities issued in 2005 that matures in 2035.

We conditionally guarantee payments of the principal and interest on the trust preferred securities. Our junior subordinated debentures are senior to our shares of common stock. As a result, we must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock and, in the event of bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of common stock. We have the right to defer distributions on our junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of common stock.

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 and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

Provisions of our articles of incorporation bylaws, as well as state and federal banking regulations, could delay or prevent a takeover of us by a third party.

Our articles of incorporation and bylaws could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include, among others, requiring advance notice for raising business matters or nominating directors at shareholders’ meetings and staggered board elections.

Any individual, acting alone or with other individuals, who are seeking to acquire, directly or indirectly, 10.0% or more of our outstanding common stock must comply with the Change in Bank Control Act, which requires prior notice to the Federal Reserve for any acquisition. Additionally, any entity that wants to acquire 5.0% or more of our outstanding common stock, or otherwise control us, may need to obtain the prior approval of the Federal Reserve under the BHCA of 1956, as amended. As a result, prospective investors in our common stock need to be aware of and comply with those requirements, to the extent applicable.

We may issue additional securities, which could dilute your ownership percentage.

In certain situations, our board of directors has the authority, without any vote of our shareholders, to issue shares of our authorized but unissued stock. In the future, we may issue additional securities, through public or private

offerings, to raise additional capital or finance acquisitions. Any such issuance would dilute the ownership of current holders of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

Southside Bank owns and operates the following properties:

- Southside Bank main branch at 1201 South Beckham Avenue, Tyler, Texas. The primary executive offices of Southside Bancshares, Inc. are located at this location;
- Fort Worth main branch located at 1320 South University Drive, Fort Worth, Texas. Additional executive offices of Southside Bancshares, Inc. are located at this location;
- Southside Bank Annex at 1211 South Beckham Avenue, Tyler, Texas. The Southside Bank Annex is directly adjacent to the main bank building. Human Resources, and other support areas are located in this building;
- Operations Annex at 1221 South Beckham Avenue, Tyler, Texas. Various back office, lending and training facilities and other support areas are located in this building;
- Southside Bank Trust at 1305 South Beckham Avenue, Tyler, Texas. The Trust Department is located in this building;
- Southside Bank Technology Center at 1010 East First Street, Tyler, Texas;
- Southside Bank main branch motor bank facility at 1010 East First Street, Tyler, Texas;
- South Broadway branch at 6201 South Broadway, Tyler, Texas;
- South Broadway branch motor bank facility at 6019 South Broadway, Tyler, Texas;
- Downtown branch at 113 West Ferguson Street, Tyler, Texas;
- Gentry Parkway branch and motor bank facility at 2121 West Gentry Parkway, Tyler, Texas;
- Highway 64 West branch and motor bank facility at 3815 State Highway 64 West, Tyler, Texas;
- Longview main branch and motor bank facility at 2001 Judson Road, Longview, Texas;
- Lindale main branch and motor bank facility at 2510 South Main Street, Lindale, Texas;
- Whitehouse main branch and motor bank facility at 901 Highway 110 North, Whitehouse, Texas;
- Jacksonville main branch and motor bank at 1015 South Jackson Street, Jacksonville, Texas;
- Gresham main branch and motor bank at 16691 FM 2493, Tyler, Texas;
- Gun Barrel City main branch and motor bank facility at 901 West Main, Gun Barrel City, Texas;
- Irving branch at 1401 Walnut Hill Lane, Irving, Texas;
- Cleburne branch at 1204 West Henderson, Cleburne, Texas;
- Euless branch at 2311 West Euless Boulevard, Euless, Texas;
- Arlington branch and motor bank facility at 2831 West Park Row, Arlington, Texas;
- Arlington branch at 950 West Arbrook Boulevard, Arlington, Texas;
- Fort Worth branch at 1000 Pennsylvania Avenue, Fort Worth, Texas;
- Fort Worth branch at 2330 East Rosedale Street, Fort Worth, Texas;
- Fort Worth branch at 6001 Bryant Irvin Road, Fort Worth, Texas;
- Fort Worth branch at 7800 White Settlement Road, Fort Worth, Texas;
- Fort Worth branch and motor bank facility at 9516 Clifford Street, Fort Worth, Texas;
- Watauga branch at 8024 Denton Highway, Watauga, Texas;
- Weatherford branch at 318 South Main Street, Weatherford, Texas; and
- 74 ATM's located throughout our market areas.

Southside Bank currently operates full service banks in leased space in 18 grocery stores and six full service branches in leased office space in the following locations:

- one in Bullard, Texas;
- one in Lindale, Texas;
- one in Flint, Texas;
- one in Whitehouse, Texas;
- one in Chandler, Texas;
- one in Palestine, Texas;
- one in Athens, Texas;
- one in Hawkins, Texas;
- three in Longview, Texas;
- seven in Tyler, Texas;
- Fort Worth operations branch at 5001 North Riverside Drive, Suite 111, Fort Worth, Texas;
- Flower Mound branch at 2341 Justin Road, Flower Mound, Texas;
- Granbury branch at 1030 East Highway 377, Suite 138, Granbury, Texas;
- Grapevine branch at 1616 West Northwest Highway, Grapevine, Texas;
- Austin branch at 8200 North Mopac, Suite 130, Austin, Texas; and
- Austin branch at 1250 South Capital of Texas Hwy, Bldg 1, Suite 101, Austin, Texas.

All of the properties detailed above are suitable and adequate to provide the banking services intended based on the type of property described. In addition, the properties for the most part are fully utilized but designed with productivity in mind and can handle the additional business volume we anticipate they will generate. As additional potential needs are identified, individual property enhancements or the need to add properties will be evaluated.

ITEM 3. LEGAL PROCEEDINGS

We are party to legal proceedings arising in the normal conduct of business. Management believes that such litigation is not material to our financial position, results of operations or cash flows.

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 trades on the NASDAQ Global Select Market under the symbol "SBSI." Set forth below are the high and low sales prices on the NASDAQ Global Select Market for each full quarterly period from January 1, 2014 to December 31, 2015. During 2015 and 2014, we declared and paid a 5% stock dividend. Stock prices listed below have been adjusted to give retroactive recognition to such stock dividends.

	2015		2014	
Sales Price Per Share	High	Low	High	Low
First quarter	$29.04	$24.68	$28.66	$22.84
Second quarter	29.76	26.19	29.67	24.32
Third quarter	29.71	24.41	32.71	27.12
Fourth quarter	28.90	24.02	32.67	27.50

See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources” for a discussion of our common stock repurchase program.

SHAREHOLDERS

There were approximately 1,532 holders of record of our common stock, the only class of equity securities currently issued and outstanding, as of March 1, 2016.

DIVIDENDS

Cash dividends declared and paid were $1.00 and $0.96 per share for the years ended December 31, 2015 and 2014, respectively. Stock dividends of 5% were also declared and paid during both of the years ended December 31, 2015 and 2014. We have paid a cash dividend at least once every year since 1970 (including dividends paid by Southside Bank prior to the incorporation of Southside Bancshares). Future dividends will depend on our earnings, financial condition and other factors that our board of directors considers to be relevant. In addition, we must make payments on our junior subordinated debentures before any dividends can be paid on the common stock. For additional discussion relating to restrictions that limit our ability to pay dividends refer to “Item 1. Business – Supervision and Regulation” and “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources.” The cash dividends were paid quarterly each year as listed below.

Cash Dividends Per Share	2015	2014
First quarter	$0.23	$0.21
Second quarter	0.23	0.21
Third quarter	0.23	0.22
Fourth quarter	0.31	0.32
Total	$1.00	$0.96

ISSUER SECURITY REPURCHASES

During the quarter ended December 31, 2015, we did not purchase any of our common stock. On January 28, 2016, the Board of Directors approved a Stock Repurchase Plan. The Board authorized the repurchase, from time to time, of up to five percent of the issued and outstanding common stock, or approximately 1.27 million shares, in open market purchases and privately negotiated transactions at prevailing market prices. The Company has no obligation to repurchase any shares under the Stock Repurchase Plan and may suspend or discontinue it at any time.

Subsequent to December 31, 2015 and through March 2, 2016, we purchased 424,701 shares of common stock at an average price of $22.89 pursuant to the Stock Repurchase Plan.

RECENT SALES OF UNREGISTERED SECURITIES

There were no equity securities sold by us during the years ended December 31, 2015, 2014, or 2013 that were not registered under the Securities Act of 1933.

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FINANCIAL PERFORMANCE
The following performance graph does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates the performance graph by reference therein.

	Period Ending					
Index	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15
Southside Bancshares, Inc.	100.00	112.74	121.26	171.66	196.81	177.93
Russell 2000	100.00	95.82	111.49	154.78	162.35	155.18
SBSI Peer Group 2015 Index*	100.00	99.65	112.16	166.59	154.96	142.27

*SBSI Peer Group 2015 Index consist of Cullen/Frost Bankers, Inc. (CFR), First Financial Bankshares, Inc. (FFIN), International Bancshares
Corporation (IBOC), Prosperity Bancshares, Inc. (PB), Texas Capital Bancshares, Inc. (TCBI).

Source : SNL Financial LC, Charlottesville, VA
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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial data regarding our results of operations and financial position for, and as of the end of, each of the fiscal years in the five-year period ended December 31, 2015. This information should be read in conjunction with “Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations” and “Item 8. Financial Statements and Supplementary Data,” as set forth in this report.

	As of and For the Years Ended December 31,				
	2015	2014 (1)	2013	2012	2011
	(in thousands, except per share data)				
Balance Sheet Data:					
Investment Securities	$752,135	$695,529	$728,981	$618,716	$284,452
Mortgage-backed Securities	$1,492,653	$1,395,498	$1,115,827	$1,051,898	$1,729,516
Loans, Net of Allowance for Loan Losses	$2,412,017	$2,167,841	$1,332,396	$1,242,392	$1,068,690
Total Assets	$5,162,076	$4,807,261	$3,445,663	$3,237,403	$3,303,817
Deposits	$3,455,407	$3,374,417	$2,527,808	$2,351,897	$2,321,671
Long-term Obligations	$562,592	$660,363	$559,660	$429,408	$321,035
Shareholders’ Equity	$444,062	$425,243	$259,518	$257,763	$258,927
Income Statement Data:					
Interest Income	$154,532	$123,778	$119,602	$116,020	$131,038
Interest Expense	$19,854	$16,956	$17,968	$26,895	$35,631
Deposit Service Income	$20,112	$15,280	$15,560	$15,433	$15,943
Net Gain on Sale of Securities Available for Sale	$3,660	$2,830	$8,472	$17,966	$11,795
Noninterest Income	$37,895	$24,489	$35,245	$40,021	$35,322
Noninterest Expense	$112,954	$97,704	$81,713	$76,107	$72,348
Net Income Attributable to Southside Bancshares, Inc.	$43,997	$20,833	$41,190	$34,695	$39,133
Per Share Data:					
Earnings Per Common Share:					
Basic	$1.74	$1.04	$2.09	$1.73	$1.96
Diluted	$1.73	$1.04	$2.09	$1.73	$1.96
Cash Dividends Paid Per Common Share	$1.00	$0.96	$0.91	$1.11	$0.90

(1) We completed the acquisition of Omni on December 17, 2014. Accordingly, our balance sheet data as of December 31, 2014 reflects the effects of the acquisition of Omni. Income statement data with respect to Omni includes only the results of Omni's operations for December 17 - December 31, 2014.

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

The following discussion and analysis provides a comparison of our results of operations for the years ended December 31, 2015, 2014, and 2013 and financial condition as of December 31, 2015 and 2014. This discussion should be read in conjunction with the financial statements and related notes included elsewhere in this report. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements of other than historical fact that are contained in this document and in written material, press releases and oral statements issued by or on behalf of Southside Bancshares, Inc., a bank holding company, may be considered to be "forward-looking statements" within the meaning of and subject to the protections of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date. These statements may include words such as "expect," "estimate," "project," "anticipate," "appear," "believe," "could," "should," "m "will," "would," "seek," "intend," "probability," "risk," "goal," "target," "objective," "plans," "potential," and similar expressions. Forward-looking statements are statements with respect to our beliefs, plans, expectations, objectives, goals, anticipations, assumptions, estimates, intentions and future performance, and are subject to significant known and unknown risks and uncertainties, which could cause our actual results to differ materially from the results discussed in the forward-looking statements. For example, discussions of the effect of our expansion, trends in asset quality and earnings from growth, and certain market risk disclosures are based upon information presently available to management and are dependent on choices about key model characteristics and assumptions and are subject to various limitations. See "Item 1. Business" and this "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." By their nature, certain of the market risk disclosures are only estimates and could be materially different from what actually occurs in the future. As a result, actual income gains and losses could materially differ from those that have been estimated. Other factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to, the following:

- general economic conditions, either globally, nationally, in the State of Texas, or in the specific markets in which we operate, including, without limitation, the deterioration of the commercial real estate, residential real estate, construction and development, energy, oil and gas, credit and liquidity markets, which could cause an adverse change in our net interest margin, or a decline in the value of our assets, which could result in realized losses;
- current or future legislation, regulatory changes or changes in monetary or fiscal policy that adversely affect the businesses in which we are engaged, including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Federal Reserve's actions with respect to interest rates, the capital requirements promulgated by the Basel Committee on Banking Supervision ("Basel Committee") and other regulatory responses to current economic conditions;
- adverse changes in the status or financial condition of the Government-Sponsored Enterprises (the "GSEs") impacting the GSEs' guarantees or ability to pay or issue debt;
- adverse changes in the credit portfolio of other U.S. financial institutions relative to the performance of certain of our investment securities;
- economic or other disruptions caused by acts of terrorism in the United States, Europe or other areas;
- changes in the interest rate yield curve such as flat, inverted or steep yield curves, or changes in the interest rate environment that impact interest margins and may impact prepayments on the mortgage-backed securities ("MBS") portfolio;
- increases in our nonperforming assets;
- our ability to maintain adequate liquidity to fund operations and growth;
- the failure of our assumptions underlying allowance for loan losses and other estimates;

- unexpected outcomes of, and the costs associated with, existing or new litigation involving us;
- changes impacting our balance sheet and leverage strategy;
- risks related to actual U.S. agency MBS prepayments exceeding projected prepayment levels;
- risks related to U.S. agency MBS prepayments increasing due to U.S. Government programs designed to assist homeowners to refinance their mortgage that might not otherwise have qualified;
- our ability to monitor interest rate risk;

- risks related to the price per barrel of crude oil;
- significant increases in competition in the banking and financial services industry;
- changes in consumer spending, borrowing and saving habits;
- technological changes;
- our ability to increase market share and control expenses;
- the effect of changes in federal or state tax laws;
- the effect of compliance with legislation or regulatory changes;
- the effect of changes in accounting policies and practices;
- credit risks of borrowers, including any increase in those risks due to changing economic conditions; and
- risks related to loans secured by real estate, including the risk that the value and marketability of collateral could decline.

All written or oral forward-looking statements made by us or attributable to us are expressly qualified by this cautionary notice. We disclaim any obligation to update any factors or to announce publicly the result of revisions to any of the forward-looking statements included herein to reflect future events or developments, unless otherwise required by law.

CRITICAL ACCOUNTING ESTIMATES

Our accounting and reporting estimates conform with U.S. generally accepted accounting principles ("GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. We consider our critical accounting policies to include the following:

Allowance for Losses on Loans. The allowance for losses on loans represents our best estimate of probable losses inherent in the existing loan portfolio. The allowance for losses on loans is increased by the provision for losses on loans charged to expense and reduced by loans charged-off, net of recoveries. The provision for losses on loans is determined based on our assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on specific borrowers and industry groups, historical loan loss experience, the level of classified and nonperforming loans and the results of regulatory examinations.

The allowance for loan loss is based on the most current review of the loan portfolio and is a result of multiple processes. The servicing officer has the primary responsibility for updating significant changes in a customer's financial position. Each officer prepares status updates on any credit deemed to be experiencing repayment difficulties which, in the officer's opinion, would place the collection of principal or interest in doubt. Our internal loan review department is responsible for an ongoing review of our loan portfolio with specific goals set for the loans to be reviewed on an annual basis.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $150,000 or more is updated on a quarterly basis in order to properly determine the necessary allowance and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

Loans are considered impaired if, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of impaired loans is generally based on the present value of expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, except that all collateral-dependent loans are measured for impairment based on fair value of the collateral. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions such as discount rates, and methodologies, such as

comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation.

Changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the conditions of the various markets in which collateral may be sold all may affect the required level of the allowance for losses on loans and the associated provision for loan losses.

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The allowance for loan losses related to purchase credit impaired (“PCI”) loans is based on an analysis that is performed each period to estimate the expected cash flows for each loan deemed PCI. To the extent that the expected cash flows from a PCI loan have decreased since the acquisition date, we establish or increase the allowance for loan losses.

For acquired loans that are not deemed credit impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value. Subsequent to the purchase date, the methods utilized to estimate the required allowance for loan losses for these loan is similar to originated loans. The remaining differences between the purchase price and the unpaid principal balance at the date of acquisition are recorded in interest income over the economic life of the loan.

As of December 31, 2015, our review of the loan portfolio indicated that a loan loss allowance of $19.7 million was appropriate to cover probable losses in the portfolio.

Refer to “Part II - Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Loan Loss Experience and Allowance for Loan Losses” and “Note 6 – Loans and Allowance for Probable Loan Losses” to our consolidated financial statements included in this report for a detailed description of our estimation process and methodology related to the allowance for loan losses.

Estimation of Fair Value. The estimation of fair value is significant to a number of our assets and liabilities. In addition, GAAP requires disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values for securities are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of yield curves. Fair values for most investment and MBS are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or estimates from independent pricing services. Where there are price variances outside certain ranges from different pricing services for specific securities, those pricing variances are reviewed with other market data to determine which of the price estimates is appropriate for that period.

Impairment of Investment Securities and Mortgage-backed Securities. Investment and MBS classified as available for sale (“AFS”) are carried at fair value and the impact of changes in fair value are recorded on our consolidated balance sheet as an unrealized gain or loss in “Accumulated other comprehensive (loss) income,” a separate component of shareholders' equity. Securities classified as AFS or held to maturity (“HTM”) are subject to our review to identify when a decline in value is other-than-temporary. When it is determined that a decline in value is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and to other comprehensive income for the noncredit portion. Factors considered in determining whether a decline in value is other-than-temporary include : (1) whether the decline is substantial, the duration of the decline and the reasons for the decline in value; (2) whether the decline is related to a credit event, a change in interest rate or a change in the market discount rate; (3) the financial condition and near-term prospects of the issuer; and (4) whether we have a current intent to sell the security and whether it is not more likely than not that we will be required to sell the security before the anticipated recovery of its amortized cost basis. For certain assets, we consider expected cash flows of the investment in determining if impairment exists.

Defined Benefit Pension Plan. The plan obligations and related assets of our defined benefit pension plan (the “Plan”) are presented in “Note 11 – Employee Benefits” to our consolidated financial statements included in this report. Entry into the Plan by new employees was frozen effective December 31, 2005. Plan assets, which consist primarily of marketable equity and debt instruments, are valued using observable market quotations. Plan obligations and the annual pension expense are determined by independent actuaries and through the use of a number of assumptions that are reviewed by management. Key assumptions in measuring the Plan obligations include the discount rate, the rate of salary increases and the estimated future return on the Plan assets. In determining the discount rate, we utilized a cash flow matching analysis to determine a range of appropriate discount rates for our defined benefit pension and restoration plans. In developing the cash flow matching analysis, we constructed a portfolio of high quality noncallable bonds (rated AA- or better) to match as close as possible the timing of future benefit payments of the Plan at December 31, 2015. Based on this cash flow matching analysis, we were able to determine an appropriate discount rate.

Salary increase assumptions are based upon historical experience and our anticipated future actions. The expected long-term rate of return assumption reflects the average return expected based on the investment strategies and asset allocation on the assets invested to provide for the Plan's liabilities. We considered broad equity and bond indices, long-term return projections, and actual long-term historical Plan performance when evaluating the expected long-term rate of return assumption. At December 31, 2015, the weighted-average actuarial assumptions of the Plan were: a discount rate of 4.56%; a long-term rate of return on Plan assets of 7.25%; and assumed salary increases of 3.50%. Material changes in pension benefit costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the number of Plan

participants, changes in the level of benefits provided, changes in the discount rates, changes in the expected long-term rate of return, changes in the level of contributions to the Plan and other factors.

OVERVIEW

OPERATING RESULTS

During the year ended December 31, 2015, our net income increased $23.2 million, or 111.2%, to $44.0 million, from $20.8 million for the same period in 2014. The increase in net income was primarily attributable to an increase in net interest income of $27.9 million and an increase in noninterest income of $13.4 million, combined with a decrease in the provision for loan losses. These items were partially offset by an increase in noninterest expense and income tax expense. Noninterest expense increased primarily due to expenses associated with the acquisition of Omni which are reflected primarily in salaries and employee benefits as well as occupancy expense. Earnings per diluted share increased $0.69, or 66.3%, to $1.73 for the year ended December 31, 2015, from $1.04 for the same period in 2014.
During the year ended December 31, 2014, our net income decreased $20.4 million, or 49.4%, to $20.8 million, from $41.2 million for the same period in 2013. The decrease in net income was primarily attributable to merger expenses related to the acquisition of Omni, a loss on the sale of loans purchased by SFG which resulted in an increase in the provision for loan losses and an impairment of our investment in SFG, and a decrease in net gain on sale of securities available for sale. These items were partially offset by a decrease in income tax expense and an increase in net interest income. Noninterest expense increased primarily due to merger related expenses which is reflected primarily in salaries and employee benefits, software and data processing expense and professional fees. Earnings per diluted share decreased to $1.04 for the year ended December 31, 2014, from $2.09 for the same period in 2013.

FINANCIAL CONDITION

Our total assets increased $354.8 million, or 7.4%, to $5.16 billion at December 31, 2015 from $4.81 billion at December 31, 2014 primarily as a result of the increases in our loans and increases in our investment portfolio and mortgage-backed securities ("MBS"). Loans increased $250.6 million, or 11.5%, to $2.43 billion compared to $2.18 billion at December 31, 2014. The increase in our loans was comprised of $167.0 million of commercial real estate, $170.4 million of construction, $16.1 million of commercial and $30.6 million of municipal loans while offset by a decrease of $35.5 million of 1-4 family residential loans and $98.0 million of loans to individuals. Our securities portfolio increased by $153.8 million, or 7.4%, to $2.24 billion compared to $2.09 billion at December 31, 2014. The increase in our securities was comprised of approximately $97.2 million of MBS and approximately $56.6 million of investment securities, comprised of U.S. Treasury, Agency and Texas municipal securities. The increase in loans and securities was funded primarily by FHLB advances and deposits.
Our nonperforming assets at December 31, 2015 increased to $32.5 million, and represented 0.63% of total assets, compared to $12.3 million, or 0.26% of total assets at December 31, 2014. Nonaccruing loans increased $16.4 million to $20.5 million and the ratio of nonaccruing loans to total loans increased to 0.84% at December 31, 2015 compared to 0.19% at December 31, 2014. Other Real Estate Owned ("OREO") decreased to $744,000 at December 31, 2015 from $1.7 million at December 31, 2014. Repossessed assets decreased to $64,000 at December 31, 2015 from $565,000 at December 31, 2014. Restructured loans at December 31, 2015 increased to $11.1 million compared to $5.9 million at December 31, 2014.
Our deposits increased $81.0 million to $3.46 billion at December 31, 2015 from $3.37 billion at December 31, 2014. Our deposits, net of brokered deposits, increased $18.1 million, or 0.5% during 2015. The increase in our deposits during 2015 was primarily the result of an increase in brokered deposits and public fund deposits. During 2015, our non-interest bearing deposits increased $11.5 million, and interest bearing deposits increased $69.5 million. During 2015, our brokered deposits increased $62.8 million and our public fund deposits increased $56.8 million.
Total FHLB advances increased $250.3 million to $1.15 billion at December 31, 2015, from $897.4 million at December 31, 2014. Short-term FHLB advances increased $348.0 million to $645.4 million at December 31, 2015 from $297.4 million at December 31, 2014. Long-term FHLB advances decreased $97.8 million to $502.3 million at December 31, 2015 from $600.1 million at December 31, 2014. Other borrowings at December 31, 2015 and 2014 totaled $62.7 million and $64.5 million, respectively, and at December 31, 2015 consisted of $2.4 million of short-term borrowings and $60.3 million of long-term debt compared to $4.2 million of short-term borrowings and $60.3 million of long-term debt at December 31, 2014.

Assets under management in our trust department decreased during 2015 and were approximately $878.3 million at December 31, 2015 compared to $932.6 million at December 31, 2014.

Shareholders' equity at December 31, 2015 totaled $444.1 million compared to $425.2 million at December 31, 2014. The increase is primarily the result of net income of $44.0 million recorded for the year ended December 31, 2015, the $1.4 million of common stock issued under our dividend reinvestment plan and stock compensation expense of $1.4 million. These increases

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were partially offset by cash dividends paid of $25.1 million and an increase in accumulated other comprehensive loss of $3.1 million. The increase in accumulated other comprehensive loss is comprised primarily of a decrease of $6.5 million, net of tax, in the unrealized gain on securities, net of reclassification adjustment and an increase of $3.4 million, net of tax, related to the change in the funded status of our defined benefit plan. See “Note 4 – Accumulated Other Comprehensive (Loss) Income” to our consolidated financial statements included in this report.

Economic conditions in our market areas have continued to perform generally better than many other parts of the country. There continues to be some economic headwinds including a decline in oil prices, however despite these headwinds, many economists predict the national economy and the economy in markets we serve will continue to grow at a slow to modest pace in 2015.

Key financial indicators management follows include, but are not limited to, numerous interest rate sensitivity and interest rate risk indicators, credit risk, operations risk, liquidity risk, capital risk, regulatory risk, competition risk, yield curve risk, U.S. Agency MBS prepayment risk, and economic risk indicators.

BALANCE SHEET STRATEGY

We utilize wholesale funding and securities to enhance our profitability and balance sheet composition by determining acceptable levels of credit, interest rate and liquidity risk consistent with prudent capital management. This balance sheet strategy consists of borrowing a combination of long- and short-term funds from the FHLB and, when determined appropriate, issuing brokered CDs. These funds are invested primarily in U.S. Agency MBS, and to a lesser extent, long-term municipal securities. Although U.S. Agency MBS often carry lower yields than traditional mortgage loans and other types of loans we make, these securities generally (i) increase the overall quality of our assets because of either the implicit or explicit guarantees of the U.S. Government, (ii) are more liquid than individual loans and (iii) may be used to collateralize our borrowings or other obligations. While the strategy of investing a substantial portion of our assets in U.S. Agency MBS and municipal securities has historically resulted in lower interest rate spreads and margins, we believe that the lower operating expenses and reduced credit risk, combined with the managed interest rate risk of this strategy, have enhanced our overall profitability over the last several years. At this time, we utilize this balance sheet strategy with the goal of enhancing overall profitability by maximizing the use of our capital.

Risks associated with the asset structure we maintain include a lower net interest rate spread and margin when compared to our peers, changes in the slope of the yield curve, which can reduce our net interest rate spread and margin, increased interest rate risk, the length of interest rate cycles, changes in volatility spreads associated with the MBS and municipal securities, the unpredictable nature of MBS prepayments and credit risks associated with the municipal securities. See “Part I - Item 1A. Risk Factors – Risks Related to Our Business” for a discussion of risks related to interest rates. Our asset structure, net interest spread and net interest margin require us to closely monitor our interest rate risk. An additional risk is the change in fair value of the AFS securities portfolio as a result of changes in interest rates. Significant increases in interest rates, especially long-term interest rates, could adversely impact the fair value of the AFS securities portfolio, which could also significantly impact our equity capital. Due to the unpredictable nature of MBS prepayments, the length of interest rate cycles, and the slope of the interest rate yield curve, net interest income could fluctuate more than simulated under the scenarios modeled by our Asset/Liability Committee (“ALCO”) and described under “Item 7A. Quantitative and Qualitative Disclosures about Market Risk” in this report.

Determining the appropriate size of the balance sheet is one of the critical decisions any bank makes. Our balance sheet is not merely the result of a series of micro-decisions, but rather the size is controlled based on the economics of assets compared to the economics of funding. The current low interest rate environment and investment and economic landscape requires that we monitor the interest rate sensitivity of the assets driving our growth and closely align ALCO objectives accordingly.

The management of our securities portfolio as a percentage of earning assets is guided by the current economics associated with increasing the securities portfolio, changes in our overall loan and deposit levels, and changes in our wholesale funding levels. If adequate quality loan growth is not available to achieve our goal of enhancing profitability by maximizing the use of capital, as described above, then we may purchase additional securities, if appropriate, which may cause securities as a percentage of earning assets to increase. Should we determine that

increasing the securities portfolio or replacing the current securities maturities and principal payments is not an efficient use of capital, we may decrease the level of securities through proceeds from maturities, principal payments on MBS or sales. Our balance sheet strategy is designed such that our securities portfolio should help mitigate financial performance associated with potential business cycles that include slower loan growth and higher credit costs.

In the year ended December 31, 2015, we primarily sold collateralized mortgage obligations ("CMO") along with some U.S. Agency mortgage pass-throughs, U.S. Agency commercial mortgage-backed securities ("CMBS"), Texas municipal securities and U.S. Treasury securities that resulted in an overall gain on the sale of AFS securities of $3.7 million. The CMOs we sold during the year had a poor risk reward due to ongoing prepayment concerns as a result of the lower long term interest rate

environment and very low book yields. The CMBS that were sold were primarily shorter duration CMBS and were more than replaced by longer duration CMBS. The U.S. Treasury securities sold were due to the low interest rates at that time. Our investment securities and U.S. Agency MBS increased from $2.09 billion at December 31, 2014, to $2.24 billion at December 31, 2015. The increase was primarily due to increased U.S. Treasury securities and CMBS. Most of the increase in the securities portfolio occurred during the second and fourth quarters when interest rates were higher on average than the other two quarters. At December 31, 2015, securities as a percentage of assets remained the same at 43.5%, when compared to December 31, 2014. Our balance sheet management strategy is dynamic and will be continually reevaluated as market conditions warrant. As interest rates, yield curves, MBS prepayments, funding costs, security spreads and loan and deposit portfolios change, our determination of the proper types, amount and maturities of securities to own, as well as funding needs and funding sources will continue to be reevaluated. Should the economics of purchasing securities decrease, we may allow this part of the balance sheet to shrink through run-off or security sales. However, should the economics become more attractive, we may continue to strategically increase the securities portfolio and the balance sheet.

With respect to liabilities, we continue to utilize a combination of FHLB advances and deposits to achieve our strategy of minimizing cost while achieving overall interest rate risk objectives as well as the liability management objectives of the ALCO. FHLB funding is the primary wholesale funding source we are currently utilizing. Our FHLB borrowings increased 27.9%, or $250.3 million, to $1.15 billion at December 31, 2015 from $897.4 million at December 31, 2014, due primarily to the increase in securities and loans. During the year ended December 31, 2015, our long-term FHLB advances decreased $97.8 million, to $502.3 million from $600.1 million at December 31, 2014. Our brokered deposits increased from $23.4 million at December 31, 2014 to $86.3 million at December 31, 2015, or 268.2%. At December 31, 2015, approximately $64.6 million of our brokered deposits were non-callable brokered CDs with a weighted average cost of 56 basis points and remaining maturities of five to thirteen months. The remaining $20.7 million were long-term brokered CDs that mature within five years and have short-term calls that we control. During the three months ended December 31, 2015, we issued approximately $1.0 million of brokered money market deposits and $21.5 million of brokered CDs. During 2015, increases in FHLB advances and brokered deposits resulted in an increase in our total wholesale funding as a percentage of deposits, not including brokered deposits, to 36.6% at December 31, 2015 from 27.5% at December 31, 2014.

RESULTS OF OPERATIONS

Our results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on assets (loans and investments) and interest expense due on our funding sources (deposits and borrowings) during a particular period. Results of operations are also affected by our noninterest income, provision for loan losses, noninterest expenses and income tax expense. General economic and competitive conditions, particularly changes in interest rates, changes in interest rate yield curves, prepayment rates of MBS and loans, repricing of loan relationships, government policies and actions of regulatory authorities, also significantly affect our results of operations. Future changes in applicable law, regulations or government policies may also have a material impact on us.

NET INTEREST INCOME

Net interest income is one of the principal sources of a financial institution's earnings stream and represents the difference or spread between interest and fee income generated from interest earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates or interest rate yield curves, as well as repricing characteristics and volume and changes in the mix of interest earning assets and interest bearing liabilities, materially impact net interest income.

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
Interest income			
Loans	$96,417	$70,598	$72,910
Investment securities – taxable	1,587	615	799
Investment securities – tax-exempt	22,468	24,038	25,483
Mortgage-backed securities	33,661	28,207	20,085
FHLB stock and other investments	298	181	182
Other interest earning assets	101	139	143
Total interest income	154,532	123,778	119,602
Interest expense			
Deposits	10,162	7,953	8,179
Short-term obligations	1,250	624	1,875
Long-term obligations	8,442	8,379	7,914
Total interest expense	19,854	16,956	17,968
Net interest income	$134,678	$106,822	$101,634

Net interest income for the year ended December 31, 2015 increased $27.9 million, or 26.1%, compared to the same period in 2014 and increased $5.2 million, or 5.1%, for the year ended December 31, 2014 compared to the same period in 2013. The overall increase in net interest income during 2015 was primarily due to increases in interest income on loans and mortgage-backed securities income, partially offset by increases in interest expense on deposits and short-term obligations. For the year ended December 31, 2015, our net interest spread and net interest margin decreased to 3.31% and 3.40% from 3.63% and 3.77%, respectively, for the same period in 2014. The overall increase in net interest income during 2014 was primarily the result of an increase in interest income from MBS and a decrease in interest expense on short-term obligations and deposits, partially offset by a decrease in interest income on loans and investment securities and an increase in long-term obligation interest expense. For the year ended December 31, 2014, our net interest spread increased to 3.63% from 3.54%, and our net interest margin increased to 3.77% from 3.69% when compared to the same period in 2013.

During the year ended December 31, 2015, total interest income increased $30.8 million, or 24.8%, when compared to the same period in 2014, and during the year ended December 31, 2014, increased $4.2 million, or 3.5%, when compared to the same period in 2013. The increase in total interest income for the year ended December 31, 2015 was the result of an increase in average interest earning assets of $1.20 billion, or 36.6%, from $3.26 billion to $4.46 billion from 2014 to 2015, while partially offset by a decrease in the average yield on average interest earning assets from 4.29% for the year ended December 31, 2014 to 3.84% for the year ended December 31, 2015. The decrease in the yield on interest earning assets during the year ended December 31, 2015 is reflective of a decrease in the average yield on loans and MBS.

The increase in total interest income for the year ended December 31, 2014 was the result of an increase in the average yield on average interest earning assets from 4.25% for the year ended December 31, 2013 to 4.29% for the year ended December 31, 2014 and an increase in average interest earning assets of $81.2 million, or 2.6%, from $3.18 billion to $3.26 billion from 2013 to 2014. The increase in the yield on interest earning assets during the year ended December 31, 2014 is reflective of an increase in the average yield on MBS and taxable investment securities.

During the year ended December 31, 2015, average loans increased $803.6 million, or 56.6%, to $2.22 billion from $1.42 billion, compared to the same period in 2014. During the year ended December 31, 2014, average loans increased $124.4 million, or 9.6%, from $1.30 billion to $1.42 billion, compared to the same period in 2013. The increase in average loans during 2015 was primarily a result of strong loan growth in our market areas and loans acquired in the acquisition of Omni. Construction loans, commercial real estate loans, and municipal loans represent a large part of this increase for both years. The average yield on loans decreased from 5.24% for the year ended December 31, 2014 to 4.52% for the year ended December 31, 2015, due to overall

lower interest rates and the higher yield automobile loans purchased by SFG and included in the portfolio until they were sold in the 4th quarter of the year ended December 31, 2014. Interest income on loans increased $25.8 million, or 36.6%, for the year ended December 31, 2015 compared to the same period in 2014 as a result of an increase in average balance, which more than offset the decrease in the average yield. The average yield on loans decreased from 5.92% for the year ended December 31, 2013 to 5.24% for the year ended December 31, 2014. Interest income on loans decreased $2.3 million, or 3.2%, for the year ended December 31, 2014 compared to the same period in 2013 as a result of the decrease in the average yield which more than offset the increase in the average balance. Due to the competitive loan pricing environment, we anticipate that we may be required to continue to offer lower interest rate loans that compete with those offered by other financial institutions in order to retain quality loan relationships. Offering lower interest rate loans could impact the overall yield on loans and, therefore, profitability.

Average investment and MBS increased $396.9 million, or 22.7%, to $2.15 billion from $1.75 billion for the year ended December 31, 2015, when compared to the same period in 2014 and decreased $50.0 million, or 2.8%, from $1.80 billion to $1.75 billion for the year ended December 31, 2014, when compared to the same period in 2013. At December 31, 2015, substantially all of our MBS were fixed rate securities. The overall yield on average investment and MBS decreased to 3.27% during the year ended December 31, 2015 from 3.72% during the same period in 2014 and increased to 3.72% during the year ended December 31, 2014 from 3.24% during the same period in 2013. The decrease in the average yield during 2015 primarily reflects an overall higher interest rate environment during 2014, the purchase of lower yielding securities when compared to those securities paying off, maturing or sold and the addition of Omni's securities portfolio at fair value in a low interest rate environment. The increase in the average yield during 2014 reflects an increase in the yield of MBS securities. Interest income on investment and MBS increased $4.9 million in 2015, or 9.2%, as the increase in the average balance more than offset the decrease in the average yield. A decrease in long-term interest rate levels combined with lower credit spreads could negatively impact our net interest margin in the future due to increased prepayments. Interest income on investment and MBS increased $6.5 million in 2014, or 14.0%, as the increase in the average yield more than offset the decrease in the average balance.

Average FHLB stock and other investments increased $17.9 million, or 62.4%, to $46.6 million, for the year ended December 31, 2015, when compared to $28.7 million for 2014 due to the increase in average FHLB advances during 2015 and the corresponding requirement to hold stock associated with those advances. Average FHLB stock and other investments decreased $2.7 million, or 8.6%, to $28.7 million, for the year ended December 31, 2014, when compared to $31.4 million for 2013 due to the decrease in average FHLB advances during 2014. Interest income from our FHLB stock and other investments increased $117,000, or 64.6%, during 2015, due to an increase in the average balance. Interest income from our FHLB stock and other investments decreased $1,000, or 0.5%, during 2014, due to a decrease in the average balance partially offset by an increase in the average yield from 0.58% for the year ended December 31, 2013 compared to 0.63% for the same period in 2014. The FHLB stock is a variable instrument with the rate typically tied to the federal funds rate. We are required as a member of FHLB to own a specific amount of stock that changes as the level of our FHLB advances and asset size change.

Average interest earning deposits decreased $15.3 million, or 27.9%, to $39.5 million, for the year ended December 31, 2015, when compared to $54.9 million for 2014. Interest income from interest earning deposits decreased $38,000 in 2015, or 27.3%, as a result of a decrease in average balance as compared to 2014. Average interest earning deposits decreased $274,000, or 0.5%, to $54.9 million, for the year ended December 31, 2014, when compared to $55.1 million for 2013. Interest income from interest earning deposits decreased $4,000, or 2.8%, for the year ended December 31, 2014, when compared to 2013, as a result of the decrease in the average balance and average yield.

During the year ended December 31, 2015, our average loans and securities increased when compared to the same period in 2014. As a result, the mix of our average interest earning assets changed as our average total securities as a percentage of total average interest earning assets totaled 49.1% during 2015 compared to 54.4% during 2014 and 57.5% during 2013. Average loans were 50.0% of average total interest earning assets during 2015 compared to 43.9% during 2014 and 40.8% during 2013. Other interest earning asset categories averaged 0.9% of average interest earning assets during 2015 compared to 1.7% during both 2014 and 2013.

Total interest expense increased $2.9 million, or 17.1%, during the year ended December 31, 2015. The increase in interest expense for 2015 was attributable to an increase in average interest bearing liabilities of $1.13 billion, or 43.6%, from $2.59 billion to $3.71 billion which was partially offset by the decrease in the average rate paid on interest bearing liabilities for the year ended December 31, 2015, to 0.53%, from 0.66% for the same period in 2014. The increase in average interest bearing liabilities was primarily the result of the increase in deposits and FHLB advances to fund the increase in loans and securities, as well as the deposits and FHLB advances acquired in the acquisition of Omni.

Total interest expense decreased $1.0 million, or 5.6%, during the year ended December 31, 2014, as compared to 2013. The decrease was attributable to a decrease in the average rate paid on interest bearing liabilities for the year ended December 31, 2014, to 0.66% from 0.71% for the same period in 2013, which more than offset the increase in average interest bearing liabilities

of $61.2 million, or 2.4%, from $2.52 billion to $2.59 billion. The decrease in the average rate paid on interest bearing liabilities of five basis points was a result of continued low short-term interest rates during the year ended December 31, 2014.

The following table sets forth our deposit averages by category for the years ended December 31, 2015, 2014 and 2013:

COMPOSITION OF DEPOSITS

	Years Ended December 31,								
	2015			2014			2013		
	Average Balance	Average Rate		Average Balance	Average Rate		Average Balance	Average Rate	
	(dollars in thousands)								
Interest Bearing Demand Deposits	$1,648,416	0.27	%	$1,231,711	0.29	%	$1,081,475	0.31	%
Savings Deposits	232,385	0.10	%	121,453	0.11	%	108,097	0.13	%
Time Deposits	845,882	0.65	%	610,178	0.70	%	640,608	0.73	%
Total Interest Bearing Deposits	2,726,683	0.37	%	1,963,342	0.41	%	1,830,180	0.45	%
Noninterest Bearing Demand Deposits	679,346	N/A		576,770	N/A		560,762	N/A	
Total Deposits	$3,406,029	0.30	%	$2,540,112	0.31	%	$2,390,942	0.34	%

Total average interest bearing deposits increased $763.3 million, or 38.9%, while the average rate paid decreased from 0.41% for the year ended December 31, 2014, to 0.37% for the year ended December 31, 2015. For the year ended December 31, 2014 average interest bearing deposits increased $133.2 million, or 7.3%, while the average rate paid decreased to 0.41%, from 0.45% for the year ended December 31, 2013. Interest expense for interest bearing deposits increased $2.2 million, or 27.8%, for the year ended December 31, 2015, when compared to the same period in 2014 due to the increase in the average balance which more than offset the decrease in the average yield. Interest expense for interest bearing deposits for the year ended December 31, 2014, decreased $226,000, or 2.8%, when compared to the same period in 2013 due to the decrease in the average yield which more than offset the increase in the average balance.

Average time deposits increased $235.7 million, or 38.6%, while the average rate paid decreased five basis points for the year ended December 31, 2015. Average time deposits decreased $30.4 million, or 4.8%, and the average rate paid decreased three basis points for the year ended December 31, 2014. Average interest bearing demand deposits increased $416.7 million, or 33.8%, and $150.2 million, or 13.9%, for the years ended December 31, 2015 and December 31, 2014, respectively, while the average rate paid decreased two basis points for each of the years ended December 31, 2015 and December 31, 2014. Average savings deposits increased $110.9 million, or 91.3%, while the average rate paid decreased one basis point for the year ended December 31, 2015. Average savings deposits increased $13.4 million, or 12.4%, while the average rate paid decreased two basis points for the year ended December 31, 2014. Average noninterest bearing demand deposits increased $102.6 million, or 17.8%, during 2015 and $16.0 million, or 2.9%, during 2014. The latter three categories, which are considered the lowest cost deposits, comprised 75.2% of total average deposits during the year ended December 31, 2015 compared to 76.0% during 2014 and 73.2% during 2013. The increase in our average total deposits during 2015 was primarily the result of our acquisition of Omni in December of 2014. The increase in our average total deposits during 2014 was primarily the result of an increase in deposits from municipalities and to a lesser extent, deposit growth due to branch expansion, and continued market penetration.

At December 31, 2015, total brokered CDs were $85.3 million compared to $23.4 million at December 31, 2014. This represented an increase of $61.8 million, or 264.0%, from 2014. Total brokered CDs decreased $31.0 million, or 56.9%, in 2014 from $54.4 million at December 31, 2013. At December 31, 2015, approximately $64.6 million of our brokered CDs were non-callable with maturities of five to thirteen months. The remaining $20.7 million were

long-term CDs that mature within five years and have short-term calls that we control. We utilize long-term callable brokered CDs because the brokered CDs better match overall ALCO objectives at the time of issuance by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. At December 31, 2015, brokered CDs represented 2.5% of deposits compared to 0.8% of deposits at December 31, 2014 and 2.2% at December 31, 2013. Our wholesale funding policy currently allows maximum brokered CDs of $180 million; however, this amount could be increased to match changes in ALCO objectives. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.

Average short-term interest bearing liabilities, consisting primarily of FHLB advances, federal funds purchased and repurchase agreements, were $384.7 million, an increase of $320.5 million, or 499.6%, for the year ended December 31, 2015 when compared to the same period in 2014. Average short-term interest bearing liabilities increased primarily to fund the increase in loans and securities, and advances acquired in the acquisition of Omni in the fourth quarter of 2014. For the year ended December 31, 2014, the decrease was $133.3 million, or 67.5%, to $64.2 million when compared to the same period in 2013. Interest expense associated with short-term interest bearing liabilities increased $626,000, or 100.3%, while the average rate paid decreased 65 basis points to 0.32% for the year ended December 31, 2015, when compared to 0.97% for the same period in 2014. Interest expense associated with short-term interest bearing liabilities decreased $1.3 million, or 66.7%, while the average rate paid increased two basis points to 0.97% for the year ended December 31, 2014, when compared to 0.95% for the same period in 2013. The increase in the interest expense during 2015 was due to the increase in the average balance and was partially offset by a decrease in the average rate paid. The decrease in the interest expense during 2014 was due to the decrease in the average balance which more than offset the increase in the average rate paid.

Average long-term interest bearing liabilities, consisting of FHLB advances, increased $43.3 million, or 8.7%, during the year ended December 31, 2015, to $540.6 million as compared to $497.3 million at December 31, 2014, primarily to fund the increase in loans and securities. Average long-term interest bearing liabilities increased $61.4 million, or 14.1%, during the year ended December 31, 2014, from $435.9 million at December 31, 2013. Interest expense associated with long-term FHLB advances increased $32,000, or 0.5%, while the average rate paid decreased 11 basis points to 1.29% for the year ended December 31, 2015 when compared to 1.40% for the same period in 2014. The increase in interest expense was due to the increase in the average balance which more than offset the decrease in the average rate paid. Interest expense associated with long-term FHLB advances increased $490,000, or 7.6%, while the average rate paid decreased eight basis points to 1.40% for the year ended December 31, 2014 when compared to 1.48% for the same period in 2013. The increase in interest expense was due to the increase in the average balance which more than offset the decrease in the average rate paid. FHLB advances are collateralized by FHLB stock, securities and nonspecific real estate loans.

Average long-term debt, consisting of our junior subordinated debentures, was $60.3 million for the years ended December 31, 2015, 2014, and 2013. The interest rate on the $20.6 million of long-term debentures issued to Southside Statutory Trust III adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points. The interest rate on the $23.2 million of long-term debentures issued to Southside Statutory Trust IV adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points. The interest rate on the $12.9 million of long-term debentures issued to Southside Statutory Trust V adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points. The interest rate on the $3.6 million of long-term debentures issued to Magnolia Trust Company I adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

AVERAGE BALANCES WITH AVERAGE YIELDS AND RATES

The following table presents average balance sheet amounts and average yields/rates for the years ended December 31, 2015, 2014 and 2013. The information should be reviewed in conjunction with the consolidated financial statements for the same years then ended. Two major components affecting our earnings are the interest earning assets and interest bearing liabilities. A summary of average interest earning assets and interest bearing liabilities is set forth below, together with the average yield on the interest earning assets and the average cost of the interest bearing liabilities.

AVERAGE BALANCES WITH AVERAGE YIELDS AND RATES
(dollars in thousands)
Years Ended

	December 31, 2015			December 31, 2014			December 31, 2013		
	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate
ASSETS									
INTEREST EARNING ASSETS:									
Loans[(1)(2)]	$2,224,401	$100,471	4.52 %	$1,420,802	$74,450	5.24 %	$1,296,440	$76,728	5.92 %
Loans Held For Sale	3,439	155	4.51 %	11,012	47	0.43 %	1,137	38	3.34 %
Securities:									
Inv. Sec. (Taxable)[(4)]	75,977	1,587	2.09 %	33,168	615	1.85 %	47,914	799	1.67 %
Inv. Sec. (Tax Exempt)[(3)(4)]	637,333	34,981	5.49 %	659,219	36,263	5.50 %	678,000	37,310	5.50 %
Mortgage-backed Sec.[(4)]	1,432,087	33,661	2.35 %	1,056,095	28,207	2.67 %	1,072,601	20,085	1.87 %
Total Securities	2,145,397	70,229	3.27 %	1,748,482	65,085	3.72 %	1,798,515	58,194	3.24 %
FHLB stock and other investments, at cost	46,584	298	0.64 %	28,684	181	0.63 %	31,378	182	0.58 %
Interest Earning Deposits	39,533	101	0.26 %	54,853	139	0.25 %	55,127	143	0.26 %
Total Interest Earning Assets	4,459,354	171,254	3.84 %	3,263,833	139,902	4.29 %	3,182,597	135,285	4.25 %
NONINTEREST EARNING ASSETS:									
Cash and Due From Banks	52,400			43,342			44,013		
Bank Premises and Equipment	110,704			55,680			50,766		
Other Assets	265,851			133,641			120,725		
Less: Allowance for Loan Losses	(16,621)			(17,177)			(19,007)		
Total Assets	$4,871,688			$3,479,319			$3,379,094		

(1) Interest on loans includes net fees on loans that are not material in amount.

(2) Interest income includes taxable-equivalent adjustments of $4,209, $3,899 and $3,856 for the years ended December 31, 2015, 2014, and 2013, respectively.

(3) Interest income includes taxable-equivalent adjustments of $12,513, $12,225 and $11,827 for the years ended December 31, 2015, 2014, and 2013, respectively.

(4) For the purpose of calculating the average yield, the average balance of securities is presented at historical cost.

Note: As of December 31, 2015, 2014 and 2013, loans totaling $20,526, $4,096 and $8,088, respectively, were on nonaccrual status. Our policy is to reverse previously accrued but unpaid interest on nonaccrual loans; thereafter, interest income is recorded to the extent received when appropriate.

AVERAGE BALANCES WITH AVERAGE YIELDS AND RATES
(dollars in thousands)
Years Ended

	December 31, 2015			December 31, 2014			December 31, 2013		
	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate
LIABILITIES AND SHAREHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES:									
Savings Deposits	$232,385	$233	0.10 %	$121,453	$136	0.11 %	$108,097	$142	0.13 %
Time Deposits	845,882	5,512	0.65 %	610,178	4,287	0.70 %	640,608	4,700	0.73 %
Interest Bearing Demand Deposits	1,648,416	4,417	0.27 %	1,231,711	3,530	0.29 %	1,081,475	3,337	0.31 %
Total Interest Bearing Deposits	2,726,683	10,162	0.37 %	1,963,342	7,953	0.41 %	1,830,180	8,179	0.45 %
Short-term Interest Bearing Liabilities	384,694	1,250	0.32 %	64,160	624	0.97 %	197,506	1,875	0.95 %
Long-term Interest Bearing Liabilities-FHLB Dallas	540,600	6,987	1.29 %	497,296	6,955	1.40 %	435,941	6,465	1.48 %
Long-term Debt [5]	60,311	1,455	2.41 %	60,311	1,424	2.36 %	60,311	1,449	2.40 %
Total Interest Bearing Liabilities	3,712,288	19,854	0.53 %	2,585,109	16,956	0.66 %	2,523,938	17,968	0.71 %
NONINTEREST BEARING LIABILITIES:									
Demand Deposits	679,346			576,770			560,762		
Other Liabilities	41,627			29,672			44,685		
Total Liabilities	4,433,261			3,191,551			3,129,385		
SHAREHOLDERS' EQUITY	438,427			287,768			249,709		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$4,871,688			$3,479,319			$3,379,094		
NET INTEREST INCOME		$151,400			$122,946			$117,317	
NET INTEREST MARGIN ON AVERAGE EARNING ASSETS			3.40 %			3.77 %			3.69 %
			3.31 %			3.63 %			3.54 %

NET INTEREST
SPREAD

(5) Represents issuance of junior subordinated debentures.

ANALYSIS OF CHANGES IN INTEREST INCOME AND INTEREST EXPENSE

The following tables set forth the dollar amount of increase (decrease) in interest income and interest expense resulting from changes in the volume of interest earning assets and interest bearing liabilities and from changes in yields/rates (in thousands):

	Years Ended December 31, 2015 Compared to 2014		
	Average Volume	Average Yield/Rate	Increase (Decrease)
INTEREST INCOME:			
Loans [1]	$37,437	$(11,416)	$26,021
Loans Held For Sale	(53)	161	108
Investment Securities (Taxable)	885	87	972
Investment Securities (Tax Exempt) [1]	(1,201)	(81)	(1,282)
Mortgage-backed Securities	9,141	(3,687)	5,454
FHLB stock and other investments	114	3	117
Interest Earning Deposits	(39)	1	(38)
Total Interest Income	46,284	(14,932)	31,352
INTEREST EXPENSE:			
Savings Deposits	113	(16)	97
Time Deposits	1,555	(330)	1,225
Interest Bearing Demand Deposits	1,129	(242)	887
Short-term Interest Bearing Liabilities	1,286	(660)	626
Long-term FHLB Advances	581	(549)	32
Long-term Debt	—	31	31
Total Interest Expense	4,664	(1,766)	2,898
Net Interest Income	$41,620	$(13,166)	$28,454

	Years Ended December 31, 2014 Compared to 2013		
	Average Volume	Average Yield/Rate	Increase (Decrease)
INTEREST INCOME:			
Loans [1]	$6,976	$(9,254)	$(2,278)
Loans Held For Sale	68	(59)	9
Investment Securities (Taxable)	(266)	82	(184)
Investment Securities (Tax Exempt) [1]	(1,033)	(14)	(1,047)
Mortgage-backed Securities	(314)	8,436	8,122
FHLB stock and other investments	(16)	15	(1)
Interest Earning Deposits	(1)	(3)	(4)
Total Interest Income	5,414	(797)	4,617
INTEREST EXPENSE:			
Savings Deposits	16	(22)	(6)
Time Deposits	(218)	(195)	(413)
Interest Bearing Demand Deposits	442	(249)	193
Short-term Interest Bearing Liabilities	(1,296)	45	(1,251)
Long-term FHLB Advances	873	(383)	490
Long-term Debt	—	(25)	(25)

Total Interest Expense	(183)	(829)	(1,012)
Net Interest Income	$5,597	$32	$5,629

(1) Interest yields on loans and securities that are nontaxable for federal income tax purposes are presented on a taxable equivalent basis.

Note: Volume/Yield/Rate variances (change in volume times change in yield/rate) have been allocated to amounts attributable to changes in volumes and to changes in yields/rates in proportion to the amounts directly attributable to those changes.

Non-GAAP Financial Measures - Our accounting and reporting policies conform to generally accepted accounting principles (GAAP) in the United States and prevailing practices in the banking industry. However, certain non-GAAP measures are used by management to supplement the evaluation of our performance. These include the following fully-taxable equivalent measures: tax-equivalent net interest income, tax-equivalent net interest margin, and tax-equivalent net interest spread, which include the effects of taxable-equivalent adjustments using a federal income tax rate of 35% to increase tax-exempt interest income to a tax-equivalent basis. Tax-equivalent adjustments are reported in Notes 2 and 3 to the Average Balances with Average Yields and Rates tables under Results of Operations.

Tax-equivalent net interest income, net interest margin and net interest spread. Net Interest Income on a tax-equivalent basis is a non-GAAP measure that adjusts for the tax-favored status of net interest income from loans and investments. We believe this measure to be the preferred industry measurement of net interest income and it enhances comparability of net interest income arising from taxable and tax-exempt sources. The most directly comparable financial measure calculated in accordance with GAAP is our net interest income. Net interest margin on a tax-equivalent basis is net interest income on a tax-equivalent basis divided by average interest-earning assets on a tax-equivalent basis. Net interest spread on a tax-equivalent basis is the difference in the average yield on average interest-earning assets on a tax equivalent basis and the average rate paid on average interest-bearing liabilities.

These non-GAAP financial measures should not be considered an alternative to GAAP-basis financial statements, and other bank holding companies may define or calculate these or similar measures differently.

PROVISION FOR LOAN LOSSES

The provision for loan losses for the year ended December 31, 2015 decreased to $8.3 million compared to $14.9 million for the year ended December 31, 2014 and $8.9 million for the year ended December 31, 2013. For the year ended December 31, 2015, net loan charge-offs decreased $18.6 million, to $1.9 million when compared to $20.5 million for the same period in 2014 and increased $9.9 million during 2014 from $10.6 million for the same period in 2013. Nonperforming assets to total assets increased to 0.63% at December 31, 2015 from 0.26% at December 31, 2014 primarily due to the downgrade of one large commercial borrowing relationship to impaired status during the first quarter of 2015 and the restructure of a large PCI commercial loan during the third quarter of 2015. During 2014, our asset quality improved as reflected in the decrease in the nonperforming assets to total assets ratio to 0.26% at December 31, 2014 from 0.39% at December 31, 2013. This decrease was primarily due to the sale of subprime automobile loans purchased by SFG during the fourth quarter of 2014 and increases in the loan categories that have historically had lower levels of charge-offs and nonperforming assets, primarily the real estate and municipal loan categories.

The decrease in net charge-offs for 2015 was a result of a decrease in total charge-offs of $18.2 million, along with an increase in total recoveries of $416,000. Net charge-offs for loans to individuals decreased 91.4%, to $1.8 million for the year ended December 31, 2015 compared to the same period in 2014. This decrease was due to charge-offs on SFG loans and the write down of the SFG loans to fair value in connection with the sale of the SFG subprime automobile loans during the year ended December 31, 2014. Net charge-offs for commercial loans increased $288,000, resulting in net charge-offs of $183,000 for the year ended December 31, 2015, compared to net recoveries of $105,000 for the same period in 2014. For the year ended December 31, 2015, we experienced net recoveries in all of our real estate loan categories. Net recoveries of construction loans increased $41,000 to $183,000, and net recoveries of commercial real estate loans increased $77,000 to $85,000 for the year ended December 31, 2015 compared to the same period in 2014. Net recoveries for 1-4 family residential loans decreased slightly, resulting in net recoveries of $57,000 for the year ended December 31, 2015, compared to $59,000 for the year ended December 31, 2014.

The increase in net charge-offs for 2014 was a result of an increase in total charge-offs of $9.0 million and a decrease in total recoveries of $947,000. Net charge-offs for loans to individuals increased 99.8%, to $20.8 million for the year ended December 31, 2014 compared to the same period in 2013. This increase was due to an increase in charge-offs on SFG loans and a write down of the SFG loans to fair value in connection with the sale of the subprime automobile loans. Net charge-offs for 1-4 family residential loans decreased $287,000, resulting in net recoveries of $59,000 for

the year ended December 31, 2014 compared to the same period in 2013. Net charge-offs for commercial loans decreased $384,000, resulting in net recoveries of $105,000. Net recoveries of construction loans increased $65,000 to $142,000 and net recoveries of commercial real estate loans decreased $264,000, to $8,000 for the year ended December 31, 2014 compared to the same period in 2013.

As of December 31, 2015, and 2014, our reviews of the loan portfolio indicated that loan loss allowances of $19.7 million and $13.3 million, respectively, were appropriate to cover probable losses in the portfolio.

NONINTEREST INCOME

Noninterest income consists of revenues generated from a broad range of financial services and activities including deposit related fee based services. The following schedule lists the accounts from which noninterest income was derived and gives totals for these accounts for the year ended December 31, 2015 and the comparable years ended December 31, 2014, and 2013:

	Years Ended December 31,		
	2015	2014	2013
	(in thousands)		
Deposit services	$20,112	$15,280	$15,560
Net gain on sale of securities available for sale	3,660	2,830	8,472
Impairment of investment in SFG Finance, LLC	—	(2,755)	—
Gain on sale of loans	2,082	323	770
Trust income	3,419	3,145	3,024
Bank owned life insurance income	2,623	1,334	3,122
Brokerage services	2,206	1,308	1,157
Other	3,793	3,024	3,140
Total noninterest income	$37,895	$24,489	$35,245

Total noninterest income for the year ended December 31, 2015 increased 54.7%, or $13.4 million, compared to 2014 and decreased 30.5%, or $10.8 million, during the year ended December 31, 2014, when compared to the same period in 2013. The increase in noninterest income for the year ended December 31, 2015 when compared to the same period in 2014 was due to an increase in all of the categories included in the table above, as well as mortgage servicing fee income, included in other income, primarily as a result of the acquisition of Omni in December 2014. The decrease in noninterest income during 2014 compared to 2013 was primarily due to a $5.6 million decrease in the net gain on sale of AFS securities and a $2.8 million impairment of equity related to the sale of the loans purchased by SFG and the repossessed assets.

During the year ended December 31, 2015, we pro-actively managed the investment portfolio and adjusted the securities acquired in the Omni acquisition to meet our investment objectives. We primarily sold U.S. Agency MBS, CMBS, CMOs, municipal securities and U.S. Treasury securities that resulted in a net gain on sale of AFS securities of $3.7 million compared to $2.8 million and $8.5 million for the same periods in 2014 and 2013, respectively. The fair value of the AFS securities portfolio at December 31, 2015 was $1.46 billion with a net unrealized gain on that date of $8.5 million. The net unrealized gain is comprised of $18.0 million in unrealized gains and $9.5 million in unrealized losses. The fair value of HTM securities portfolio at December 31, 2015 was $799.8 million with a net unrealized gain on that date of $6.6 million. The net unrealized gain is comprised of $25.3 million in unrealized gains and $18.7 million in unrealized losses. During the quarter ended December 31, 2015, the size of the securities portfolio increased due primarily to an increase in U.S. Treasury securities and CMBS which was partially offset by a decrease in municipal securities as a result of sales. The U.S. Treasury securities and CMBS purchased were longer duration bonds purchased due to the increase in long-term interest rates during the fourth quarter. There can be no assurance that the level of security gains reported during the year ended December 31, 2015, will continue in future periods.

During both of the years ended December 31, 2014 and 2013, as interest rates remained low, we continued to sell primarily lower yielding, longer duration municipal securities and more prepayment volatile MBS and replaced them with primarily shorter duration municipal securities. The sale of these securities resulted in a net gain on the sale of AFS securities of $2.8 million and $8.5 million, respectively.

We recorded an impairment charge of $2.8 million on our investment in SFG in the year ended December 31, 2014. The impairment occurred as a result of our decision to sell the SFG purchased automobile loans and the associated write down to fair market value and transfer to loans held for sale of $74.8 million.

Deposit services income increased $4.8 million, or 31.6%, for the year ended December 31, 2015, as compared to the same period in 2014 and decreased $280,000, or 1.8%, for the year ended December 31, 2014, as compared to the

same period in 2013. The increase in 2015 was due primarily to an increase in ATM and debit card income as well as service charges on deposit accounts and NSF and overdraft income primarily as a result of the acquisition of Omni. Gain on sale of loans increased $1.8 million, or 544.6%, for the year ended December 31, 2015, when compared to the same period in 2014 due to an increase in the volume of loans sold and the related servicing release and secondary market fees primarily as a result of the acquisition of Omni. Gain on sale of loans decreased $447,000, or 58.1%, for the year ended December 31, 2014, when compared to the same period in 2013. This decrease was primarily a result of a decrease in the volume of loans sold

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and the related servicing release and secondary market fees. The decrease in loans sold was due to a greater emphasis on retaining loans for our own portfolio and the overall reduction in mortgage refinancing during 2014.
Bank owned life insurance (“BOLI”) income increased $1.3 million, or 96.6%, for the year ended December 31, 2015, when compared to the same period in 2014 due to the addition of approximately $45.0 million in BOLI acquired in the acquisition of Omni in the fourth quarter of 2014. BOLI income decreased $1.8 million, or 57.3%, for the year ended December 31, 2014, when compared to the same period in 2013 primarily as a result of two death benefits received, one for a retired covered officer and one for an active covered officer in 2013.
Brokerage services income increased $898,000, or 68.7% , for the year ended December 31, 2015, when compared to the same period in 2014 primarily as a result of the acquisition of Omni. Brokerage services income increased $151,000, or 13.1%, for the year ended December 31, 2014 when compared to the same period in 2013 due to growth in client base.
Other income increased $769,000, or 25.4%, for the year ended December 31, 2015 compared to the same period in 2014, primarily due to an increase in mortgage servicing fee income.

NONINTEREST EXPENSE

The following table lists the accounts which comprise noninterest expense for the years ended December 31, 2015, 2014 and 2013:

	Years Ended December 31,		
	2015	2014	2013
	(in thousands)		
Salaries and employee benefits	$67,221	$60,821	$52,054
Occupancy expense	12,883	7,259	7,539
Advertising, travel & entertainment	2,708	2,219	2,642
ATM and debit card expense	3,132	1,331	1,328
Professional fees	3,877	7,827	2,782
Software and data processing expense	3,858	4,629	2,018
Telephone and communications	1,978	1,222	1,529
FDIC insurance	2,510	1,765	1,713
FHLB prepayment fees	—	539	1,048
Other	14,787	10,092	9,060
Total noninterest expense	$112,954	$97,704	$81,713

Noninterest expense for the year ended December 31, 2015 increased $15.3 million, or 15.6%, when compared to the year ended December 31, 2014 and increased $16.0 million, or 19.6% for the year ended December 31, 2014, when compared to the year ended December 31, 2013.

Salaries and employee benefits expense increased $6.4 million, or 10.5%, during the year ended December 31, 2015, when compared to the same period in 2014 and increased $8.8 million, or 16.8%, during the year ended December 31, 2014, when compared to the same period in 2013. The increase in 2015 was primarily the result of increases in direct salary expense, retirement expense and health insurance expense. The increase in 2014 was due to the $8.9 million of post combination expense for the acceleration of unvested Omni stock options and restricted stock related to the acquisition of Omni in addition to $150,000 in a one time payment to certain Omni officers, all included in salaries and employee benefits.

Direct salary expense and payroll taxes increased $11.0 million, or 24.4%, for the year ended December 31, 2015, when compared to the same period in 2014 and increased $2.3 million, or 5.5%, for the year ended December 31, 2014, when compared to the same period in 2013. The increase in direct salary expense for 2015 was primarily due to non-recurring salary payments, severance, and stay pay of $4.1 million for the year ended December 31, 2015, as well as additional employees added associated with the acquisition of Omni, and to a lesser extent, normal salary increases effective in the first quarter of 2015. This increase was partially offset by the decrease in salary expense related to the dissolution of SFG.

Retirement expense, included in salary and benefits, increased $2.8 million, or 136.2%, for the year ended December 31, 2015, when compared to the same period in 2014 and decreased $3.0 million, or 59.8%, for the year ended December 31, 2014, when compared to the same period in 2013. The increase for 2015 was primarily related to the increase in the defined benefit and restoration plans, and to a lesser extent, we experienced increases in our deferred compensation plan expense, 401(k) plan expense and split dollar plan expense. The defined benefit and restoration plan expense increased primarily due to the unfunded status of the plan and the decrease in the discount rate to 4.14% for 2015 compared to 5.06% for 2014. The decrease for 2014 was primarily due to the increase in the discount rate to 5.06% for 2014 compared to 4.08% for 2013. The assumed long-term rate of return was 7.25% for years 2013 through 2015. We will continue to evaluate the assumed long-term rate of return and the discount rate to determine if either should be changed in the future. If either of these assumptions decrease, the cost and funding required for the retirement plan could increase.

Health and life insurance expense, included in salary and benefits, increased $1.5 million, or 30.7%, for the year ended December 31, 2015, when compared to the same period in 2014 due to increased health claims expense and plan administrative cost for the comparable period of time as well as the acquisition of Omni in the fourth quarter of 2014.

Health and life insurance expense increased $604,000, or 14.4%, for the year ended December 31, 2014, when compared to the same period in 2013 due to increased health claims expense and plan administrative cost during 2014. We have a self-insured health plan which is supplemented with stop loss insurance policies. Health insurance costs are rising nationwide and these costs may increase during 2016.

Occupancy expense increased $5.6 million, or 77.5%,for the year ended December 31, 2015, when compared to the same period in 2014, due to the addition of 14 branches resulting from the acquisition of Omni in the fourth quarter of 2014, while partially offset by a decrease in expenses related to our dissolution of SFG.
Advertising, travel and entertainment increased $489,000, or 22.0%, for the year ended December 31, 2015, when compared to the same period in 2014 and decreased $423,000, or 16.0%, for the year ended December 31, 2014, when compared to the same period in 2013. The increase in 2015 was due to the expenses related to the acquisition of Omni. The decrease in 2014 was primarily a result of decreased travel expenses related to SFG.
ATM and debit card expense increased $1.8 million, or 135.3%, for the year ended December 31, 2015, when compared to the same period in 2014 due primarily to the addition of 21 ATMs associated with the acquisition of Omni.
Professional fees decreased $4.0 million, or 50.5%, for the year ended December 31, 2015, compared to the same period in 2014. Professional fees increased $5.0 million, or 181.3%, for year ended December 31, 2014, compared to the same period in 2013. The decrease during 2015 was due to an increased level during 2014 of legal and accounting fees associated with the Omni acquisition.
Software and data processing expense decreased $771,000, or 16.7%, for the year ended December 31, 2015, as compared to the same period in 2014 and increased $2.6 million, or 129.4%, for the year ended December 31, 2014, as compared to the same period in 2013. The decrease in 2015 was due primarily to expense associated with the software contracts canceled related to the acquisition of Omni during the fourth quarter of 2014.
Telephone and communications increased $756,000, or 61.9%, for the year ended December 31, 2015, as compared to the same period in 2014 and decreased $307,000, or 20.1%, for the year ended December 31, 2014, as compared to the same period in 2013. The increase in 2015 was primarily due to the addition of 14 branches associated with the acquisition of Omni while partially offset by a decrease related to our dissolution of SFG. The decrease during 2014 was due to continued savings from renegotiated contracts.
FDIC insurance increased $745,000, or 42.2%, for the year ended December 31, 2015, as compared to the same period in 2014 due to an increase in the total assessment base which is average consolidated total assets less average tangible equity, which resulted primarily due to the acquisition of Omni.
FHLB prepayment fees decreased $509,000, or 48.6%, for the year ended December 31, 2014, as compared to the same period in 2014 as a result of the prepayment of FHLB advances of $39.2 million during 2014. FHLB prepayment fees were $1.0 million for the year ended December 31, 2013 as a result of the prepayment of FHLB advances of $94.3 million. There were no FHLB prepayment fees paid in 2015.
Other expenses increased $4.7 million, or 46.5%, for the year ended December 31, 2015, as compared to the same period in 2014 and $1.0 million, or 11.4%, for the year ended December 31, 2014, as compared to the same period in 2013. The increase in 2015 was primarily due to increases in amortization expense related to the core deposit intangible, losses associated with check cards, losses on other real estate owned ("OREO"), the retirement of assets in the dissolution of SFG and closures of branch locations, brokerage services expense, increases in online mobile banking expenses, supplies expense and equipment expense related to the acquisition of Omni. The increase in 2014 was primarily due to a reserve established associated with the sale of the SFG subprime automobile loans, and other expenses related to overall growth.

INCOME TAXES

Pre-tax income for the year ended December 31, 2015 was $51.3 million compared to $18.7 million for the year ended December 31, 2014, and $46.3 million for the year ended December 31, 2013.
Income tax expense was $7.3 million for the year ended December 31, 2015 and represented an increase of $9.4 million, or 436.4%, when compared to the year ended December 31, 2014, and decreased $7.3 million, or 142.5%, to an income tax benefit of $2.2 million for the year ended December 31, 2014, when compared to the year ended December 31, 2013. The effective tax rate as a percentage of pre-tax income was 14.2% in 2015, as compared to an effective benefit rate of 11.6% in 2014 and effective tax rate of 11.0% in 2013. The increase in the income tax expense and effective tax rate for the year ended December 31, 2015 was due to a decrease in tax-exempt income as a percentage of pre-tax income, as compared to the same period in 2014. The decrease in the income tax expense and effective tax rate for the year ended December 31, 2014 was due to an increase in tax-exempt income as a percentage

of taxable income as compared to the prior year primarily due to the significant increase in our average tax-exempt securities portfolio for 2014 as compared to 2013. The net deferred tax asset totaled $19.9 million at December 31, 2015 as compared to $12.7 million in 2014. No valuation allowance for deferred tax assets was recorded at December 31, 2015 or December 31, 2014, as management believes it is more likely than not that all of the deferred tax assets will be realized in future years.

LENDING ACTIVITIES

One of our main objectives is to seek attractive lending opportunities in Texas, primarily in the counties in which we operate. Substantially all of our loan originations are made to borrowers who live in and conduct business in the counties in Texas in which we operate or adjoin, with the exception of municipal loans which are made almost entirely in Texas. Municipal loans are made to municipalities, counties, school districts, and colleges primarily throughout the state of Texas. Prior to the sale of SFG during the fourth quarter of 2014, we purchased portfolios of automobile loans from a variety of lenders throughout the United States. These were high yield loans representing existing subprime automobile loans with payment histories that were collateralized by new and used automobiles.

Total loans as of December 31, 2015 increased $250.6 million, or 11.5%, and the average loan balance outstanding for the year increased $803.6 million, or 56.6%, when compared to 2014. The increase in total loans is primarily a result of increased origination activity primarily in the Austin and Dallas-Fort Worth markets.

Construction loans increased $170.4 million, or 63.6%, from December 31, 2014 to December 31, 2015 and commercial real estate loans increased $167.0 million, or 35.7%, respectively. Municipal loans as of December 31, 2015 increased $30.6 million, or 11.9%, from December 31, 2014. Commercial loans increased $16.1 million, or 7.1%, from December 31, 2014 to December 31, 2015. 1-4 family residential loans decreased $35.5 million, or 5.1%, from December 31, 2014 to December 31, 2015. Loans to individuals decreased $98.0 million, or 36.3%, from December 31, 2014 to December 31, 2015.

The increase in construction loans, commercial loans and commercial real estate loans was primarily due to the growth in our Austin and Dallas-Fort Worth markets. In our loan portfolio, loans dependent upon private household income represent a significant concentration. Due to the number of customers involved who work in all sectors of the numerous local, state and national economies, we believe the risk in this portion of the portfolio is adequately spread throughout the economic communities we serve, which assists in mitigating this concentration. The decrease in 1-4 family residential loans was due primarily to payoffs in excess of originations, and the decrease in loans to individuals reflects the continued roll-off of the indirect automobile loan portfolio in connection with the dissolution of SFG.

A significant portion of our loan portfolio is dependent on the medical community. Medical loan types include commercial loans and commercial real estate loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations. The medical community represents a concentration of risk in our Commercial loan and Commercial Real Estate loan portfolio. See “Item 1. Business – Market Area.” We believe that risk in the medical community is mitigated because it is spread among multiple practice types and multiple specialties. Should the government change the amount it pays the medical community through the various government health insurance programs or if new government regulation impacts the profitability of the medical community, the medical community could be adversely impacted which in turn could result in higher default rates by borrowers in the medical industry.

The aggregate amount of loans that we are permitted to make under applicable bank regulations to any one borrower, including non-affiliate related entities is 25% of Tier 1 capital. Our legal lending limit at December 31, 2015, was approximately $104.1 million. Our largest loan relationship at December 31, 2015 was approximately $37.1 million.

The average yield on loans for the year ended December 31, 2015, decreased to 4.52% from 5.24% for the year ended December 31, 2014. This decrease was reflective of the sale of the higher yielding SFG subprime automobile loans and to a lesser extent the overall lower interest rate environment during 2015 and the lower rates associated with the

new loans added and repriced during 2015.

LOAN PORTFOLIO COMPOSITION AND ASSOCIATED RISK

The following table sets forth loan totals for the years presented (in thousands):

	December 31,				
	2015	2014	2013	2012	2011
Real Estate Loans:					
Construction	$438,247	$267,830	$125,219	$113,744	$111,361
1-4 Family Residential	655,410	690,895	390,499	368,845	247,479
Commercial	635,210	468,171	262,536	236,760	206,519
Commercial Loans	242,527	226,460	157,655	160,058	143,552
Municipal Loans	288,115	257,492	245,550	220,947	207,261
Loans to Individuals	172,244	270,285	169,814	162,623	171,058
Total Loans	$2,431,753	$2,181,133	$1,351,273	$1,262,977	$1,087,230

For purposes of this discussion, our loans are divided into Real Estate Loans, Commercial Loans, Municipal Loans and Loans to Individuals.

REAL ESTATE LOANS

Real estate loans represent our greatest concentration of loans. We attempt to mitigate the amount of risk associated with this group of loans through the type of loans originated and geographic distribution. At December 31, 2015, the majority of our real estate loans were collateralized by properties located in our market areas. Of the $1.73 billion in real estate loans, $655.4 million, or 37.9%, represent loans collateralized by residential dwellings that are primarily owner-occupied. Historically, the amount of losses suffered on this type of loan has been significantly less than those on other properties. Our loan policy requires an appraisal or evaluation on the property, based on the size and complexity of the transaction, prior to funding any real estate loan and also outlines the requirements for appraisals on renewals.

We pursue an aggressive policy of reappraisal on any real estate loan that is in the process of foreclosure and potential exposures are recognized and reserved for or charged off as soon as they are identified. Our ability to liquidate certain types of properties that may be obtained through foreclosure could adversely affect the volume of our nonperforming real estate loans.

Real estate loans are divided into 1-4 Family Residential Loans, Construction Loans and Commercial. Commercial real estate consists of $583.4 million of commercial real estate loans, $46.8 million of loans secured by multi-family properties and $5.0 million of loans secured by farm land. Commercial Real Estate loans are discussed in more detail below.

1-4 Family Residential Loans

Residential loan originations are generated by our loan officers, in-house origination staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents and builders. We focus our lending efforts primarily on the origination of loans secured by first mortgages on owner-occupied, 1-4 family residences. Substantially all of our 1-4 family residential originations are secured by properties located in or near our market areas. Historically, we have originated a portion of our residential loans for sale into the secondary market. These loans are reflected on the balance sheet as loans held for sale. These secondary market investors, other than FNMA, typically pay us a service release premium in addition to a predetermined price based on the interest rate of the loan originated. We retain liabilities related to early prepayments, defaults, failure to adhere to origination and processing guidelines and other issues. We have internal controls in place to mitigate many of these liabilities and historically our realized liability has been extremely low. In addition, many of the retained liabilities expire one year from the date a loan is sold. We warehouse these loans until they are transferred to the secondary market investor, which usually occurs within 45 days.

Our 1-4 family residential loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan . Our 1-4 family residential loans are made at both fixed and adjustable interest rates.

We review information concerning the income, financial condition, employment and credit history when evaluating the creditworthiness of the applicant.

We also make home equity loans, which are included as part of the 1-4 family residential loans, and at December 31, 2015, these loans totaled $101.0 million. Under Texas law, these loans, when combined with all other mortgage indebtedness for the property, are capped at 80% of appraised value.

Construction Loans

Our construction loans are collateralized by property located primarily in or near the market areas we serve. Several of our construction loans will be owner-occupied. Construction loans for non-owner occupied projects are financed, but these typically have cash flows from executed leased tenants, secondary sources of repayment and in some cases, additional collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property. Speculative and commercial construction loans are subject to underwriting standards similar to that of the commercial portfolio. Owner occupied 1-4 family residential construction loans are subject to the underwriting standards of the permanent loan.

Commercial Real Estate Loans

Commercial real estate loans primarily include loans collateralized by commercial office buildings, retail, medical facilities and offices, senior living, assisted living and skilled nursing facilities, warehouse facilities, hotels and churches. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

COMMERCIAL LOANS

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type, other than the medical industry. Loans to borrowers in the medical industry include all loan types listed above for commercial loans. Collateral for these loans varies depending on the type of loan and financial strength of the borrower. The primary source of repayment for loans in the medical community is cash flow from continuing operations.

In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

MUNICIPAL LOANS

We have a specific lending department that makes loans to municipalities and school districts primarily throughout the state of Texas. Municipal loans outside the state of Texas have been limited to adjoining states. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service. Lending money directly to these municipalities allows us to earn a higher yield for similar durations than we could if we purchased municipal securities. Total loans to municipalities and school districts as of December 31, 2015 increased $30.6 million when compared to 2014. At December 31, 2015, we had total loans to municipalities and school districts of $288.1 million.

LOANS TO INDIVIDUALS

Substantially all originations of our loans to individuals are made to consumers in our market areas. The majority of loans to individuals are collateralized by titled equipment, which are primarily automobiles. At December 31, 2015, these types of loans accounted for approximately $120.1 million, or 69.7%, of total loans to individuals. The indirect automobile portfolio acquired from Omni continued to pay down during 2015 to $79.1 million at December 31, 2015, when compared to $152.8 million for the same period in 2014. We intend to let this portfolio fully liquidate.

During the fourth quarter of 2014, we closed on the sale of all of our subprime automobile loans purchased through SFG, as well as the repossessed assets held by SFG. As a result, the carrying amount of SFG loans totaling $70.3 million were sold and were therefore not included in our loan portfolio as of December 31, 2014. There were no subsequent loan pool purchases through SFG from December 2014 until the time it was dissolved in April 2015.

Home equity loans, which are included in 1-4 family residential loans, have replaced some of the traditional loans to individuals. In addition, we make loans for a full range of other consumer purposes, which may be secured or unsecured depending on the credit quality and purpose of the loan.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards we employ for consumer loans include an application, a determination of the applicant's payment history on other debts, with the greatest weight being given to payment history with us, and an assessment of the borrower's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount. Most of our loans to individuals are collateralized, which management believes should assist in limiting our exposure.

LOAN MATURITIES AND SENSITIVITY TO CHANGES IN INTEREST RATES

The following table represents loan maturities and sensitivity to changes in interest rates for our real estate construction, commercial and municipal loans. The amounts of these loans outstanding at December 31, 2015, which, based on remaining scheduled repayments of principal, are due in (1) one year or less, (2) more than one year but less than five years, and (3) more than five years, are shown in the following table. The amounts due after one year are classified according to the sensitivity to changes in interest rates.

	Due in One Year or Less[(1)]	After One but Within Five Years	After Five Years
	(in thousands)		
Real Estate Loans – Construction	$149,114	$243,285	$45,848
Commercial Loans	131,288	86,783	24,456
Municipal Loans	28,042	87,411	172,662
Total	$308,444	$417,479	$242,966

Loans with Maturities After One Year for Which:		
	Interest Rates are Fixed or Predetermined	$329,067
	Interest Rates are Floating or Adjustable	$331,378

(1) The volume of commercial loans due within one year reflects our general policy of attempting to limit these loans to a short-term maturity. Nonaccrual loans totaling $14.4 million are reflected in the due after five years column.

LOANS TO AFFILIATED PARTIES

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2015, 2014 and 2013, these loans totaled $8.1 million, $7.1 million and $5.5 million, respectively. These loans represented 1.8%, 1.7%, and 2.1% of shareholders' equity as of December 31, 2015, 2014 and 2013, respectively.

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

Our allowance for loan losses was $19.7 million at December 31, 2015, or 0.8% of loans, an increase of $6.4 million, or 48.5%, compared to $13.3 million at December 31, 2014. The increase in the allowance for loan losses is due primarily to additional provision associated with loan growth and impaired loans. Loans increased during 2015 as a result of increased origination activity primarily in the Austin and Dallas-Fort Worth markets.

The allowance for loan losses is based on the most current review of the loan portfolio and is a result of multiple processes. First, the bank utilizes historical data to establish general reserve amounts for each class of loans. The historical charge- off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements. Second, our lenders have the primary responsibility for identifying problem loans based on customer financial stress and underlying collateral. These recommendations are reviewed by senior loan administration, the special assets department, and the loan

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review department. Third, the loan review department independently reviews the portfolio on an annual basis. The loan review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of considerations including the size of the loan, the type of credit extended, the seasoning of the loan and the performance of the loan. The loan review scope, as it relates to size, focuses more on larger dollar loan relationships, typically, for example, aggregate debt of $500,000 or greater. The loan review officer also reviews specific reserves compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $150,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

We calculate historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced to the total population of loans in the pool. The historical gross loss ratios are updated based on actual charge-off experience quarterly and adjusted for qualitative factors. Our pools of similar loans include consumer loans and loans secured by 1-4 residential family loans.

Prior to September 30, 2014, SFG loans included in loans to individuals that experienced past due status or extension of maturity characteristics were reserved for at higher levels based on the circumstances associated with each specific loan. In general, the reserves for SFG were calculated based on the past due status of the loan. For reserve purposes, the portfolio was segregated by past due status and by the remaining term variance from the original contract. During repayment, loans that paid late took longer to repay than the original contract. Additionally, some loans may have been granted extensions for extenuating payment circumstances and evaluated for troubled debt classification. The remaining term extensions increased the risk of collateral deterioration and, accordingly, reserves were increased to recognize this risk.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may be experienced as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, and geographic and industry loan concentration.

As of December 31, 2015, our review of the loan portfolio indicated that a loan loss allowance of $19.7 million was appropriate to cover probable losses in the portfolio. Changes in economic and other conditions may require future adjustments to the allowance for loan losses.

After all of the data in the loan portfolio is accumulated the reserve allocations are separated into various loan classes detailed in the table below. In addition, the following table presents information regarding the average amount of net loans outstanding, changes in the allowance for loan losses, selected asset quality ratios and an allocation of the allowance for loan losses (dollars in thousands).

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

	Years Ended December 31,				
	2015	2014	2013	2012	2011
Average Net Loans Outstanding	$2,224,401	$1,420,802	$1,296,440	$1,180,095	$1,054,882
Balance of Allowance for Loan Losses at Beginning of Period	$13,292	$18,877	$20,585	$18,540	$20,711
Loan Charge-Offs:					
Real Estate-Construction	(24)	(14)	—	(41)	(46)
Real Estate-1-4 Family Residential	(58)	(22)	(319)	(239)	(675)
Real Estate-Commercial	—	—	(67)	(159)	(271)
Commercial Loans	(336)	(66)	(512)	(402)	(1,254)
Municipal Loans	(249)	—	—	—	—
Loans to Individuals	(3,688)	(22,461)	(12,676)	(10,188)	(10,231)
Total Loan Charge-Offs	(4,355)	(22,563)	(13,574)	(11,029)	(12,477)
Recovery of Loans Previously Charged-off:					
Real Estate-Construction	207	156	77	121	61
Real Estate-1-4 Family Residential	115	81	91	172	98
Real Estate-Commercial	85	8	339	6	275
Commercial Loans	153	171	233	312	449
Loans to Individuals	1,896	1,624	2,247	1,727	1,927
Total Recovery of Loans Previously Charged-Off	2,456	2,040	2,987	2,338	2,810
Net Loan Charge-Offs	(1,899)	(20,523)	(10,587)	(8,691)	(9,667)
Provision for Loan Losses	8,343	14,938	8,879	10,736	7,496
Balance of Allowance for Loan Losses at End of Period	$19,736	$13,292	$18,877	$20,585	$18,540
Net Charge-Offs to Average Net Loans Outstanding	0.09 %	1.44 %	0.82 %	0.74 %	0.92 %
Allowance for Loan Losses to Nonaccruing Loans	96.15	324.51	233.40	199.58	180.02
Allowance for Loan Losses to Nonperforming Assets	60.76	108.27	138.74	139.87	140.58
Allowance for Loan Losses to Total Loans	0.81	0.61	1.40	1.63	1.71

Allocation of Allowance for Loan Losses (dollars in thousands):

	Years Ended December 31,														
	2015			2014			2013			2012			2011		
	Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans		Amount	Percent of Loans To Total Loans	
Real Estate															
Construction	$4,350	18.0	%	$2,456	12.3	%	$2,142	9.3	%	$2,355	9.0	%	$2,620	10.2	%
1-4 Family Residential	2,595	27.0	%	2,822	31.6	%	3,277	28.9	%	3,545	29.2	%	1,957	22.8	%
Commercial	4,577	26.1	%	3,025	21.5	%	2,572	19.4	%	2,290	18.7	%	3,051	19.0	%
Commercial Loans	6,596	10.0	%	3,279	10.4	%	1,970	11.7	%	3,158	12.7	%	2,877	13.2	%
Municipal Loans	725	11.8	%	716	11.8	%	668	18.2	%	633	17.5	%	619	19.1	%
Loans to Individuals	893	7.1	%	994	12.4	%	8,248	12.5	%	7,373	12.9	%	6,244	15.7	%
Other	—	0.0	%	—	0.0	%	—	0.0	%	1,231	0.0	%	1,172	0.0	%
Ending Balance	$19,736	100.0	%	$13,292	100.0	%	$18,877	100.0	%	$20,585	100.0	%	$18,540	100.0	%

See “Consolidated Financial Statements - Note 6 – Loans and Allowance for Probable Loan Losses.”

NONPERFORMING ASSETS

Nonperforming assets consist of delinquent loans 90 days or more past due, nonaccrual loans, OREO, repossessed assets and restructured loans. Nonaccrual loans are loans 90 days or more delinquent and collection in full of both the principal and interest is not expected. Additionally, some loans that are not delinquent may be placed on nonaccrual status due to doubts about full collection of principal or interest. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. Restructured loans represent loans that have been renegotiated to provide a reduction or deferral of interest or principal because of deterioration in the financial position of the borrowers. The restructuring of a loan is considered a “troubled debt restructuring” if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Categorization of a loan as nonperforming is not in itself a reliable indicator of potential loan loss. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower must be considered in judgments as to potential loan loss. OREO represents real estate taken in full or partial satisfaction of debts previously contracted. The dollar amount of OREO is based on a current evaluation of the OREO at the time it is recorded on our books, net of estimated selling costs. Updated valuations are obtained as needed and any additional impairments are recognized.

Total nonperforming assets at December 31, 2015 were $32.5 million representing an increase of $20.2 million, or 164.6%, from $12.3 million at December 31, 2014. From December 31, 2014 to December 31, 2015, nonaccrual loans increased $16.4 million, or 401.1%, to $20.5 million. Of this total, 67.7% are commercial loans, 13.7% are commercial real estate loans, 9.0% are residential real estate loans, 7.1% are loans to individuals and 2.5% are construction loans. OREO decreased $1.0 million, or 57.2%, to $744,000 from December 31, 2014 to December 31, 2015. We are actively marketing all properties and none are being held for investment purposes. Restructured loans

increased $5.3 million, or 89.7%, to $11.1 million. Repossessed assets