PROSPERITY BANCSHARES INC
Form 10-K
February 29, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For The Fiscal Year Ended December 31, 2015

OR

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

For the transition period from ________to________

Commission File Number 001-35388

PROSPERITY BANCSHARES, INC.®

(Exact name of registrant as specified in its charter)

Texas	**74-2331986**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
Prosperity Bank Plaza	
4295 San Felipe	
Houston, Texas	**77027**
(Address of principal executive offices)	**(Zip Code)**

Registrant s Telephone Number, Including Area Code: (713) 693-9300

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

Common Stock, par value $1.00 per share	**New York Stock Exchange, Inc.**
(Title of each class)	**(Name of each exchange on which registered)**

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 x No ¨

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

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 x No ¨

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

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

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

Large Accelerated Filer x Accelerated Filer ¨ Non-accelerated Filer ¨ Smaller Reporting Company ¨

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

The aggregate market value of the shares of common stock held by non-affiliates as of June 30, 2015, based on the closing price of the common stock on the New York Stock Exchange on June 30, 2015 was approximately $3.80 billion.

As of February 25, 2016, the number of outstanding shares of common stock was 69,873,802.

Documents Incorporated by Reference:

Portions of the Company s Proxy Statement relating to the 2016 Annual Meeting of Shareholders, which will be filed within 120 days after December 31, 2015, are incorporated by reference into Part III, Items 10-14 of this Annual Report on Form 10-K.

PROSPERITY BANCSHARES, INC.®

2015 ANNUAL REPORT ON FORM 10-K

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PART I

ITEM 1. BUSINESS
General

Prosperity Bancshares, Inc.®, a Texas corporation (the Company), was formed in 1983 as a vehicle to acquire the former Allied Bank in Edna, Texas, which was chartered in 1949 as The First National Bank of Edna and is now known as Prosperity Bank. The Company is a registered financial holding company that derives substantially all of its revenues and income from the operation of its bank subsidiary, Prosperity Bank® (Prosperity Bank® or the Bank). The Bank provides a wide array of financial products and services to small and medium-sized businesses and consumers. As of December 31, 2015, the Bank operated 241 full service banking locations; 60 in the Houston area, including The Woodlands; 30 in the South Texas area, including Corpus Christi and Victoria; 36 in the Dallas/Fort Worth area; 22 in the East Texas area; 29 in the Central Texas area, including Austin and San Antonio; 34 in the West Texas area, including Lubbock, Midland-Odessa and Abilene; 16 in the Bryan/College Station area, 6 in the Central Oklahoma area and 8 in the Tulsa, Oklahoma area. The Company s principal executive office is located at Prosperity Bank Plaza, 4295 San Felipe in Houston, Texas and its telephone number is (713) 693-9300. The Company s website address is *www.prosperitybankusa.com*.

The Company s market consists of the communities served by its banking centers. The diverse nature of the economies in each local market served by the Company provides the Company with a varied customer base and allows the Company to spread its lending risk throughout a number of different industries including professional service firms and their principals, manufacturing, tourism, recreation, petrochemicals, farming and ranching. The Company s market areas outside of Houston, Dallas, Corpus Christi, San Antonio, Lubbock, Austin, Tulsa and Oklahoma City are dominated by either small community banks or branches of larger regional banks. Management believes that the Company, through its responsive customer service and community banking philosophy, combined with the sophistication of a larger regional bank holding company, has a competitive advantage in its market areas and excellent growth opportunities through acquisitions, new banking center locations and additional business development.

Operating under a community banking philosophy, the Company seeks to develop broad customer relationships based on service and convenience while maintaining its conservative approach to lending and sound asset quality. The Company has grown through a combination of internal growth, the acquisition of community banks and branches of banks and the opening of new banking centers. Utilizing a low cost of funds and employing stringent cost controls, the Company has been profitable in every year of its existence, including the periods of adverse economic conditions in Texas.

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In addition to internal growth, the Company completed the following acquisitions within the last ten years (through December 31, 2015):

Acquired Entity	Acquired Bank	Completion Date	Number of Banking Centers Acquired (1)
First Capital Bankers, Inc.	FirstCapital Bank, s.s.b.	2005	20
Grapeland Bancshares, Inc.	First State Bank of Grapeland	2005	2
SNB Bancshares, Inc.	Southern National Bank of Texas	2006	6(2)
Texas United Bancshares, Inc.	State Bank, GNB Financial, n.a., Gateway National Bank and Northwest Bank	2007	34
The Bank of Navasota	The Bank of Navasota	2007	1
Banco Popular, NA (6 branches)	N/A	2008	5
1st Choice Bancorp	1st Choice Bank	2008	1
Franklin Bank (from FDIC, as receiver) (3)	N/A	2008	33
U.S. Bank (3 branches)	N/A	2010	3
First Bank (19 branches)	N/A	2010	15
Texas Bankers, Inc.	Bank of Texas	2012	2
The Bank Arlington	The Bank Arlington	2012	1
American State Financial Corporation	American State Bank	2012	37
Community National Bank	Community National Bank	2012	1
East Texas Financial Services, Inc.	Firstbank	2013	4
Coppermark Bancshares, Inc.	Coppermark Bank	2013	6
FVNB Corp.	First Victoria National Bank	2013	20
F&M Bancorporation Inc.	The F&M Bank & Trust Company	2014	11

(1) The number of banking centers added does not include any locations of the acquired entity that were closed and consolidated with existing banking centers of the Company upon consummation of the transaction or closed after consummation of the transaction.
(2) Included one banking center under construction at the time of consummation.
(3) Assumed approximately $3.6 billion of deposits and acquired certain assets, including 33 banking centers, from the Federal Deposit Insurance Corporation (FDIC), acting in its capacity as receiver for Franklin Bank.

Recent Acquisitions

Acquisition of Tradition Bancshares, Inc. On January 1, 2016, the Company completed the acquisition of Tradition Bancshares, Inc. (Tradition) and its wholly-owned subsidiary Tradition Bank headquartered in Houston, Texas. Tradition Bank operated 7 banking offices in the Houston, Texas area, including its main office in Bellaire, 3 banking centers in Katy and 1 banking center in The Woodlands.

As of December 31, 2015, Tradition, on a consolidated basis, reported total assets of $548.0 million, total loans of $253.3 million, total deposits of $488.9 million and shareholders equity of $43.1 million. Under the terms of the definitive agreement, the Company issued 679,528 shares of Company common stock plus $39.0 million in cash for all outstanding shares of Tradition capital stock, for a total merger consideration of $71.5 million, based on the Company s closing stock price of $47.86. On the effective date, the Company recognized preliminary goodwill of $27.5 million, which is calculated as the excess of both the consideration exchanged and liabilities assumed compared with the fair value of the assets acquired. The Company is currently in the process of obtaining fair values for certain acquired assets and assumed liabilities and, therefore, the estimates are preliminary.

Available Information

The Company s website address is *www.prosperitybankusa.com*. The Company makes available free of charge on or through its website its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Information contained on the Company s website is not incorporated by reference into this Annual Report on Form 10-K and is not part of this or any other report.

Officers and Associates

The Company s directors and officers are important to the Company s success and play a key role in the Company s business development efforts by actively participating in civic and public service activities in the communities served by the Company.

The Company has invested heavily in its officers and associates by recruiting talented officers in its market areas and providing them with economic incentives in the form of stock-based compensation and bonuses based on cross-selling performance. The senior management team has substantial experience in the Houston, Dallas, Austin, Bryan/College Station, East Texas, South Texas, West Texas, Oklahoma City and Tulsa markets and the surrounding communities in which the Company has a presence. Each banking center location is overseen by a local president or manager with knowledge of the community and lending expertise in the specific industries found in the community. The Company entrusts its banking center presidents and managers with authority and flexibility within general parameters with respect to product pricing and decision making in order to minimize the bureaucratic structure of larger banks. The Company operates each banking center as a separate profit center, maintaining separate data with respect to each banking center s net interest income, efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. Each banking center has its own listed local business telephone number. Customers are served by a local banker with decision making authority.

As of December 31, 2015, the Company and the Bank had 3,037 full-time equivalent associates, 859 of whom were officers of the Bank. The Company provides medical and hospitalization insurance to its full-time associates. The Company considers its relations with associates to be good. Neither the Company nor the Bank is a party to any collective bargaining agreement.

Banking Activities

The Company, through the Bank, offers a variety of traditional loan and deposit products to its customers, which consist primarily of consumers and small and medium-sized businesses. The Bank tailors its products to the specific needs of customers in a given market. At December 31, 2015, the Bank maintained approximately 594,300 separate deposit accounts including certificates of deposit and 55,600 separate loan accounts. At December 31, 2015, noninterest-bearing demand deposits were 29.1% of the Bank s total deposits. For the year ended December 31, 2015, the Company s average cost of funds was 0.22% and the Company s average cost of deposits (excluding all borrowings) was 0.21%.

The Company has been an active real estate lender, with commercial real estate and 1-4 family residential loans comprising 33.2% and 25.0%, respectively, of the Company s total loans as of December 31, 2015. The Company also offers commercial loans, loans for automobiles and other consumer durables, home equity loans, debit and credit cards, internet banking and other cash management services, mobile banking, trust and wealth management, retail brokerage services, mortgage banking services and automated telephone banking. The Company offers businesses a broad array of loan products including term loans, lines of credit and loans for working capital, business expansion and the purchase of equipment and machinery; land development and

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interim construction loans for builders; and owner-occupied and non-owner occupied commercial real estate loans.

By offering certificates of deposit, interest checking accounts, savings accounts and overdraft protection at competitive rates, the Company gives its depositors a full range of traditional deposit products.

The Company also maintains a trust department with $1.50 billion in assets under management as of December 31, 2015. The trust department provides trust services in the Company s various market areas.

Business Strategies

The Company s main objective is to increase deposits and loans through internal growth, as well as through acquisition opportunities, while maintaining efficiency, individualized customer service and maximizing profitability. To achieve this objective, the Company has employed the following strategic goals:

Continue Community Banking Emphasis. Although the Company has significantly grown in the last several years, it intends to continue operating as a community banking organization focused on meeting the specific needs of consumers and small and medium-sized businesses in its market areas. The Company provides a high degree of responsiveness combined with a wide variety of banking products and services. The Company staffs its banking centers with experienced bankers with lending expertise in the specific industries found in the given community, and gives them authority to make certain pricing and credit decisions, avoiding the bureaucratic structure of larger banks.

Expand Market Share Through Internal Growth and a Disciplined Acquisition Strategy. The Company intends to continue seeking opportunities, both inside and outside its existing markets, to expand either by acquiring existing banks or branches of banks or by establishing new banking centers. All of the Company s acquisitions have been accretive to earnings within 12 months after acquisition date and generally have supplied the Company with relatively low-cost deposits which have been used to fund the Company s lending and investing activities. However, the Company makes no guarantee that future acquisitions, if any, will be accretive to earnings within any particular time period. Factors used by the Company to evaluate expansion opportunities include (1) the similarity in management and operating philosophies, (2) whether the acquisition will be accretive to earnings and enhance shareholder value, (3) the ability to improve the efficiency ratio through economies of scale, (4) whether the acquisition will strategically expand the Company s geographic footprint, and (5) the opportunity to enhance the Company s market presence in existing market areas.

Increase Loan Volume and Diversify Loan Portfolio. While maintaining its conservative approach to lending, the Company has emphasized both new and existing loan products, focusing on managing its commercial real estate and commercial loan portfolios. From December 31, 2014 to December 31, 2015, the Company s commercial and industrial loans decreased from $1.81 billion to $1.69 billion, or 6.3%, and represented 19.5% and 17.9% of the total portfolio, respectively, for the same period. Commercial real estate (including multifamily residential) increased from $3.03 billion to $3.13 billion, or 3.3%, and represented 32.8% and 33.2% of the total portfolio, as of December 31, 2014 and 2015, respectively. From December 31, 2014 to December 31, 2015, 1-4 family residential mortgage loans (including home equity loans) increased from $2.52 billion to $2.64 billion, or 4.7%, and represented 27.3% and 27.9% of the total portfolio, respectively. In addition, the Company targets business owners, professional service firms, including legal and medical practices, for loans secured by owner-occupied premises, working capital or equipment and personal loans to their principals.

Maintain Sound Asset Quality. The Company continues to maintain the sound asset quality that has been representative of its historical loan portfolio. As the Company continues to diversify and increase its lending activities and acquire loans in acquisitions, it may face higher risks of nonpayment and increased risks in the event of prolonged economic downturns. The Company intends to continue to employ the strict underwriting guidelines and comprehensive loan review process that have contributed to its low incidence of nonperforming assets and its minimal charge-offs in relation to its size.

Continue Focus on Efficiency. The Company plans to maintain its stringent cost control practices and policies. The Company has invested significantly in the infrastructure required to centralize many of its critical operations, such as data processing and loan processing. For its banking centers, which the Company operates as independent profit centers, the Company supplies complete support in the areas of loan review, internal audit, compliance and training. Management believes that this centralized infrastructure can accommodate additional growth while enabling the Company to minimize operational costs through economies of scale.

Enhance Cross-Selling. The Company uses incentives and friendly competition to encourage cross-selling efforts and increase cross-selling results among its associates. Officers and associates have access to each customer s existing and related account relationships and are better able to inform customers of additional products when customers visit or call the various banking centers or use their drive-in facilities. In addition, the Company includes product information in monthly statements and other mailings.

Competition

The banking business is highly competitive, and the profitability of the Company depends principally on its ability to compete in its market areas. The Company competes with other commercial banks, savings banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking firms, asset-based nonbank lenders and certain other nonfinancial entities, including retail stores which may maintain their own credit programs and certain governmental organizations which may offer more favorable financing than the Company. The Company believes it has been able to compete effectively with other financial institutions by emphasizing customer service, technology and responsive decision-making with respect to loans, by establishing long-term customer relationships and building customer loyalty and by providing products and services designed to address the specific needs of its customers.

Supervision and Regulation

The supervision and regulation of bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the Deposit Insurance Fund (DIF) of the FDIC and the banking system as a whole, and not for the protection of the bank holding company s shareholders or creditors. The banking agencies have broad enforcement power over bank holding companies and banks including the power to impose substantial fines and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and the Bank are subject. References in this Annual Report on Form 10-K to applicable statutes and regulations are brief summaries thereof, do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations.

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The Company

The Company is a financial holding company pursuant to the Gramm-Leach-Bliley Act and a bank holding company registered under the Bank Holding Company Act of 1956, as amended (BHCA). Accordingly, the Company is subject to supervision, regulation and examination by the Board of Governors of the Federal Reserve System (Federal Reserve Board). The Gramm-Leach-Bliley Act, the BHCA and other federal laws subject financial and bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations. Further, since the Company has securities registered with the Securities and Exchange Commission and traded on the New York Stock Exchange, it is also subject to the supervision and regulation of these organizations.

Regulatory Restrictions on Dividends. The Company is regarded as a legal entity separate and distinct from the Bank. The principal source of the Company s revenues is dividends received from the Bank. As described in more detail below, federal law places limitations on the amount that state banks may pay in dividends, which the Bank must adhere to when paying dividends to the Company. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if the prospective rate of earnings retention is consistent with the organization s expected capital needs and financial condition. The Federal Reserve Board s policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company s ability to serve as a source of strength to its banking subsidiaries. The Federal Reserve Board is authorized to limit or prohibit the payment of dividends if, in the Federal Reserve Board s opinion, the payment of dividends would constitute an unsafe or unsound practice in light of a bank holding company s financial condition. In addition, the Federal Reserve Board has indicated that each bank holding company should carefully review its dividend policy, and has discouraged payment ratios that are at maximum allowable levels, which is the maximum dividend amount that may be issued and allow the company to still maintain its target Tier 1 capital ratio, unless both asset quality and capital are very strong.

Stress Testing. Pursuant to the Dodd -Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), in October 2012, the Federal Reserve Board published its final rules regarding company-run stress testing. The rules require institutions with average total consolidated assets greater than $10 billion, such as the Company and the Bank, to conduct an annual company-run stress test of capital and consolidated earnings and losses under one base and at least two stress scenarios provided by bank regulatory agencies. Beginning with the 2016 stress test, institutions with total consolidated assets between $10 billion and $50 billion use data as of December 31st and scenarios released by the agencies. The results of these stress tests must be reported to the agencies by July 31st of the following year. Public disclosure of summary stress test results under the severely adverse scenario will occur between October 15th and October 31st. The Company s capital ratios reflected in the stress test calculations are an important factor considered by the Federal Reserve Board in evaluating the capital adequacy of the Company and the Bank and determining whether proposed payments of dividends or stock repurchases may be an unsafe or unsound practice.

Source of Strength. Under Federal Reserve Board policy, a bank holding company has historically been required to act as a source of financial strength to each of its banking subsidiaries. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, the Company is expected to commit resources to support the Bank, including support at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. As discussed below, a bank holding company, in certain circumstances, could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

In the event of a bank holding company s bankruptcy under Chapter 11 of the U.S. Bankruptcy Code, the trustee will be deemed to have assumed and is required to cure immediately any deficit under any commitment by the debtor holding company to any of the federal banking agencies to maintain the capital of an insured depository institution. Any claim for breach of such obligation will generally have priority over most other unsecured claims.

Scope of Permissible Activities. Under the BHCA, bank holding companies generally may not acquire a direct or indirect interest in or control of more than 5% of the voting shares of any company that is not a bank or bank holding company or from engaging in activities other than those of banking, managing or controlling banks or furnishing services to or performing services for its subsidiaries, except that it may engage in, directly or indirectly, certain activities that the Federal Reserve Board has determined to be so closely related to banking or managing and controlling banks as to be a proper incident thereto. In approving acquisitions or the addition of activities, the Federal Reserve Board considers, among other things, whether the acquisition or the additional activities can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh such possible adverse effects as undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices.

Notwithstanding the foregoing, the Gramm-Leach-Bliley Act eliminated the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers and permits bank holding companies to become financial holding companies and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. The Gramm-Leach- Bliley Act defines financial in nature to include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. No regulatory approval will be required for a financial holding company, such as the Company, to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

The Company s financial holding company status depends upon it maintaining its status as well capitalized and well managed under applicable Federal Reserve Board regulations. If a financial holding company ceases to meet these requirements, the Federal Reserve Board may impose corrective capital and/or managerial requirements on the financial holding company and place limitations on its ability to conduct the broader financial activities permissible for financial holding companies. Until the financial holding company returns to compliance, it may not acquire a company engaged in such financial activities without prior approval of the Federal Reserve Board. In addition, the Federal Reserve Board may require divestiture of the holding company s depository institutions and/or its non-bank subsidiaries if the deficiencies persist.

While the Federal Reserve Board is the umbrella regulator for financial holding companies and has the power to examine banking organizations engaged in new activities, regulation and supervision of activities which are financial in nature or determined to be incidental to such financial activities will be handled along functional lines. Accordingly, activities of subsidiaries of a financial holding company will be regulated by the agency or authorities with the most experience regulating that activity as it is conducted in a financial holding company.

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

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

Anti-Tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Basel III Capital Adequacy Requirements Effective January 1, 2015. In July 2013, the Federal Reserve Board and the FDIC published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee s December 2010 framework known as Basel III for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank, under the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions regulatory capital ratios and replace the prior risk-weighting approach, which was derived from the Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee s 2004 Basel II capital accords. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies rules. The Basel III Capital Rules became effective for the Company and the Bank on January 1, 2015, subject to a phase-in period for certain provisions.

The Basel III Capital Rules, among other things, (1) introduced a new capital measure called Common Equity Tier 1 (CET1), (2) specified that Tier 1 capital consists of CET1 and Additional Tier 1 capital instruments meeting specified requirements, (3) defined CET1 narrowly by requiring that most deductions/ adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (4) expanded the scope of the deductions/adjustments as compared to existing regulations.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that certain deferred tax assets 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 items, in the aggregate, exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). Under the capital standards in effect as of December 31, 2014, the effects of accumulated other comprehensive income items included in capital were excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations that do not have $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure, including the Company and the Bank, are able to make a one-time permanent election to continue to exclude these items. The Company and the Bank have made this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Company s available-for-sale securities portfolio. Under the Basel III Capital Rules, trust preferred securities no longer included in Tier 1 capital of bank holding companies may be included as Tier 2 capital on a permanent basis.

The Basel III Capital Rules also introduced a new capital conservation buffer, composed entirely of CET1, that is designed to absorb losses during periods of economic stress and has the effect of increasing the minimum required risk-weighted capital ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a countercyclical capital buffer that is applicable to only certain covered institutions and does not have any current applicability to the Company or the Bank. Banking institutions with a ratio of CET1 to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The initial minimum capital ratios under the Basel III Capital Rules that became effective as of January 1, 2015 are (1) 4.5% CET1 to risk-weighted assets, (2) 6.0% Tier 1 capital to risk-weighted assets, (3) 8.0% Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets, and (4) 4.0% Tier 1 capital to average quarterly assets as reported on consolidated financial statements (known as the leverage ratio). As of December 31, 2015, the Company s ratio of CET1 to risk-weighted assets was 13.55%, Tier 1 capital to risk-weighted assets was 13.55%, Total capital to risk-weighted assets was 14.25% and Tier 1 capital to average quarterly assets was 7.97%.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company to maintain an additional capital conservation buffer of 2.5% CET1, effectively resulting in minimum ratios of (1) CET1 to risk-weighted assets of at least 7.0%, (2) Tier 1 capital to risk-weighted assets of at least 8.5%, (3) Total capital to risk-weighted assets of at least 10.5% and (4) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

With respect to the Bank, the Basel III Capital Rules also revise the prompt corrective action regulations as discussed below under The Bank Corrective Measures for Capital Deficiencies.

The Basel III Capital Rules prescribe a standardized approach for risk weightings that expanded the risk-weighting categories from the previous four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. In addition, the Basel III Capital Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

The federal banking agencies risk-based and leverage capital ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Liquidity Requirements. Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III liquidity framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, are now required by regulation.

One test, referred to as the liquidity coverage ratio (LCR), is designed to ensure that a banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio (NSFR), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will provide banking entities with incentives to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. In September 2014, the federal banking agencies approved final rules implementing (1) the LCR for advanced approaches banking organizations (i.e., banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure) and (2) a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations. Neither rule applies to the Company or the Bank. The federal banking agencies have not yet proposed rules to implement the NSFR or addressed the scope of banking organizations to which it will apply. The Basel Committee s final NSFR document states that the NSFR applies to internationally active banks, as did its final LCR document with respect to that ratio.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take prompt corrective action to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes undercapitalized, it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary s compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution s holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution s assets at the time it became undercapitalized or the amount necessary to cause the institution to be adequately capitalized. The bank regulators have greater power in situations where an institution becomes significantly or critically undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The BHCA requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider, among other things, the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served and various competitive factors.

Control Acquisitions. The Change in Bank Control Act (CBCA) prohibits a person or group of persons from acquiring control of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, a person may not acquire 25% (5% in the case of an acquiror that is a bank holding company) or more of a bank holding company s or bank s voting securities, or otherwise obtain control or a controlling influence over a bank holding company or bank without the approval of the Federal Reserve Board. In 2008, the Federal Reserve Board issued a policy statement on equity investments in bank holding companies and banks, which allows the Federal Reserve Board to generally be able to conclude that an entity s investment is not controlling if the entity does not own in excess of 15% of the voting power and 33% of the total equity of the bank holding company or bank. Depending on the nature of the overall investment and the capital structure of the banking organization, the Federal Reserve Board will permit, based on the policy statement, noncontrolling investments in the form of voting and nonvoting shares that represent in the aggregate (1) less than one-third of the total equity of the banking organization (and less than one-third of any class of voting securities, assuming conversion of all convertible nonvoting securities held by the entity) and (2) less than 15% of any class of voting securities of the banking organization.

The Volcker Rule. The Volcker Rule under the Dodd-Frank Act prohibits banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain hedge funds and private equity funds. Since neither the Company nor the Bank engages in the types of trading or investing covered by the Volcker Rule, the Volcker Rule does not currently have any effect on the operations of the Company or the Bank.

The Bank

The Bank is a Texas-chartered banking association, the deposits of which are insured by the DIF of the FDIC. The Bank is not a member of the Federal Reserve System; therefore, the Bank is subject to supervision and regulation by the FDIC and the Texas Department of Banking. Such supervision and regulation subject the Bank to special restrictions, requirements, potential enforcement actions and periodic examination by the FDIC and the Texas Department of Banking. Because the Federal Reserve Board regulates the Company, the Federal Reserve Board also has supervisory authority which affects the Bank. Further, because the Bank had total assets of over $10 billion as of December 31, 2015, the Bank is subject to supervision and regulation by the Consumer Financial Protection Bureau (CFPB). The CFPB is responsible for implementing, examining and enforcing compliance with federal consumer protection laws.

Equivalence to National Bank Powers. The Texas Constitution, as amended in 1986, provides that a Texas-chartered bank has the same rights and privileges that are or may be granted to national banks domiciled in Texas. To the extent that the Texas laws and regulations may have allowed state-chartered banks to engage in a broader range of activities than national banks, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) has operated to limit this authority. FDICIA provides that no state bank or subsidiary thereof may engage as principal in any activity not permitted for national banks, unless the institution complies with applicable capital requirements and the FDIC determines that the activity poses no significant risk to the DIF. In general, statutory restrictions on the activities of banks are aimed at protecting the safety and soundness of depository institutions.

Financial Modernization. Under the Gramm-Leach-Bliley Act, a national bank may establish a financial subsidiary and engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting as principal, insurance company portfolio investment, real estate development, real estate investment, annuity issuance and merchant banking activities. To do so, a bank must be well capitalized, well managed and have a CRA rating of satisfactory or better. Subsidiary banks of a financial holding company or national banks with financial subsidiaries must remain well capitalized and well managed in order to continue to engage in activities that are financial in nature without regulatory actions or restrictions, which could include divestiture of the financial in nature subsidiary or subsidiaries. In addition, a financial holding company or a bank may not acquire a company that is engaged in activities that are financial in nature unless each of the subsidiary banks of the financial holding company or the bank has a CRA rating of satisfactory or better.

Although the powers of state chartered banks are not specifically addressed in the Gramm-Leach-Bliley Act, Texas-chartered banks such as the Bank, will have the same if not greater powers as national banks through the parity provision contained in the Texas Constitution.

Branching. Pursuant to the Dodd-Frank Act, banks are permitted to engage in de novo interstate branching if the laws of the state where the new branch is to be established would permit the establishment of the branch if it were chartered by such state, subject to applicable regulatory review and approval requirements. The Dodd-Frank Act also created certain regulatory requirements for interstate mergers and acquisitions, including that the acquiring bank must be well capitalized and well managed.Texas law provides that a Texas-chartered bank can establish a branch anywhere in Texas provided that the branch is approved in advance by the Texas Department of Banking. The branch must also be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers.

Restrictions on Transactions with Affiliates and Insiders. Transactions between the Bank and its nonbanking affiliates, including the Company, are subject to Section 23A of the Federal Reserve Act. In general, Section 23A imposes limits on the amount of such transactions to 10% of the Bank s capital stock and surplus and requires that such transactions be secured by designated amounts of specified collateral. It also limits the amount of advances to third parties which are collateralized by the securities or obligations of the Company or its subsidiaries. The Dodd-Frank Act significantly expanded the coverage and scope of the limitations on affiliate transactions within a banking organization.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act which generally requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons. The Federal Reserve Board has also issued Regulation W which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretive guidance with respect to affiliate transactions.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as insiders) contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets. Dividends paid by the Bank have provided a substantial part of the Company s operating funds and for the foreseeable future it is anticipated that dividends paid by the Bank to the Company will continue to be the Company s principal source of operating funds. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the Bank. Under federal law, the Bank cannot pay a dividend if, after paying the dividend, the Bank will be undercapitalized. The FDIC may declare a dividend payment to be unsafe and unsound even though the Bank would continue to meet its capital requirements after the dividend. Because the Company is a legal entity separate and distinct from its subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary s liquidation or reorganization will be subject to the prior claims of the subsidiary s creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository institution holding company (such as the Company) or any shareholder or creditor thereof.

Consumer Financial Protection. The Bank is subject to a number of federal and state consumer protection laws that extensively govern its relationship with its customers. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Service Members Civil Relief Act and these laws respective state-law counterparts, as well as state usury laws and laws regarding unfair and deceptive acts and practices. These and other federal laws, among other things, require disclosures of the cost of credit and terms of deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, prohibit unfair, deceptive and abusive practices, restrict the Bank s ability to raise interest rates and subject the Bank to substantial regulatory oversight. Violations of applicable consumer protection laws can result in significant potential liability from litigation brought by customers, including actual damages, restitution and attorneys fees. Federal bank regulators, state attorneys general and state and local consumer protection agencies may also seek to enforce consumer protection requirements and obtain these and other remedies, including regulatory sanctions, customer rescission rights, action by the state and local attorneys general in each jurisdiction in which the Bank operates and civil money penalties. Failure to comply with consumer protection requirements may also result in the Bank s failure to obtain any required bank regulatory approval for merger or acquisition transactions the Bank may wish to pursue or its prohibition from engaging in such transactions even if approval is not required.

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The Dodd-Frank Act established the CFPB, which has supervisory authority over depository institutions with total assets of $10 billion or greater. The CFPB focuses its supervision and regulatory efforts on (1) risks to consumers and compliance with the federal consumer financial laws when it evaluates the policies and practices of a financial institution; (2) the markets in which firms operate and risks to consumers posed by activities in those markets; (3) depository institutions that offer a wide variety of consumer financial products and services; (4) certain depository institutions with a more specialized focus; and (5) non-depository companies that offer one or more consumer financial products or services.

The CFPB has broad rulemaking authority for a wide range of consumer financial laws that apply to all banks, including, among other things, the authority to prohibit unfair, deceptive or abusive acts and practices. Abusive acts or practices are defined as those that materially interfere with a consumer s ability to understand a term or condition of a consumer financial product or service or take unreasonable advantage of a consumer s (1) lack of financial savvy, (2) inability to protect himself in the selection or use of consumer financial products or services, or (3) reasonable reliance on a covered entity to act in the consumer s interests. The CFPB can issue cease-and-desist orders against banks and other entities that violate consumer financial laws. The CFPB may also institute a civil action against an entity in violation of federal consumer financial law in order to impose a civil penalty or injunction. The CFPB has examination and enforcement authority over all banks with more than $10 billion in assets, as well as their affiliates.

Examinations. The FDIC periodically examines and evaluates state non-member banks. The Texas Department of Banking also conducts examinations of state banks, but may accept the results of a federal examination in lieu of conducting an independent examination. In addition, the FDIC and Texas Department of Banking may elect to conduct a joint examination. Further, because the Bank has total assets of over $10 billion as of December 31, 2015, the CFPB has examination authority with respect to the Bank s compliance with federal consumer protection laws. Compliance with consumer protection laws will be considered when banking regulators are asked to approve a proposed transaction.

Capital Adequacy Requirements. The FDIC has adopted regulations establishing minimum requirements for the capital adequacy of insured institutions. The FDIC may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The FDIC s risk-based capital guidelines generally require state banks to have a minimum ratio of CET1 to risk-weighted assets of 4.5%, Tier 1 capital to total risk-weighted assets of 6.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for the Bank as for the Company. As of December 31, 2015, the Bank s ratio of CET1 to risk-weighted assets was 13.10%, Tier 1 capital to total risk-weighted assets was 13.10% and its ratio of total capital to total risk-weighted assets was 13.80%.

The FDIC s leverage guidelines require state banks to maintain Tier 1 capital of no less than 4.0% of average total assets. The Texas Department of Banking has issued a policy which generally requires state chartered banks to maintain a leverage ratio (defined in accordance with federal capital guidelines) of 5.0%. As of December 31, 2015, the Bank s ratio of Tier 1 capital to average total assets (leverage ratio) was 7.70%.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required to take prompt corrective action with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are well-capitalized, adequately capitalized, under capitalized, significantly under capitalized and critically under capitalized.

A bank is well capitalized if it has a total risk-based capital ratio of 10.0% or higher; a CET1 capital ratio of 6.5% or higher; a Tier 1 risk-based capital ratio of 8.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure.

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A bank is adequately capitalized if it has a total risk-based capital ratio of 8.0% or higher; a CET1 capital ratio of 4.5% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 4.0% or higher; and does not meet the criteria for a well capitalized bank.

A bank is under capitalized if it has a total risk-based capital ratio of less than 8.0%; a CET1 capital ratio less than 4.5%; a Tier 1 risk-based capital ratio of less than 6.0% or a leverage ratio of less than 4.0%.

A bank is significantly under capitalized if it has a total risk-based capital ratio of less than 6.0%; a CET1 capital ratio less than 3.0%; a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%.

A bank is critically under capitalized if it has tangible equity equal to or less than 2.0% of average quarterly tangible assets.

At December 31, 2015, the Bank was classified as well-capitalized for purposes of the FDIC s prompt corrective action regulations in effect as of such date.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution s capital decreases, the FDIC s enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The FDIC has only very limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator.

Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Deposit Insurance Assessments. Substantially all of the deposits of the Bank are insured up to applicable limits (currently $250,000) by the DIF, and the Bank must pay deposit insurance assessments to the FDIC for such deposit insurance protection. A depository institution s DIF assessment is calculated by multiplying its assessment rate by the assessment base, which is defined as the average consolidated total assets less the average tangible equity of the depository institution. The initial base assessment rate is based on its capital level and CAMELS ratings, certain financial measures to assess an institution s ability to withstand asset related stress and funding related stress and, in some cases, additional discretionary adjustments by the FDIC to reflect additional risk factors. For large institutions, including the Bank, the initial base assessment rate ranges from five to 35 basis points on an annualized basis (basis points representing cents per $100 of assessable assets). After the effect of potential base-rate adjustments, the total base assessment rate could range from 2.5 to 45 basis points on an annualized basis. The potential adjustments to an institution s initial base assessment rate include (i) a potential decrease of up to five basis points for certain long-term unsecured debt except for well-capitalized institutions with a CAMELS rating of 1 or 2, and (ii) a potential increase of up to 10 basis points for brokered deposits in excess of 10% of domestic deposits. As the DIF reserve ratio grows, the rate schedule will be adjusted downward. Additionally, an institution must pay a premium equal to 50 basis points on every dollar of long-term, unsecured debt held by the depository institution to the extent that such debt exceeds 3% of an institution s Tier 1 capital held by that depository institution if such debt was issued by another insured depository institution (excluding debt guaranteed under the Temporary Liquidity Guarantee Program).

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The FDIC s current DIF restoration plan is designed to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. At least semi-annually, the FDIC will update its loss and income projections for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking, if required. In October 2015, the FDIC published for comment a proposed rule that would enable the FDIC to reach the 1.35% DIF reserve ratio by imposing a surcharge on the quarterly assessments of depository institutions with total consolidated assets of $10 billion or more. The Bank is monitoring developments with respect to the proposed rule and its potential impact on its deposit insurance assessments.

Interchange Fees. Under the Durbin Amendment to the Dodd-Frank Act, the Federal Reserve Board adopted rules establishing standards for assessing whether the interchange fees that may be charged with respect to certain electronic debit transactions are reasonable and proportional to the costs incurred by issuers for processing such transactions. Interchange fees, or swipe fees, are charges that merchants pay to the Bank and other card-issuing banks for processing electronic payment transactions. Federal Reserve Board rules applicable to financial institutions that have assets of $10 billion or more provide that the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. An upward adjustment of no more than 1 cent to an issuer s debit card interchange fee is allowed if the card issuer develops and implements policies and procedures reasonably designed to achieve certain fraud-prevention standards. The Federal Reserve Board also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product.

Concentrated Commercial Real Estate Lending Regulations. The federal banking agencies, including the FDIC, have promulgated guidance governing financial institutions with concentrations in commercial real estate lending, which was re-emphasized in December 2015. The guidance provides that a bank has a concentration in commercial real estate lending if (1) total reported loans for construction, land development and other land represent 100% or more of total capital or (2) total reported loans secured by multifamily and non-farm residential properties and loans for construction, land development and other land represent 300% or more of total capital and the bank s commercial real estate loan portfolio has increased 50% or more during the prior 36 months. Owner occupied loans are excluded from this second category. If a concentration is present, management must employ heightened risk management practices that address the following key elements: including board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending.

Community Reinvestment Act. The Community Reinvestment Act of 1977 (CRA) and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank s record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) requires federal banking agencies to make public a rating of a bank s performance under the CRA. In the case of a bank holding company, the CRA performance records of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction.

Anti-Money Laundering and Anti-Terrorism Legislation. A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (the USA Patriot Act) substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The United States Treasury Department has issued and, in some cases, proposed a number of regulations that apply various

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requirements of the USA Patriot Act to financial institutions. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Certain of those regulations impose specific due diligence requirements on financial institutions that maintain correspondent or private banking relationships with non-U.S. financial institutions or persons. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Office of Foreign Assets Control Regulation. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the OFAC rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control (OFAC). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (1) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on U.S. persons engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (2) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Privacy. In addition to expanding the activities in which banks and bank holding companies may engage, the Gramm-Leach-Bliley Act also imposed new requirements on financial institutions with respect to customer privacy. The Gramm-Leach-Bliley Act generally prohibits disclosure of customer information to non-affiliated third parties unless the customer 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 customers annually. Financial institutions, however, will be required to comply with state law if it is more protective of customer privacy than the Gramm-Leach-Bliley Act.

Incentive Compensation. In June 2010, the Federal Reserve Board, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization s incentive compensation arrangements should (1) provide incentives that do not encourage risk-taking beyond the organization s ability to effectively identify and manage risks, (2) be compatible with effective internal controls and risk management, and (3) be supported by strong corporate governance, including active and effective oversight by the organization s board of directors. These three principles are incorporated into proposed joint compensation regulations proposed by the federal banking agencies under the Dodd-Frank Act. The regulations have not been finalized, but as proposed, would impose limitations on the manner in which the Bank may structure compensation for its executives.

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

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Legislative and Regulatory Initiatives

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

Effect on Economic Environment

The policies of regulatory authorities, including the monetary policy of the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve Board to affect the money supply are open market operations in U.S. government securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve Board monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on the business and earnings of the Company and its subsidiaries cannot be predicted.

ITEM 1A. RISK FACTORS

An investment in the Company s common stock involves risks. The following is a description of the material risks and uncertainties that the Company believes affect its business and an investment in the common stock. Additional risks and uncertainties that the Company is unaware of, or that it currently deems immaterial, also may become important factors that affect the Company and its business. If any of the risks described in this Annual Report on Form 10-K were to occur, the Company s financial condition, results of operations and cash flows could be materially and adversely affected. If this were to happen, the value of the common stock could decline significantly and you could lose all or part of your investment.

Risks Associated with the Company s Business

If the Company is not able to continue its historical levels of growth, it may not be able to maintain its historical earnings trends.

To achieve its past levels of growth, the Company has focused on both internal growth and acquisitions. The Company may not be able to sustain its historical rate of growth or may not be able to grow at all. More specifically, the Company may not be able to obtain the financing necessary to fund additional growth and may not be able to find suitable acquisition candidates. Various factors, such as economic conditions and competition, may impede or prohibit the opening of new banking centers and the completion of acquisitions. Further, the Company may be unable to attract and retain experienced bankers, which could adversely affect its internal growth. If the Company is not able to continue its historical levels of growth, it may not be able to maintain its historical earnings trends.

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If the Company is unable to manage its growth effectively, its operations could be negatively affected.

Companies that experience rapid growth face various risks and difficulties, including:

- finding suitable markets for expansion;
- finding suitable candidates for acquisition;
- attracting funding to support additional growth;
- maintaining asset quality;
- attracting and retaining qualified management; and
- maintaining adequate regulatory capital.

In addition, in order to manage its growth and maintain adequate information and reporting systems within its organization, the Company must identify, hire and retain additional qualified associates, particularly in the accounting and operational areas of its business.

If the Company does not manage its growth effectively, its business, financial condition, results of operations and future prospects could be negatively affected, and the Company may not be able to continue to implement its business strategy and successfully conduct its operations.

The Company s profitability depends significantly on local economic conditions.

The Company s success depends primarily on the general economic conditions of the primary markets in Texas and Oklahoma in which it operates and where its loans are concentrated. The local economic conditions in Texas and Oklahoma have a significant impact on the Company s commercial, real estate and construction, land development and other land loans; the ability of its borrowers to repay their loans; and the value of the collateral securing these loans. Accordingly, if the population or income growth in the Company s market areas is slower than projected, income levels, deposits and housing starts could be adversely affected and could result in a reduction of the Company s expansion, growth and profitability. In addition, due to the large number of oil and gas companies in the Company s market areas, if prolonged, the current decline in oil prices may negatively impact economic conditions in these areas. If the Company s market areas experience a downturn or a recession for a prolonged period of time, the Company could experience significant increases in nonperforming loans, which could lead to operating losses, impaired liquidity and eroding capital. A significant decline in general economic conditions, caused by inflation, a decline in commodity prices, recession, acts of terrorism, outbreaks of hostilities or other international or domestic calamities, unemployment or other factors could impact these local economic conditions and could negatively affect the Company s financial condition, results of operations and cash flows.

The Company s business is subject to interest rate risk and fluctuations in interest rates may adversely affect its financial condition and results of operations.

The majority of the Company s assets are monetary in nature and, as a result, the Company is subject to significant risk from changes in interest rates. Changes in interest rates can impact the Company s net interest income as well as the valuation of its assets and liabilities. The Company s earnings are significantly dependent on its net interest income. Net interest income is the difference between the interest income earned on loans, investments and other interest-earning assets and the interest expense paid on deposits, borrowings and other interest-bearing liabilities.

Changes in monetary policy, including changes in interest rates, could influence the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, and could also affect (1) the Company s ability to originate loans and obtain deposits, (2) the fair value of the Company s financial assets and liabilities and (3) the average duration of the Company s 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, the Company s 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 decrease more quickly than the interest rates paid on deposits and other borrowings. Further, the Company s assets and liabilities may react differently to changes in overall market rates or conditions because there may be mismatches between the repricing or maturity characteristics of the assets and liabilities. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company s business, financial condition and results of operations.

If the Company is unable to identify and acquire other financial institutions and successfully integrate its acquired businesses, its business and earnings may be negatively affected.

The market for acquisitions remains highly competitive, and the Company may be unable to find acquisition candidates in the future that fit its acquisition and growth strategy. To the extent that the Company is unable to find suitable acquisition candidates, an important component of its growth strategy may be lost.

Acquisitions of financial institutions involve operational risks and uncertainties and acquired companies may have unforeseen liabilities, exposure to asset quality problems, key employee and customer retention problems and other problems that could negatively affect the Company s organization. The Company may not be able to complete future acquisitions; and, if completed, the Company may not be able to successfully integrate the operations, management, products and services of the entities that it acquires and eliminate redundancies. The integration process could result in the loss of key employees or disruption of the combined entity s ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect the Company s ability to maintain relationships with customers and employees or achieve the anticipated benefits of the transaction. The integration process may also require significant time and attention from the Company s management that they would otherwise direct at servicing existing business and developing new business. The Company s inability to find suitable acquisition candidates and failure to successfully integrate the entities it acquires into its existing operations may increase its operating costs significantly and adversely affect its business and earnings.

The Company s dependence on loans secured by real estate subjects it to risks relating to fluctuations in the real estate market that could adversely affect its financial condition, results of operations and cash flows.

Approximately 77.1% of the Company s total loans as of December 31, 2015 consisted of loans included in the real estate loan portfolio, with 37.8% in commercial real estate (including farmland and multifamily residential), 27.9% in residential real estate (including home equity) and 11.4% in construction, land development and other land loans. The real estate collateral 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. A weakening of the real estate market in the Company s primary market areas could have an adverse effect on the demand for new loans, the ability of borrowers to repay outstanding loans, the value of real estate and other collateral securing the loans and the value of real estate owned by the Company. If real estate values decline, it is also more likely that the Company would be required to increase its allowance for credit losses, which could adversely affect its financial condition, results of operations and cash flows.

The Company s commercial real estate and commercial loans expose it to increased credit risks, and these risks will increase if the Company succeeds in increasing these types of loans.

The Company, while maintaining its conservative approach to lending, has emphasized both new and existing loan products, focusing on managing its commercial real estate (including farmland and multifamily residential) and commercial loan portfolios, and intends to continue to increase its lending activities and acquire loans in possible future acquisitions. As a result, commercial real estate and commercial loans as a proportion of its portfolio could increase. As of December 31, 2015, commercial real estate (including farmland and multifamily residential) and commercial loans totaled $5.26 billion. In general, commercial real estate loans and commercial loans yield higher returns and often generate a deposit relationship, but also pose greater credit risks than do owner-occupied residential real estate loans. These types of loans are also typically larger than residential real estate loans. Accordingly, the deterioration of one or several of these loans could cause a significant increase in nonperforming loans, which could result in a loss of earnings from these loans and an increase in the provision for credit losses and net charge-offs.

The Company makes both secured and some unsecured commercial loans. Unsecured loans generally involve a higher degree of risk of loss than do secured loans because, without collateral, repayment is wholly dependent upon the success of the borrowers businesses. Secured commercial loans are generally collateralized by accounts receivable, inventory, equipment or other assets owned by the borrower and include a personal guaranty of the business owner. Compared to real estate, that type of collateral is more difficult to monitor, its value is harder to ascertain, it may depreciate more rapidly and it may not be as readily saleable if repossessed. Further, commercial loans generally will be serviced primarily from the operation of the business, which may not be successful, while commercial real estate loans generally will be serviced from income on the properties securing the loans. As the Company s various commercial loan portfolios increase, the corresponding risks and potential for losses from these loans will also increase.

The Company s allowance for credit losses may not be sufficient to cover actual credit losses, which could adversely affect its earnings.

As a lender, the Company is exposed to the risk that its loan customers may not repay their loans according to the terms of these loans and the collateral securing the payment of these loans may be insufficient to fully compensate the Company for the outstanding balance of the loan plus the costs to dispose of the collateral. The Company maintains an allowance for credit losses in an attempt to cover estimated losses inherent in its loan portfolio. Additional credit losses will likely occur in the future and may occur at a rate greater than the Company has experienced to date. The determination of the appropriate level of the allowance inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks, future trends and general economic conditions, all of which may undergo material changes. If the Company s assumptions prove to be incorrect or if it experiences significant credit losses in future periods, its current allowance may not be sufficient to cover actual credit losses and adjustments may be necessary to allow for different economic conditions or adverse developments in its loan portfolio. A material addition to the allowance could cause net income, and possibly capital, to decrease.

In addition, federal and state regulators periodically review the Company s allowance for credit losses and may require the Company to increase its provision for credit losses or recognize further charge-offs, based on judgments different than those of the Company s management. An increase in the Company s allowance for credit losses or charge-offs as required by these regulatory agencies could have a material adverse effect on the Company s operating results and financial condition.

The small to medium-sized businesses that the Company lends to may have fewer resources to weather a downturn in the economy, which could materially harm the Company s operating results.

The Company makes loans to privately-owned businesses, many of which are considered to be small to medium-sized businesses. Small to medium-sized businesses frequently have smaller market share than their competition, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience significant volatility in operating results. Any one or more of these factors may impair the borrower s ability to repay a loan. In addition, the success of a small to medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons, and the death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay a loan. Economic downturns, a sustained decline in commodity prices and other events that negatively impact the Company s market areas could cause the Company to incur substantial credit losses that could negatively affect the Company s results of operations and financial condition.

Liquidity risk could impair the Company s ability to fund operations and jeopardize its financial condition.

Liquidity is essential to the Company s business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on its liquidity. The Company s access to funding sources in amounts adequate to finance its activities or on terms which are acceptable to it could be impaired by factors that affect the Company specifically or the financial services industry or economy in general. Factors that could detrimentally impact the Company s access to liquidity sources include a decrease in the level of its business activity as a result of a downturn in the markets in which its loans are concentrated or adverse regulatory action against it. The Company s ability to borrow could also be impaired by factors that are not specific to it, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets.

If the goodwill that the Company recorded in connection with a business acquisition becomes impaired, it could require charges to earnings.

Goodwill represents the amount by which the acquisition cost exceeds the fair value of net assets the Company acquired in the purchase of another financial institution. The Company reviews goodwill for impairment at least annually, or more frequently if events or changes in circumstances indicate the carrying value of the asset might be impaired.

The Company determines impairment by comparing the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. Any such adjustments are reflected in the Company s results of operations in the periods in which they become known. At December 31, 2015, the Company s goodwill totaled $1.87 billion. While the Company has not recorded any such impairment charges since it initially recorded the goodwill, there can be no assurance that the Company s future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on its financial condition and results of operations.

The Company s accounting estimates and risk management processes rely on analytical and forecasting models and tools.

The processes the Company uses to estimate its probable credit 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 the Company s financial condition and results of operations, depend upon the use of analytical and forecasting models and tools. These models and tools reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are accurate, the models and tools may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. Any such failure in the Company s analytical or forecasting models and tools could have a material adverse effect on the Company s business, financial condition and results of operations.

The Company may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks and other institutional clients. Many of these transactions expose the Company to credit risk in the event of a default by a counterparty or client. In addition, the Company s credit risk may be exacerbated when the collateral held by the Company cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Company. Any such losses could have a material adverse effect on the Company s financial condition, results of operations and cash flows.

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The Company may need to raise additional capital in the future and such capital may not be available when needed or at all.

The Company may need to raise additional capital in the future to provide it with sufficient capital resources and liquidity to meet regulatory capital requirements or its commitments and business needs. In addition, the Company may elect to raise additional capital to support its business or to finance acquisitions, if any. If needed, the Company s ability to raise additional capital will depend on many things, including conditions in the capital markets at that time, which are outside of its control, and its financial performance.

The Company cannot assure you that such capital will be available to it on acceptable terms or at all. Any occurrence that may limit its access to the capital markets, such as a decline in the confidence of investors, depositors of Prosperity Bank or counterparties participating in the capital markets, may adversely affect the Company s capital costs and its ability to raise capital and, in turn, its liquidity. Moreover, if the Company needs to raise capital in the future, it may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on the Company s business, financial condition and results of operations.

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

From time to time, the Company may implement or may acquire new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, the Company 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 the Company s 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 the Company s business, financial condition and results of operations.

An interruption in or breach in security of the Company s information systems may result in a loss of customer business and have an adverse effect on the Company s results of operations, financial condition and cash flows.

The Company relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems, whether caused by physical damage, hackers, viruses or other malware, could jeopardize the security of information stored in and transmitted through the Company s computer systems and network infrastructure as well as result in failures or disruptions in the Company s customer relationship management, general ledger, deposits, servicing or loan origination systems. While the Company maintains specific cyber insurance coverage, which would apply in the event of various breach scenarios, the amount of coverage may not be adequate in any particular case. In addition, cyber threat scenarios are inherently difficult to predict and can take many forms, some of which may not be covered under the Company s cyber insurance coverage. Although the Company, with the help of third-party service providers, has and intends to continue to implement security technology and operational procedures to prevent such damage, there can be no assurance that these security measures will entirely mitigate these risks. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms the Company and its third- party service providers use to protect client transaction data. The occurrence of any such failures, interruptions or security breaches could damage the Company s reputation, result in a loss of customer business, subject the

Company to additional regulatory

scrutiny or expose the Company to civil litigation and possible financial liability, any of which could have a material adverse effect on the Company s results of operations, financial condition and cash flows.

The Company is subject to certain risks in connection with its use of technology.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The Company s future success depends in part upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience as well as create additional efficiencies in its operations. Many of the Company s competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers, which may negatively affect the Company s results of operations, financial condition and cash flows. Further, as technology advances, the ability to initiate transactions and access data has become more widely distributed among mobile devices, personal computers, automated teller machines, remote deposit capture sites and similar access points. These technological advances increase cybersecurity risk. While the Company maintains programs intended to prevent or limit the effects of cybersecurity risk, there is no assurance that unauthorized transactions or unauthorized access to customer information will not occur. The financial, reputational and regulatory impact of unauthorized transactions or unauthorized access to customer information could be significant.

The Company s operations rely on external vendors.

The Company relies on certain external vendors to provide products and services necessary to maintain day-to-day operations of the Company. These third parties provide key components of the Company s business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, Internet connections and network access. While the Company has selected these third-party vendors carefully, it does not control their actions. Any complications caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect the Company s ability to deliver products and services to its customers and otherwise conduct its business. Financial or operational difficulties of a third-party vendor could also hurt the Company s operations if those difficulties interfere with the vendor s ability to provide services. Furthermore, the Company s vendors could also be sources of operational and information security risk, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third-party vendors could also create significant delay and expense. Problems caused by external vendors could be disruptive to the Company s operations, which could have a material adverse impact on the Company s business and, in turn, the Company s financial condition and results of operations.

The Company s business may be adversely affected by security breaches at third parties.

The Company s customers interact with their own and other third party systems, which pose operational risks to the Company. The Company may be adversely affected by data breaches at retailers and other third parties who maintain data relating to the Company s customers that involve the theft of customer data, including the theft of customers debit card, credit card, wire transfer and other identifying and/or access information used to make purchases or payments at such retailers and to other third parties. Despite third-party security risks that are beyond the Company s control, the Company offers its customers protection against fraud and attendant losses for unauthorized use of debit and credit cards in order to stay competitive in the marketplace. Offering such protection to customers exposes the Company to significant expenses and potential losses related to reimbursing the Company s customers for fraud losses, reissuing the compromised cards and increased monitoring for suspicious activity. In the event of a data breach at one or more retailers of considerable magnitude, the Company s business, financial condition and results of operations may be adversely affected.

The Company is subject to claims and litigation pertaining to intellectual property.

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

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

The Company is subject to claims and litigation pertaining to fiduciary responsibility.

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

The Company operates in a highly regulated environment and, as a result, is subject to extensive regulation and supervision.

The Company and the Bank are 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 the Company s shareholders. These regulations affect the Company s lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Any change in applicable regulations or federal or state legislation could have a substantial impact on the Company, the Bank and their respective operations.

The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes in light of the performance of and government intervention in the financial services sector during the several years prior to the implementation of such Act. Additional legislation and regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could significantly affect the Company s powers, authority and operations, or the powers, authority and operations of the Bank in substantial and unpredictable ways. Further, regulators have significant discretion and power to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of this regulatory discretion and power could have a negative impact on the Company. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company s business, financial condition and results of operations.

The Company s risk management framework may not be effective in identifying, managing or mitigating risks and/or losses to it.

The Company has implemented a risk management framework to identify and manage its risk exposure, which is reviewed and overseen by the Company s Risk Committee. This framework is comprised of various processes, systems and strategies, and is designed to manage the types of risk to which the Company is subject, including, among others, credit, market, liquidity, operational, financial, interest rate, legal and regulatory, compliance, strategic, reputation, fiduciary and general economic risks. The Company s framework also includes financial or other modeling methodologies, which involves management assumptions and judgment. In addition, under this framework, the Company has developed a risk appetite statement to detail its risk tolerance levels at an enterprise-wide level. There is no assurance that this risk management framework will be effective under all circumstances or that it will adequately identify, manage or mitigate any risk or loss to the Company. If this framework is not effective, the Company may be subject to potentially adverse regulatory consequences and could suffer unexpected losses and its financial condition or results of operations could be materially adversely affected.

The Company is subject to losses resulting from fraudulent and negligent acts on the part of loan applicants, correspondents or other third parties.

The Company relies heavily upon information supplied by third parties, including the information contained in credit applications, property appraisals, title information, equipment pricing and valuation and employment and income documentation, in deciding which loans the Company will originate, as well as the terms of those loans. If any of the information upon which the Company relies is misrepresented, either fraudulently or inadvertently, and the misrepresentation is not detected prior to asset funding, the value of the asset may be significantly lower than expected, or the Company may fund a loan that it would not have funded or on terms it would not have extended. Whether a misrepresentation is made by the applicant or another third party, the Company generally bears the risk of loss associated with the misrepresentation. A loan subject to a material misrepresentation is typically unsellable or subject to repurchase if it is sold prior to detection of the misrepresentation. The sources of the misrepresentations are often difficult to locate, and it is often difficult to recover any of the monetary losses the Company may suffer.

The Company is subject to environmental liability risk associated with lending activities.

A significant portion of the Company s loan portfolio is secured by real property. During the ordinary course of business, the Company may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Company may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Company to incur substantial expenses and may materially reduce the affected property s value or limit the Company s 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 the Company s exposure to environmental liability. Although the Company has policies and procedures to perform an environmental review before initiating any foreclosure action on 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 the Company s financial condition and results of operations.

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Risks Associated with the Company s Common Stock

The Company s corporate organizational documents and the provisions of Texas law to which it is subject may delay or prevent a change in control of the Company that a shareholder may favor.

The Company s amended and restated articles of incorporation and amended and restated bylaws contain various provisions which may delay, discourage or prevent an attempted acquisition or change of control of the Company. These provisions include:

- a board of directors classified into three classes of directors with the directors of each class having staggered three-year terms;
- a provision that any special meeting of the Company s shareholders may be called only by the chairman of the board and chief executive officer, the president, a majority of the board of directors or the holders of at least 50% of the Company s shares entitled to vote at the meeting;
- a provision establishing certain advance notice procedures for nomination of candidates for election as directors and for shareholder proposals to be considered at an annual or special meeting of shareholders; and
- a provision that denies shareholders the right to amend the Company s bylaws.

The Company s articles of incorporation provide for noncumulative voting for directors and authorize the board of directors to issue shares of its preferred stock without shareholder approval and upon such terms as the board of directors may determine. The issuance of the Company s preferred stock could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, a controlling interest in the Company. In addition, certain provisions of Texas law, including a provision which restricts certain business combinations between a Texas corporation and certain affiliated shareholders, may delay, discourage or prevent an attempted acquisition or change in control of the Company.

There are restrictions on the Company s ability to pay dividends.

Holders of the Company s common stock are only entitled to receive such dividends as the Company s Board of Directors may declare out of funds legally available for such payments. Although the Company has historically declared cash dividends on its common stock, it is not required to do so and there can be no assurance that the Company will pay dividends in the future. Any declaration and payment of dividends on common stock will depend upon the Company s earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, the Company s ability to service any equity or debt obligations senior to the common stock and other factors deemed relevant by the Board of Directors.

The Company s principal source of funds to pay dividends on the shares of common stock is cash dividends that the Company receives from the Bank. Various banking laws applicable to the Bank limit the payment of dividends and other distributions by the Bank to the Company, and may therefore limit the Company s ability to pay dividends on its common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

As of December 31, 2015, the Company conducted business at 241 full-service banking centers. The Company s principal executive office is located at Prosperity Bank Plaza, 4295 San Felipe, in the Galleria area in Houston, Texas. The Company also owns or leases other facilities in which its banking centers are located as listed below by geographical market area. The expiration dates of the leases range from 2016 to 2040 and do not include renewal periods which may be available at the Company s option.

The following table sets forth specific information regarding the banking centers located in each of the Company s geographical market areas at December 31, 2015:

Geographical Area	Number of Banking Centers	Number of Leased Banking Centers	Deposits at December 31, 2015 (dollars in thousands)
Bryan/College Station area	16		$ 1,173,244
Houston area	60	14	5,395,660
Central Texas area	29	3	1,388,386
Dallas/Fort Worth area	36	9	1,529,009
East Texas area	22		751,776
West Texas area	34	6	2,417,680
South Texas area	30	3	2,638,089
Central Oklahoma area	6	1	758,227
Tulsa Oklahoma area	8	2	1,629,048
	241	**38**	**$ 17,681,119**

ITEM 3. LEGAL PROCEEDINGS

The Company and the Bank are defendants, from time to time, in legal actions arising from transactions conducted in the ordinary course of business. The Company and the Bank believe, after consultations with legal counsel, that the ultimate liability, if any, arising from such actions will not have a material adverse effect on their financial statements.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II.

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

Common Stock Market Prices

The Company s common stock is listed on the New York Stock Exchange under the symbol PB. As of February 25, 2016, there were 69,873,802 shares outstanding and 3,538 shareholders of record. The number of beneficial owners is unknown to the Company at this time.

The following table presents the high and low intra-day sales prices for the common stock as reported by the New York Stock Exchange:

2015	**High**	**Low**
Fourth Quarter	$ 57.04	$ 46.23
Third Quarter	59.97	43.76
Second Quarter	59.30	50.91
First Quarter	55.88	45.01
2014	**High**	**Low**
Fourth Quarter	$ 61.15	$ 52.62
Third Quarter	63.73	55.99
Second Quarter	67.49	56.04
First Quarter	67.68	59.75

Dividends

Holders of common stock are entitled to receive dividends when, as and if declared by the Company s Board of Directors out of funds legally available therefor. While the Company has declared dividends on its common stock since 1994, and paid quarterly dividends aggregating $1.1175 per share for 2015 and $0.9925 per share for 2014, there is no assurance that the Company will continue to pay dividends in the future. Future dividends on the common stock will depend upon the Company s earnings and financial condition, liquidity and capital requirements, the general economic and regulatory climate, the Company s ability to service any equity or debt obligations senior to the common stock and other factors deemed relevant by the Board of Directors of the Company.

As a holding company, the Company is ultimately dependent upon its subsidiaries to provide funding for its operating expenses, debt service and dividends. Various banking laws applicable to the Bank limit the payment of dividends and other distributions by the Bank to the Company, and may therefore limit the Company s ability to pay dividends on its common stock. Regulatory authorities could impose administratively stricter limitations on the ability of the Bank to pay dividends to the Company if such limits were deemed appropriate to preserve certain capital adequacy requirements.

In addition, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy in relation to the organization s overall asset quality, level of current and prospective earnings and level, composition and quality of capital. The guidance provides that the Company should inform and consult with the

Federal Reserve Board prior to declaring and paying a dividend that exceeds earnings for the period for which the dividend is being paid or that could result in an adverse change to the Company s capital structure.

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The cash dividends declared per share by quarter (and paid on the first business day of the subsequent quarter) for the Company s last two fiscal years were as follows:

	2015	2014
Fourth Quarter	$ 0.3000	$ 0.2725
Third Quarter	0.2725	0.2400
Second Quarter	0.2725	0.2400
First Quarter	0.2725	0.2400

Recent Sales of Unregistered Securities

None.

Securities Authorized for Issuance under Equity Compensation Plans

As of December 31, 2015, the Company had outstanding stock options granted under its 2004 stock award plan and restricted stock issued under its 2004 and 2012 stock award plans, all of which were approved by the Company s shareholders. The following table provides information as of December 31, 2015 regarding the Company s equity compensation plans under which the Company s equity securities are authorized for issuance:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	28,800	$ 32.07	948,249 (1)
Equity compensation plans not approved by security holders			
	28,800	$ 32.07	948,249

(1) All of these awards are available under the Company s 2012 Stock Incentive Plan. The Company s other stock award plans have expired, and no new awards may be issued thereunder.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

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Performance Graph

The following Performance Graph compares the cumulative total shareholder return on the Company s common stock for the period beginning at the close of trading on December 31, 2010 to December 31, 2015, with the cumulative total return of the S&P 500 Total Return Index and the Nasdaq Bank Index for the same period. Dividend reinvestment has been assumed. The Performance Graph assumes $100 invested on December 31, 2010 in the Company s common stock, the S&P 500 Total Return Index and the Nasdaq Bank Index. The historical stock price performance for the Company s common stock shown on the graph below is not necessarily indicative of future stock performance.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Prosperity Bancshares, Inc., the S&P 500 Index, and the NASDAQ Bank Index

*$100 invested on 12/31/10 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

	12/10	12/11	12/12	12/13	12/14	12/15
Prosperity Bancshares, Inc.	$ 100.00	$ 104.64	$ 110.95	$ 170.22	$ 151.14	$ 133.47
S&P 500	100.00	102.11	118.45	156.82	178.29	180.75
NASDAQ Bank	100.00	90.68	104.29	147.41	153.18	166.77

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of the Company for, and as of the end of, each of the years in the five-year period ended December 31, 2015, is derived from and should be read in conjunction with the Company s consolidated financial statements and the notes thereto appearing elsewhere in this Annual Report on Form 10-K.

	As of and for the Years Ended December 31,				
	2015	2014 (1)	2013 (1)	2012 (1)	2011
	(In thousands, except per share data)				
Income Statement Data:					
Interest income	$ 669,701	$ 714,795	$ 539,297	$ 419,842	$ 371,908
Interest expense	39,191	43,641	40,471	39,136	45,240
Net interest income	630,510	671,154	498,826	380,706	326,668
Provision for credit losses	7,560	18,275	17,240	6,100	5,200
Net interest income after provision for credit losses	622,950	652,879	481,586	374,606	321,468
Noninterest income	120,781	120,832	95,427	75,535	56,043
Noninterest expense	313,536	327,962	247,196	198,457	163,745
Income before taxes	430,195	445,749	329,817	251,684	213,766
Provision for income taxes	143,549	148,308	108,419	83,783	72,017
Net income	$ 286,646	$ 297,441	$ 221,398	$ 167,901	$ 141,749
Per Share Data:					
Basic earnings per share	$ 4.09	$ 4.32	$ 3.66	$ 3.24	$ 3.03
Diluted earnings per share	4.09	4.32	3.65	3.23	3.01
Book value per share	49.45	46.50	42.19	37.02	33.41
Cash dividends declared per share	1.1175	0.9925	0.8850	0.8000	0.7200
Dividend payout ratio	27.30%	22.99%	24.41%	24.74%	23.80%
Weighted average shares outstanding (basic)	70,033	68,855	60,421	51,794	46,846
Weighted average shares outstanding (diluted)	70,049	68,911	60,578	51,941	47,017
Shares outstanding at end of period	70,022	69,780	66,048	56,447	46,910
Balance Sheet Data (at period end):					
Total assets	$ 22,037,216	$ 21,507,733	$ 18,642,028	$ 14,583,573	$ 9,822,671
Securities	9,502,427	9,045,776	8,224,448	7,442,065	4,658,936
Loans	9,438,589	9,244,183	7,775,221	5,179,940	3,765,906
Allowance for credit losses	81,384	80,762	67,282	52,564	51,594
	1,918,244	1,933,138	1,713,569	1,243,321	945,533

Total goodwill and intangibles						
Other real estate owned	2,963		3,237	7,299	7,234	8,328
Total deposits	17,681,119		17,693,158	15,291,271	11,641,844	8,060,254
Federal funds purchased and other borrowings	491,399		8,724	10,689	256,753	12,790
Junior subordinated debentures		(2)	167,531	124,231	85,055	85,055
Total shareholders equity	3,462,910		3,244,826	2,786,818	2,089,389	1,567,265

(Table continued on the next page)

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	As of and for the Years Ended December 31,				
	2015	2014 (1)	2013 (1)	2012 (1)	2011
	(In thousands, except per share data)				
Average Balance Sheet Data:					
Total assets	$ 21,618,604	$ 20,596,929	$ 16,255,914	$ 12,432,666	$ 9,628,884
Securities	9,541,443	8,723,011	7,932,782	6,364,917	4,625,833
Loans	9,200,765	8,988,069	6,202,897	4,514,171	3,648,701
Allowance for credit losses	80,894	72,714	57,001	51,770	51,871
Total goodwill and intangibles	1,934,099	1,853,350	1,395,323	1,078,804	949,273
Total deposits	17,157,864	16,690,344	12,764,302	9,748,843	7,751,196
Junior subordinated debentures	29,443	154,902	91,584	85,055	86,557
Total shareholders equity	3,368,788	3,080,324	2,378,234	1,844,334	1,513,749
Performance Ratios:					
Return on average assets	1.33%	1.44%	1.36%	1.35%	1.47%
Return on average common equity	8.51%	9.66%	9.31%	9.10%	9.36%
Net interest margin (tax equivalent)	3.38%	3.80%	3.58%	3.53%	3.98%
Efficiency ratio (3)	41.87%	41.81%	41.60%	43.48%	42.76%
Asset Quality Ratios (4):					
Nonperforming assets to total loans and other real estate	0.46%	0.40%	0.29%	0.25%	0.32%
Net charge-offs to average loans	0.08%	0.05%	0.04%	0.11%	0.14%
Allowance for credit losses to total loans	0.86%	0.87%	0.87%	1.01%	1.37%
Allowance for credit losses to nonperforming loans (5)	201.8%	240.3%	443.3%	920.1%	1442.0%
Capital Ratios (4):					
Leverage ratio	7.97% (7)	7.69%	7.42%	7.10%	7.89%
Average shareholders equity to average total assets	15.58%	14.96%	14.63%	14.83%	15.72%
CET1 capital ratio (6)	13.55% (7)	N/A	N/A	N/A	N/A
Tier 1 risk-based capital ratio	13.55% (7)	13.80%	13.27%	14.40%	15.90%
Total risk-based capital ratio	14.25% (7)	14.56%	14.02%	15.22%	17.09%

(1) The Company completed the acquisition of F&M Bancorporation Inc. on April 1, 2014. The Company completed three acquisitions during the twelve month period ended December 31, 2013 and four acquisitions during the

twelve month period ended December 31, 2012.

(2) The Company redeemed all outstanding junior subordinated debentures during the first quarter of 2015.

(3) Calculated by dividing total noninterest expense, excluding credit loss provisions, by net interest income plus noninterest income, excluding net gains and losses on the sale of securities and assets. Additionally, taxes are not part of this calculation.

(4) At period end, except for net charge-offs to average loans and average shareholders equity to average total assets, which is for periods ended at such dates.

(5) Nonperforming loans consist of nonaccrual loans, loans contractually past due 90 days or more and any other loan management deems to be nonperforming.

(6) CET1 capital ratio is required under the Basel III Capital Rules effective January 1, 2015.

(7) Calculated pursuant to the phase-in provisions of the Basel III Capital Rules.

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

Special Cautionary Notice Regarding Forward-Looking Statements

Statements and financial discussion and analysis contained in this Annual Report on Form 10-K that are not statements of historical fact constitute forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on assumptions and involve a number of risks and uncertainties, many of which are beyond the Company s control. Many possible events or factors could affect the future financial results and performance of the Company and could cause such results or performance to differ materially from those expressed in the forward-looking statements. These possible events or factors include, but are not limited to:

changes in the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations resulting in, among other things, a deterioration in credit quality or reduced demand for credit, including the result and effect on the Company s loan portfolio and allowance for credit losses;

changes in interest rates and market prices, which could reduce the Company s net interest margins, asset valuations and expense expectations;

changes in the levels of loan prepayments and the resulting effects on the value of the Company s loan portfolio;

changes in local economic and business conditions, including commodity prices, which adversely affect the Company s customers and their ability to transact profitable business with the company, including the ability of the Company s borrowers to repay their loans according to their terms or a change in the value of the related collateral;

increased competition for deposits and loans adversely affecting rates and terms;

the timing, impact and other uncertainties of any future acquisitions, including the Company s ability to identify suitable future acquisition candidates, the success or failure in the integration of their operations, and the ability to enter new markets successfully and capitalize on growth opportunities;

the possible impairment of goodwill associated with an acquisition and possible adverse short-term effects on the results of operations;

increased credit risk in the Company s assets and increased operating risk caused by a material change in commercial, consumer and/or real estate loans as a percentage of the total loan portfolio;

the concentration of the Company s loan portfolio in loans collateralized by real estate;

the failure of assumptions underlying the establishment of and provisions made to the allowance for credit losses;

changes in the availability of funds resulting in increased costs or reduced liquidity;

a deterioration or downgrade in the credit quality and credit agency ratings of the securities in the Company s securities portfolio;

increased asset levels and changes in the composition of assets and the resulting impact on the Company s capital levels and regulatory capital ratios;

the Company s ability to acquire, operate and maintain cost effective and efficient systems without incurring unexpectedly difficult or expensive but necessary technological changes;

the loss of senior management or operating personnel and the potential inability to hire qualified personnel at reasonable compensation levels;

government intervention in the U.S. financial system;

- changes in statutes and government regulations or their interpretations applicable to financial holding companies and the Company s present and future banking and other subsidiaries, including changes in tax requirements and tax rates;

- poor performance by external vendors;

- the failure of analytical and forecasting models and tools used by the Company to estimate probable credit losses and to measure the fair value of financial instruments;

- additional risks from new lines of businesses or new products and services;

- claims or litigation related to intellectual property or fiduciary responsibilities;

- the failure of the Company s enterprise risk management framework to identify or address risks adequately;

- a failure in or breach of operational or security systems of the Company s infrastructure, or those of its third-party vendors and other service providers, including as a result of cyber attacks;

- potential risk of environmental liability associated with lending activities;

- acts of terrorism, an outbreak of hostilities or other international or domestic calamities, weather or other acts of God and other matters beyond the Company s control; and

- other risks and uncertainties described in this Annual Report on Form 10-K or in the Company s other reports and documents filed with the Securities and Exchange Commission.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. The Company believes it has chosen these assumptions or bases in good faith and that they are reasonable. However, the Company cautions you that assumptions or bases almost always vary from actual results, and the differences between assumptions or bases and actual results can be material. Therefore, the Company cautions you not to place undue reliance on its forward-looking statements. The forward-looking statements speak only as of the date the statements are made. The Company undertakes no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management s Discussion and Analysis of Financial Condition and Results of Operations analyzes the major elements of the Company s balance sheets and statements of income. This section should be read in conjunction with the Company s consolidated financial statements and accompanying notes and other detailed information appearing elsewhere in this Annual Report on Form 10-K.

Overview

The Company generates the majority of its revenues from interest income on loans, service charges on customer accounts and income from investment in securities. In 2015, the Company continued to benefit from additional products and services that were added in 2012 and 2013, including trust services, brokerage, mortgage lending, credit card and independent sales organization sponsorship operations. The revenues are partially offset by interest expense paid on deposits and other borrowings and noninterest expenses such as administrative and occupancy expenses. Net interest income is the difference between interest income on earning assets such as loans and securities and interest expense on liabilities such as deposits and borrowings which are used to fund those assets. Net interest income is the Company s largest source of revenue. The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net interest income and margin.

Three principal components of the Company s growth strategy are internal growth, stringent cost control practices and acquisitions, including strategic merger transactions. The Company focuses on continual internal growth. Each banking center is operated as a separate profit center, maintaining separate data with respect to its net interest income, efficiency ratio, deposit growth, loan growth and overall profitability. Banking center presidents and managers are accountable for performance in these areas and compensated accordingly. The Company also focuses on maintaining stringent cost control practices and policies. The Company has centralized many of its critical operations, such as data processing and loan processing. Management believes that this centralized infrastructure can accommodate substantial additional growth while enabling the Company to minimize operational costs through certain economies of scale. The Company also intends to continue to seek expansion opportunities. During 2014, the Company completed the acquisition of F&M Bancorporation Inc. This acquisition added 11 banking centers after consolidation. During 2013, the Company completed three acquisitions, acquiring East Texas Financial Services Inc., Coppermark Bancshares, Inc. and FVNB Corp. Combined, these acquisitions added 30 banking centers after consolidation with nearby Prosperity Bank banking centers.

Net income was $286.6 million, $297.4 million and $221.4 million for the years ended December 31, 2015, 2014 and 2013, respectively, and diluted earnings per share were $4.09, $4.32 and $3.65, respectively, for these same periods. The change in net income during 2015 was principally due to a decrease in net interest income resulting from lower purchase accounting loan discount accretion. The change in net income during 2014 was principally due to an increase in net interest income resulting from balance sheet growth from acquisitions. The Company posted returns on average assets of 1.33%, 1.44% and 1.36% and returns on average common equity of 8.51%, 9.66% and 9.31% for the years ended December 31, 2015, 2014 and 2013, respectively. The Company s efficiency ratio was 41.87% in 2015, 41.81% in 2014 and 41.60% in 2013. The efficiency ratio is calculated by dividing total noninterest expense (excluding credit loss provisions) by net interest income plus noninterest income (excluding net gains and losses on the sale of securities and assets). Additionally, taxes are not part of this calculation.

Total assets at December 31, 2015 and 2014 were $22.04 billion and $21.51 billion, respectively. Total deposits at December 31, 2015 and 2014 were $17.68 billion and $17.69 billion, respectively. Total loans were $9.44 billion at December 31, 2015, an increase of $194 million or 2.1% compared with $9.24 billion at December 31, 2014. At December 31, 2015, the Company had $40.3 million in nonperforming loans and its allowance for credit losses was $81.4 million compared with $33.6 million in nonperforming loans and an allowance for credit losses of $80.8 million at December 31, 2014. Shareholders equity was $3.46 billion and $3.24 billion at December 31, 2015 and 2014, respectively.

Recent Developments

Acquisition of Tradition Bancshares, Inc. On January 1, 2016, the Company completed the acquisition of Tradition Bancshares, Inc. (Tradition) and its wholly-owned subsidiary Tradition Bank headquartered in Houston, Texas. Tradition Bank operated 7 banking offices in the Houston, Texas area, including its main office in Bellaire, 3 banking centers in Katy and 1 banking center in The Woodlands.

As of December 31, 2015, Tradition, on a consolidated basis, reported total assets of $548.0 million, total loans of $253.3 million, total deposits of $488.9 million and shareholders equity of $43.1 million. Under the terms of the definitive agreement, the Company issued 679,528 shares of Company common stock plus $39.0 million in cash for all outstanding shares of Tradition capital stock, for a total merger consideration of $71.5 million, based on the Company s closing stock price of $47.86. On the effective date, the Company recognized preliminary goodwill of $27.5 million, which is calculated as the excess of both the consideration exchanged and liabilities assumed compared with the fair value of the assets acquired. The Company is currently in the process of obtaining fair values for certain acquired assets and assumed liabilities and, therefore, the estimates are preliminary.

On January 1, 2016, in connection with the acquisition of Tradition, the Company assumed $7.2 million in junior subordinated debentures. The Company has given irrevocable notice of its intent to redeem the outstanding debentures on April 7, 2016 and has advised the Federal Reserve Board of its redemption intent and timing. The

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Federal Reserve Board had no objections to the redemption. The Company will fund the redemption of the trust preferred securities through a dividend from the Bank.

Critical Accounting Policies

The Company s significant accounting policies are integral to understanding the results reported. The Company s accounting policies are described in detail in Note 1 to the consolidated financial statements, appearing elsewhere is this Annual Report on Form 10-K. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity:

Allowance for Credit Losses The allowance for credit losses is established through charges to earnings in the form of a provision for credit losses. The Company s allowance for credit losses consists of two elements: (1) specific valuation allowances based on probable losses on impaired loans; and (2) a general valuation allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company. The allowance for acquired credit losses is calculated as described under the heading Accounting for Acquired Loans and the Allowance for Acquired Credit Losses below. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company s loan portfolio. Based on an evaluation of the portfolio, management presents a quarterly review of the allowance for credit losses to the Bank s Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In making its evaluation, management considers factors such as historical loan loss experience, the amount of nonperforming assets and related collateral, the volume, growth and composition of the portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the portfolio through its internal loan review process and other relevant factors. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management s judgment, should be charged off. Charge-offs occur when loans are deemed to be uncollectible. For further discussion of the methodology used in the determination of the allowance for credit losses, see Financial Condition Allowance for Credit Losses below and Note 1 to the consolidated financial statements.

Accounting for Acquired Loans and the Allowance for Acquired Credit Losses The Company accounts for its acquisitions using the acquisition method of accounting. Accordingly, the assets, including loans, and liabilities of the acquired entity were recorded at their fair values at the acquisition date. No allowance for credit losses related to the acquired loans is recorded on the acquisition date, as the fair value of the acquired loans incorporates assumptions regarding credit risk. These fair value estimates associated with acquired loans, and based on a discounted cash flow model, include estimates related to market interest rates and undiscounted projections of future cash flows that incorporate expectations of prepayments and the amount and timing of principal, interest and other cash flows, as well as any shortfalls thereof.

At period-end after acquisition, the fair-valued acquired loans from each acquisition are reassessed to determine whether an addition to the allowance for credit losses is appropriate due to further credit quality deterioration. For further discussion of the methodology used in the determination of the allowance for credit losses for acquired loans, see Financial Condition Allowance for Credit Losses below.

For further discussion of the Company s acquisition and loan accounting, see Note 1 to the consolidated financial statements.

Goodwill and Intangible Assets Goodwill and intangible assets that have indefinite useful lives are subject to an impairment test at least annually, or more often, if events or circumstances indicate that it is more likely than not that the fair value of the Company s reporting unit is below the carrying value of its equity. Under Accounting Standards

Codification (ASC) topic 350-20, Intangibles Goodwill and Other Goodwill, companies have the option to first assess qualitative factors to determine whether it is more likely than not that

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the fair value of a reporting unit is less than its carrying amount as a basis for determining the need to perform step one of the annual test for goodwill impairment. An entity has an unconditional option to bypass the qualitative assessment described in the preceding paragraph for any reporting unit in any period and proceed directly to performing the first step of the goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

If the Company bypasses the qualitative assessment, a two-step goodwill impairment test is performed. The two-step process begins with an estimation of the fair value of the Company s reporting unit compared with its carrying value. If the carrying amount exceeds the fair value of the reporting unit, a second test is completed comparing the implied fair value of the reporting unit s goodwill to its carrying value to measure the amount of impairment.

Estimating the fair value of the Company s reporting unit is a subjective process involving the use of estimates and judgments, particularly related to future cash flows of the reporting unit, discount rates (including market risk premiums) and market multiples. Material assumptions used in the valuation tools include the comparable public company price multiples used in the terminal value, future cash flows and the market risk premium component of the discount rate. The estimated fair values of the reporting unit is determined using a blend of two commonly used valuation techniques: the market approach and the income approach. The Company gives consideration to both valuation techniques, as either technique can be an indicator of value. For the market approach, valuations of the reporting unit were based on an analysis of relevant price multiples in market trades in companies with similar characteristics. For the income approach, estimated future cash flows (derived from internal forecasts and economic expectations) and terminal value (value at the end of the cash flow period, based on price multiples) were discounted. The discount rate was based on the imputed cost of equity capital.

The Company had no intangible assets with indefinite useful lives at December 31, 2015. Other identifiable intangible assets that are subject to amortization are being amortized on a non-pro rata basis over the years expected to be benefited, which the Company believes is between ten and fifteen years. These amortizable intangible assets are reviewed for impairment if circumstances indicate their value may not be recoverable based on a comparison of fair value to carrying value. Based on the Company s annual goodwill impairment test as of September 30, 2015, management does not believe any of its goodwill is impaired as of December 31, 2015, because the fair value of the Company s equity exceeded its carrying value. While the Company believes no impairment existed at December 31, 2015, under accounting standards applicable at that date, different conditions or assumptions, or changes in cash flows or profitability, if significantly negative or unfavorable, could have a material adverse effect on the outcome of the Company s impairment evaluation and financial condition or future results of operations.

Stock-Based Compensation The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting. The Company s results of operations reflect compensation expense for all employee stock-based compensation. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions including stock price volatility and employee turnover that are utilized to measure compensation expense.

Other-Than-Temporarily Impaired Securities When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair market value is below amortized cost, additional analysis is performed to determine whether an impairment exists. Available for sale and held to maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company s results of operations and financial condition.

Fair Values of Financial Instruments. The Company determines the fair market values of financial instruments based on the fair value hierarchy established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value. Level 1 inputs include quoted market prices, where available. If such quoted market prices are not available, Level 2 inputs are used. These inputs are based upon internally developed analytical tools that primarily use observable market-based parameters. Level 3 inputs are unobservable inputs which are typically based on an entity s own assumptions, as there is little, if any, related market activity. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Results of Operations

Net Interest Income

The Company s operating results depend primarily on its net interest income, which is the difference between interest income on interest-earning assets, including securities and loans, and interest expense incurred on interest-bearing liabilities, including deposits and other borrowed funds. Interest rate fluctuations, as well as changes in the amount and type of earning assets and liabilities, combine to affect net interest income. The Company s net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as a volume change. It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds, referred to as a rate change.

2015 versus 2014. Net interest income before the provision for credit losses for 2015 was $630.5 million compared with $671.2 million for 2014, a decrease of $40.6 million or 6.1%. The decrease in net interest income was primarily due to a decrease in purchase accounting loan discount accretion of $43.8 million for the year ended December 31, 2015, partially offset by a decrease in interest expense of $4.5 million. The decrease in interest expense was due to the redemption of all junior subordinated debentures during the first quarter of 2015 and a decrease in the average balance for certificates and other time deposits. Interest income was $669.7 million in 2015, a decrease of $45.1 million or 6.3% compared with 2014. Interest income on loans was $475.4 million for 2015, a decrease of $50.3 million or 9.6% compared with 2014. This was primarily due to a decrease in purchase accounting loan discount accretion of $43.8 million from $95.9 million for the year ended December 31, 2014 to $52.1 million for the year ended December 31, 2015 and a 68-basis-point decrease in the average yield earned on loans, partially offset by an increase in average loans outstanding of $212.7 million. The Company had $94.7 million of total outstanding discounts on purchased loans, of which $60.4 million was accretable at December 31, 2015. Interest income on securities was $194.0 million during 2015, an increase of $5.3 million or 2.8% compared with 2014 due primarily to an increase in average securities of $818.4 million, partially offset by a 13-basis-point decrease in the average yield earned on securities. Average interest-bearing liabilities increased $453.0 million or 3.6% for 2015 compared with 2014 and the average rate paid decreased from 0.34% to 0.30% for the same time period, resulting in an overall decrease in interest expense of $4.5 million. During 2015, average noninterest-bearing deposits increased $336.7 million or 7.2% from $4.69 billion during 2014 to $5.02 billion during 2015. This increase in noninterest-bearing funds contributed to a decrease in total cost of funds to 0.22% during 2015 from 0.25% during 2014.

Net interest margin, defined as net interest income divided by average interest-earning assets, on a tax equivalent basis, was 3.38% for 2015, a decrease of 42 basis points compared with 3.80% for 2014.

2014 versus 2013. Net interest income before the provision for credit losses for 2014 was $671.2 million compared with $498.8 million for 2013, an increase of $172.3 million or 34.5%. The increase in net interest income was primarily due to a $3.67 billion or 25.9% increase in average earning assets during 2014 and a 5 basis point decrease in the average rate paid on interest-bearing liabilities. The increase in average earning assets was due to the full year effect of the acquisition of FVNB Corp. and its wholly owned subsidiary, First Victoria National Bank (collectively, FVNB) completed in November 2013 and the F&M acquisition completed on April 1, 2014. Interest income was $714.8 million in 2014, an increase of $175.5 million or 32.5% compared with 2013. Interest income on loans was $525.7 million for 2014, an increase of $149.6 million or 39.8% compared with 2013 due primarily to a $2.79 billion increase in average loans outstanding. Additionally, during 2014 and 2013, interest income on loans benefited from purchase accounting loan discount accretion of $95.9 million and $62.7 million, respectively, which partially offset the decrease in interest rates on the loan portfolio. The Company had $161.4 million of total outstanding discounts on purchased loans, of which $99.0 million was accretable at December 31, 2014. Interest income on securities was $188.7 million during 2014, an increase of $25.8 million or 15.8% compared with 2013 due primarily to an increase in average securities of $790.2 million. Average interest-bearing liabilities increased $2.24 billion or 21.5% for 2014 compared with 2013 and the average rate paid decreased from 0.39% to 0.34% for the same time period, resulting in an overall increase in interest expense of $3.2 million. During 2014, average noninterest-bearing deposits increased $1.34 billion or 40.1% from $3.35 billion during 2013 to $4.69 billion during 2014. This increase in noninterest-bearing funds contributed to a decrease in total cost of funds to 0.25% during 2014 from 0.29% during 2013.

Net interest margin, on a tax equivalent basis, was 3.80% for 2014, an increase of 22 basis points compared with 3.58% for 2013.

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The following table presents, for the periods indicated, the total dollar amount of average balances, interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. Except as indicated in the footnotes, no tax-equivalent adjustments were made and all average balances are daily average balances. Any nonaccruing loans have been included in the table as loans carrying a zero yield.

	Years Ended December 31,								
	2015			2014			2013		
	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Interest Paid	Average Yield/ Rate
	(Dollars in thousands)								
Assets									
Interest-Earning Assets:									
Loans	$ 9,200,765	$ 475,427	5.17%	$ 8,988,069	$ 525,716	5.85%	$ 6,202,897	$ 376,117	6.06%
Investment securities	9,541,443	194,003	2.03%	8,723,011	188,744	2.16%	7,932,782	162,993	2.05%
Federal funds sold and other earning assets	116,283	271	0.23%	143,754	335	0.23%	50,318	187	0.37%
Total interest-earning assets	18,858,491	$ 669,701	3.55%	17,854,834	$ 714,795	4.00%	14,185,997	$ 539,297	3.80%
Allowance for credit losses	(80,894)			(72,714)			(57,001)		
Noninterest-earning assets	2,841,007			2,814,809			2,126,918		
Total assets	$ 21,618,604			$ 20,596,929			$ 16,255,914		
Liabilities and Shareholders Equity									
Interest-Bearing Liabilities:									
Interest-bearing demand deposits	$ 3,873,495	$ 8,776	0.23%	$ 3,516,987	$ 8,561	0.24%	$ 2,651,320	$ 7,917	0.30%
Savings and money market deposits	5,505,524	13,488	0.24%	5,355,967	13,406	0.25%	4,237,323	11,961	0.28%
Certificates and other time deposits	2,754,466	13,810	0.50%	3,129,710	15,904	0.51%	2,530,065	15,344	0.61%
	623,441	1,508	0.24%	144,570	772	0.53%	470,854	1,497	0.32%

Federal funds purchased and other borrowings									
Securities sold under repurchase agreements	329,745	818	0.25%	361,025	938	0.26%	443,231	1,201	0.27%
Junior subordinated debentures	29,443	791	2.69%	154,902	4,060	2.62%	91,584	2,551	2.79%
Total interest-bearing liabilities	13,116,114	39,191	0.30%	12,663,161	43,641	0.34%	10,424,377	40,471	0.39%
Noninterest-Bearing Liabilities:									
Noninterest-bearing demand deposits	5,024,379			4,687,680			3,345,594		
Other liabilities	109,323			165,764			107,709		
Total liabilities	18,249,816			17,516,605			13,877,680		
Shareholders equity	3,368,788			3,080,324			2,378,234		
Total liabilities and shareholders equity	$ 21,618,604			$ 20,596,929			$ 16,255,914		
Net interest rate spread			3.25%			3.66%			3.41%
Net interest income and margin (1)		$ 630,510	3.34%		$ 671,154	3.76%		$ 498,826	3.52%
Net interest income and margin (tax equivalent) (2)		$ 636,612	3.38%		$ 679,122	3.80%		$ 507,194	3.58%

(1) The net interest margin is equal to net interest income divided by average interest-earning assets.

(2) In order to make pretax income and resultant yields on tax-exempt investments and loans comparable to those on taxable investments and loans, a tax equivalent adjustment has been computed using a federal income tax rate of 35% for the years ended December 31, 2015, 2014 and 2013 and other applicable effective tax rates.

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The following table presents information regarding the dollar amount of changes in interest income and interest expense for the periods indicated for each major component of interest-earning assets and interest-bearing liabilities and distinguishes between the changes attributable to changes in volume and changes in interest rates. For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated to rate.

	Years Ended December 31,					
	2015 vs. 2014			2014 vs. 2013		
	Increase (Decrease) Due to Change in			Increase (Decrease) Due to Change in		
	Volume	Rate	Total	Volume	Rate	Total
	(Dollars in thousands)					
Interest-Earning assets:						
Loans	$ 12,441	$ (62,730)	$ (50,289)	$ 168,881	$ (19,282)	$ 149,599
Securities	17,709	(12,450)	5,259	16,237	9,514	25,751
Federal funds sold and other temporary investments	(64)		(64)	348	(200)	148
Total increase (decrease) in interest income	30,086	(75,180)	(45,094)	185,466	(9,968)	175,498
Interest-Bearing liabilities:						
Interest-bearing demand deposits	868	(653)	215	2,585	(1,941)	644
Savings and money market accounts	374	(292)	82	3,158	(1,713)	1,445
Certificates of deposit	(1,907)	(187)	(2,094)	3,637	(3,077)	560
Other borrowings	2,558	(1,822)	736	(1,037)	312	(725)
Securities sold under repurchase agreements	(81)	(39)	(120)	(223)	(40)	(263)
Junior subordinated debentures	(3,288)	19	(3,269)	1,764	(255)	1,509
Total increase (decrease) in interest expense	(1,476)	(2,974)	(4,450)	9,884	(6,714)	3,170
Increase (decrease) in net interest income	$ 31,562	$ (72,206)	$ (40,644)	$ 175,582	$ (3,254)	$ 172,328

Provision for Credit Losses

The Company s provision for credit losses is established through charges to income in the form of the provision in order to bring the Company s allowance for credit losses to a level deemed appropriate by management based on the factors discussed under Financial Condition Allowance for Credit Losses. The allowance for credit losses at December 31, 2015 was $81.4 million, representing 0.86% of total loans as of such date. Acquired loans were recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, interest rates, projected default rates, loss given default and recovery rates with no carryover of any existing allowance for credit losses. The provision for credit losses for the year ended December 31, 2015 was $7.6 million compared with $18.3 million for the year ended December 31, 2014 and $17.2 million for the year ended December 31, 2013. Net charge-offs for the years ended December 31, 2015, 2014 and 2013 were $6.9 million, $4.8 million and $2.5

million, respectively.

Noninterest Income

The Company s primary sources of recurring noninterest income are NSF fees, credit, debit and ATM card income, and service charges on deposit accounts. The Company added to its brokerage and trust lines of business with the acquisition of FVNB on November 1, 2013. Noninterest income does not include loan origination fees which are recognized over the life of the related loan as an adjustment to yield using the interest method. For the

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year ended December 31, 2015, noninterest income totaled $120.8 million, a decrease of $51 thousand compared with 2014. The decrease was primarily due to a decrease in NSF fees and net gain on sale of assets, partially offset by an increase in mortgage income and other income.

For the year ended December 31, 2014, noninterest income totaled $120.8 million, an increase of $25.4 million or 26.6% compared with $95.4 million in 2013. This increase was primarily due to the increased service charges on the deposit accounts acquired in the F&M acquisition and the full year effect of the FVNB acquisition, including the additional brokerage and trust business. In addition, gain on the sale of assets increased $4.7 million during the year ended December 31, 2014 compared with the same period in 2013, primarily due to a $2.2 million gain on the sale of the agent bank credit card and agent bank merchant processing business of Bankers Credit Card Services, Inc., a subsidiary acquired as part of the acquisition of Coppermark, and gains on the sale of real property.

The following table presents, for the periods indicated, the major categories of noninterest income:

	Years Ended December 31,		
	2015	**2014**	**2013**
	(Dollars in thousands)		
Nonsufficient funds (NSF) fees	$ 34,284	$ 37,048	$ 35,173
Credit card, debit card and ATM card income	23,534	22,889	22,463
Service charges on deposit accounts	17,095	16,452	12,864
Trust income	8,030	8,108	4,356
Mortgage income	5,720	4,264	4,038
Brokerage income	5,953	5,868	1,518
Bank owned life insurance income	5,548	5,189	3,635
Net gain (loss) on sale of assets	2,403	4,658	(13)
Other	18,214	16,356	11,393
Total noninterest income	$ 120,781	$ 120,832	$ 95,427

Noninterest Expense

For the year ended December 31, 2015, noninterest expense totaled $313.5 million, a decrease of $14.4 million or 4.4% compared with 2014. This decrease was mainly due to a decrease in salary and employee benefits, professional and legal fees and net occupancy and equipment expense.

For the year ended December 31, 2014, noninterest expense totaled $328.0 million, an increase of $80.8 million or 32.7% compared with $247.2 million for the same period in 2013. This increase was mainly due to the full year effect of the FVNB acquisition completed in November 2013 and the F&M acquisition completed in 2014. Additionally, the Company incurred $3.1 million of pre-tax merger related expenses during 2014. The merger related expenses are reflected on the Company s income statement for the applicable periods and are reported primarily in the categories of salaries and benefits, data processing and professional and legal fees.

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The following table presents, for the periods indicated, the major categories of noninterest expense:

	Years Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Salaries and employee benefits (1)	$ 192,872	$ 199,270	$ 148,494
Non-staff expenses:			
Net occupancy and equipment	23,638	24,756	18,934
Credit and debit card, data processing and software amortization	15,782	15,790	11,908
Regulatory assessments and FDIC insurance	14,433	15,017	10,261
Property taxes	7,028	7,410	5,827
Core deposit intangibles amortization	9,530	9,940	6,145
Depreciation	12,959	13,730	10,593
Communications (2)	11,121	11,609	9,471
Other real estate expense	625	1,019	711
Professional and legal fees	3,044	5,636	3,573
Printing and supplies	2,158	2,427	2,616
Other	20,346	21,358	18,663
Total noninterest expense	$ 313,536	$ 327,962	$ 247,196

(1) Total salaries and employee benefits include $11.1 million, $8.2 million and $4.2 million in 2015, 2014 and 2013, respectively, in stock based compensation expense.
(2) Communications expense includes telephone, data circuits, postage, and courier expenses.

Salaries and Employee Benefits. Salaries and employee benefits were $192.9 million for the year ended December 31, 2015, a decrease of $6.4 million or 3.2% compared with 2014. This was primarily due to a decrease in FTEs and a decrease in incentive compensation. Salaries and employee benefits increased $50.8 million or 34.2% to $199.3 million at December 31, 2014, compared with $148.5 million at December 31, 2013, primarily due to the full year effect of the FVNB acquisition and the F&M acquisition completed during 2014. The number of FTEs employed by the Company were 3,037, 3,096 and 2,995 at December 31, 2015, 2014 and 2013, respectively. Total salaries and benefits for the year ended December 31, 2015 include $11.1 million in stock based compensation expense compared with $8.2 million and $4.2 million recorded for the years ended December 31, 2014 and 2013, respectively. This increase was primarily due to the stock awards granted during 2015.

Debit Card, Data Processing and Software Amortization. Debit card, data processing and software amortization expenses were $15.8 million, $15.8 million and $11.9 million for the years ended December 31, 2015, 2014 and 2013, respectively. There was no significant change or event related to debit cards, data processing, and software amortization during 2015 to result in a substantial shift in expense compared with 2014.

Regulatory Assessments and FDIC Insurance. Regulatory assessments and FDIC insurance assessments were $14.4 million for the year ended December 31, 2015, a decrease of $584 thousand or 3.9%, compared with $15.0 million for the year ended December 31, 2014. The decrease was primarily due to a decrease in FDIC insurance assessment fees. Assessments for the year ended December 31, 2014 increased $4.8 million to $15.0 million compared to $10.3 million for the year ended December 31, 2013. This increase was primarily due to the increase in deposits as a result of the FVNB and F&M acquisitions.

Property Taxes. Property taxes were $7.0 million for the year ended December 31, 2015, a decrease of $382 thousand or 5.2% compared with 2014. Property taxes increased $1.6 million or 27.2% to $7.4 million at December 31, 2014, compared with $5.8 million at December 31, 2013. This was primarily due to the additional property acquired from F&M and FVNB.

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Core Deposit Intangibles Amortization. Core deposit intangibles (CDI) amortization was $9.5 million for the year ended December 31, 2015, a decrease of $410 thousand or 4.1% compared with $9.9 million for the year ended December 31, 2014. This decrease was primarily due to a reduction in the annual amortization rate of certain previously recognized intangible assets. CDI amortization increased $3.8 million or 61.8% to $9.9 million at December 31, 2014, compared with $6.1 million for the year ended December 31, 2013. The increase in CDI for 2014 compared to 2013 was primarily attributable to the full year effect of the FVNB acquisition and the F&M acquisition completed during 2014. CDI are being amortized on a non-pro rata basis over an estimated life of 10 to 15 years.

Other Real Estate. Other real estate expense was $625 thousand for the year ended December 31, 2015, a decrease of $394 thousand or 38.7%, compared with $1.0 million for the year ended December 31, 2014. The decrease in other real estate expense was due primarily to decreased other real estate carrying cost. Other real estate expense increased $308 thousand or 43.3% to $1.0 million for the year ended December 31, 2014 compared with $711 thousand for the year ended December 31, 2013. The increase in other real estate expense was due primarily to an increase in other real estate carrying costs as a result of the acquisition in 2014.

Professional and Legal Fees. Professional and legal fees were $3.0 million for the year ended December 31, 2015, a decrease of $2.6 million or 46.0% compared with $5.6 million for the year ended December 31, 2014. This decrease was primarily due to less acquisition-related legal and professional fees and less consulting activity needed to comply with regulatory requirements. Professional and legal fees increased $2.1 million or 57.7% for the year ended December 31, 2014, compared with $3.6 million for the year ended December 31, 2013. The increase was primarily due to an increase in consulting and professional fees related to additional regulatory requirements.

Efficiency Ratio

The efficiency ratio is a supplemental financial measure utilized in management s internal evaluation of the Company and is not defined under generally accepted accounting principles (GAAP). The efficiency ratio is calculated by dividing total noninterest expense, excluding credit loss provisions, by net interest income plus noninterest income, excluding net gains and losses on the sale of securities and on the sale of assets. Taxes are not part of this calculation. An increase in the efficiency ratio indicates that more resources are being utilized to generate the same volume of income, while a decrease would indicate a more efficient allocation of resources. The Company s efficiency ratio was 41.87% for the year ended December 31, 2015, compared with 41.81% for the year ended December 31, 2014. The efficiency ratios for 2015, 2014, and 2013 were impacted by pre-tax merger-related expenses of $120 thousand, $3.1 million, and $3.2 million, respectively. The Company s efficiency ratio was 41.60% for the year ended December 31, 2013.

Income Taxes

The amount of federal and state income tax expense is influenced by the amount of pre-tax income, the amount of tax-exempt income and the amount of other nondeductible expenses. Income tax expense was $143.5 million for the year ended December 31, 2015, a decrease of $4.8 million or 3.2% compared with $148.3 million for the year ended December 31, 2014.The decrease was primarily attributable to lower pre-tax net earnings for the year ended December 31, 2015. Income tax expense increased $39.9 million or 36.8% for the year ended December 31, 2014, compared with $108.4 million for the year ended December 31, 2013. The increase was primarily attributable to higher pre-tax net earnings for the year ended December 31, 2014. The effective tax rate for the years ended December 31, 2015, 2014 and 2013 was 33.4%, 33.3% and 32.9%, respectively. The effective income tax rates differed from the U.S. statutory rate of 35% during the comparable periods primarily due to the effect of tax-exempt income from loans and securities.

Impact of Inflation

The Company s consolidated financial statements and related notes included in this Annual Report on Form 10-K have been prepared in accordance with GAAP. These require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative value of money over time due to inflation or recession.

Unlike many industrial companies, substantially all of the Company s assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Company s performance than the effects of general levels of inflation. Interest rates may not necessarily move in the same direction or in the same magnitude as the prices of goods and services. However, other operating expenses do reflect general levels of inflation.

Financial Condition

Loan Portfolio

At December 31, 2015, total loans were $9.44 billion, an increase of $194.4 million or 2.1%, compared with $9.24 billion at December 31, 2014. Loans at December 31, 2015 included $23.9 million of loans held for sale. At December 31, 2015, total loans were 53.4% of deposits and 42.8% of total assets. At December 31, 2014, total loans were $9.24 billion, an increase of $1.47 billion or 18.9%, compared with $7.78 billion at December 31, 2013. Loans at December 31, 2014 included $8.6 million of loans held for sale. Loan growth was impacted by the acquisition of F&M. As of March 31, 2014 (the day prior to acquisition), F&M reported, on a consolidated basis, total loans of $1.74 billion.

The following table summarizes the Company s total loan portfolio by type of loan as of the dates indicated:

	December 31,									
	2015		2014		2013		2012		2011	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
ommercial nd industrial	$ 1,692,246	17.9%	$ 1,806,267	19.5%	$ 1,279,777	16.5%	$ 771,114	14.9%	$ 406,433	10.8%
eal estate:										
onstruction, nd evelopment nd other land oans	1,073,198	11.4%	1,026,475	11.1%	865,511	11.1%	550,768	10.6%	482,140	12.8%
-4 family esidential (1)	2,360,798	25.0%	2,250,251	24.3%	1,870,365	24.1%	1,255,765	24.2%	1,007,266	26.7%
ome equity	279,867	2.9%	271,930	3.0%	261,355	3.4%	186,801	3.6%	146,999	3.9%
ommercial eal estate ncluding nultifamily esidential) (2)	3,131,083	33.2%	3,030,340	32.8%	2,753,797	35.2%	1,990,642	38.5%	1,441,226	38.3%

armland	434,349	4.6%	361,943	3.9%	332,648	4.3%	211,156	4.1%	136,008	3.6%
griculture	214,469	2.3%	189,703	2.1%	198,610	2.6%	74,481	1.4%	34,226	0.9%
onsumer	142,363	1.5%	160,595	1.7%	146,942	1.9%	103,725	2.0%	78,187	2.1%
ther	110,216	1.2%	146,679	1.6%	66,216	0.9%	35,488	0.7%	33,421	0.9%
otal loans (3)	$ 9,438,589	100.0%	$ 9,244,183	100.0%	$ 7,775,221	100.0%	$ 5,179,940	100.0%	$ 3,765,906	100.0%

(1) Includes loans held for sale of $23.9 million, $8.6 million, $2.2 million and $10.4 million at December 31, 2015, 2014, 2013 and 2012, respectively. There were no loans held for sale at December 31, 2011.

(2) Commercial real estate loans include approximately $1.42 billion, $1.51 billion, $1.49 billion, $1.05 billion and $727 thousand of owner-occupied loans for the years ended December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

(3) Includes fair value discounts on acquired loans of $94.7 million, $161.4 million, $133.3 million, $79.9 million and $109 thousand at December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

The Company separates its loan portfolio into two general categories of loans: (1) loans originated by Prosperity Bank and made pursuant to the Company s loan policy and procedures in effect at the time the loan was made are referred to as legacy loans and (2) acquired loans, which are loans acquired in a business combination. Those acquired loans that are renewed or substantially modified after the date of the business combination, which therefore causes them to become subject to the Company s allowance for credit losses methodology, are referred to as acquired legacy loans. If a renewal or substantial modification of an acquired loan is underwritten by the Company with a new credit analysis, the loan will no longer be categorized as an acquired loan. For example, acquired loans to one borrower may be combined into a new loan with a new loan

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number and categorized as a legacy loan. Acquired loans with a fair value discount or premium at the date of the business combination that remained at the reporting date are referred to as fair-valued acquired loans. All fair-valued acquired loans are further categorized into Non-PCI loans and PCI loans (purchased credit impaired loans). Acquired loans with evidence of credit quality deterioration at acquisition for which it is probable that the Company would not be able to collect all contractual amounts due are PCI loans.

The following tables summarize the Company s legacy and acquired loan portfolios broken out into legacy loans, acquired legacy loans, Non-PCI loans and PCI loans as of the dates indicated.

	December 31, 2015				
			Acquired Loans		
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans	Total Loans
			(dollars in thousands)		
Residential mortgage loans held for sale	$ 23,933	$	$	$	$ 23,933
Commercial and industrial	1,038,118	419,932	218,583	15,613	1,692,246
Real estate:					
Construction, land development and other land loans	954,587	64,158	53,533	920	1,073,198
1-4 family residential (including home equity)	2,115,857	88,852	406,754	5,269	2,616,732
Commercial real estate (including multi-family residential)	2,204,662	327,192	581,599	17,630	3,131,083
Farmland	335,689	18,188	80,082	390	434,349
Agriculture	143,265	66,415	4,785	4	214,469
Consumer and other	196,859	25,289	30,431		252,579
Total loans held for investment	6,989,037	1,010,026	1,375,767	39,826	9,414,656
Total	$ 7,012,970	$ 1,010,026	$ 1,375,767	$ 39,826	$ 9,438,589

	December 31, 2014				
			Acquired Loans		
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans	Total Loans
			(dollars in thousands)		
Residential mortgage loans held for sale	$ 8,602	$	$	$	$ 8,602
Commercial and industrial	846,665	518,855	414,647	26,100	1,806,267
Real estate:					
	801,321	114,066	109,946	1,142	1,026,475

Construction, land development and other land loans					
1-4 family residential (including home equity)	1,877,843	94,331	535,479	5,926	2,513,579
Commercial real estate (including multi-family residential)	1,883,267	263,904	859,702	23,467	3,030,340
Farmland	244,162	13,520	103,809	452	361,943
Agriculture	105,448	72,051	12,149	55	189,703
Consumer and other	189,161	56,839	61,274		307,274
Total loans held for investment	5,947,867	1,133,566	2,097,006	57,142	9,235,581
Total	$ 5,956,469	$ 1,133,566	$ 2,097,006	$ 57,142	$ 9,244,183

The Company s commercial real estate loans (including multifamily residential) increased $100.7 million or 3.3% to $3.13 billion at December 31, 2015 from $3.03 billion at December 31, 2014. The Company s 1-4 family residential mortgage loans (including home equity) increased $103.2 million or 4.1% to $2.62 billion at December 31, 2015 from $2.51 billion at December 31, 2014. These increases were primarily related to legacy loan growth.

The Company offers a broad range of short to medium-term commercial loans, primarily collateralized, to businesses for working capital (including inventory and receivables), business expansion (including acquisitions of real estate and improvements) and the purchase of equipment and machinery. Historically, the Company has originated loans for its own account, including all loans in the 1-4 family residential category, and has not securitized its loans. Additionally, the Company, through its Home Loan Center, originates longer-term residential mortgage loans for sale into the secondary market. The purpose of a particular loan generally determines its structure.

Loans to borrowers with aggregate debt relationships over $1.0 million and below $3.5 million are evaluated and acted upon on a daily basis by two of the company-wide loan concurrence officers. Loans to borrowers with aggregate debt relationships above $3.5 million are evaluated and acted upon by an officers loan committee which meets weekly. In addition to the officers loan committee evaluation, loans to borrowers with aggregate debt relationships from $25.0 million to $50.0 million are evaluated and acted upon by the directors loan committee which consists of three directors of the Bank and meets as necessary. Loans to borrowers with aggregate debt relationships over $50.0 million are evaluated and acted upon by the Bank s Board of Directors either at a regularly scheduled monthly board meeting or by teleconference or written consent.

Commercial and Industrial Loans. In nearly all cases, the Company s commercial loans are made in the Company s market areas and are underwritten on the basis of the borrower s ability to service the debt from income. As a general practice, the Company takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower or principal. Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. In general, commercial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial loans is due to the type of collateral securing these loans as well as the expectation that commercial loans generally will be serviced principally from the operations of the business, and those operations may not be successful. Historical trends have shown these types of loans to have higher delinquencies than mortgage loans. As a result of these additional complexities, variables and risks, commercial loans require more thorough underwriting and servicing than other types of loans.

Included in commercial loans are commitments to oil and gas producers secured by proven, developed and producing reserves and commitments to service, equipment and midstream companies secured mainly by accounts receivable, inventory and equipment. Mineral reserve values supporting commitments to producers are normally re-determined semi-annually using reserve studies prepared by a third-party or the Company s oil and gas engineer. Accounts receivable and inventory borrowing bases for service companies are typically re-determined monthly. Funding requests by both producers and service companies are monitored relative to the most recently determined borrowing base. As of December 31, 2015, the Company had $178.6 million in funded commitments outstanding to oil and gas production companies and $80.3 million in unfunded commitments, for a total of $258.9 million. This compares with funded commitments to production companies of $272.0 million as of December 31, 2014 and $165.3 million in unfunded commitments, for a total of $437.3 million. Total unfunded commitments to producers include letters of credit issued in lieu of oil well plugging bonds. As of December 31, 2015, the Company had outstanding $220.5 million in funded commitments to service companies and $116.1 million in unfunded commitments for a total of $336.6 million. This compares with funded commitments to service companies of $228.4 million as of December 31, 2014 and $121.5 million in unfunded commitments, for a total of $349.9 million.

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Commercial Real Estate. The Company makes commercial real estate loans collateralized by owner-occupied and nonowner-occupied real estate to finance the purchase of real estate. The Company s commercial real estate loans are collateralized by first liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15- to 20-year period. Payments on loans secured by nonowner-occupied properties are often dependent on the successful operation or management of the properties. Accordingly, repayment of these loans may be subject to adverse conditions in the real estate market or the economy to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property s operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flow, appraisals and a review of the financial condition of the borrower.

1-4 Family Residential Loans. The Company s lending activities also include the origination of 1-4 family residential mortgage loans (including home equity loans) collateralized by owner-occupied residential properties located in the Company s market areas. The Company offers a variety of mortgage loan portfolio products which generally are amortized over five to 25 years. Loans collateralized by 1-4 family residential real estate generally have been originated in amounts of no more than 89% of appraised value or have mortgage insurance. The Company requires mortgage title insurance and hazard insurance. The Company retains these portfolio loans for its own account rather than selling them into the secondary market. By doing so, the Company incurs interest rate risk as well as the risks associated with nonpayments on such loans. The Company s Home Loan Center offers a variety of mortgage loan products which are generally amortized over 30 years, including FHA and VA loans. The Company sells the loans originated by the Home Loan Center into the secondary market.

Construction, Land Development and Other Land Loans. The Company makes loans to finance the construction of residential and, to a lesser extent, nonresidential properties. Construction loans generally are collateralized by first liens on real estate and have floating interest rates. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described above are also used in the Company s construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover all of the unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

Agriculture Loans. The Company provides agriculture loans for short-term crop production, including rice, cotton, milo and corn, farm equipment financing and agriculture real estate financing. The Company evaluates agriculture borrowers primarily based on their historical profitability, level of experience in their particular agriculture industry, overall financial capacity and the availability of secondary collateral to withstand economic and natural variations common to the industry. Because agriculture loans present a higher level of risk associated with events caused by nature, the Company routinely makes on-site visits and inspections in order to identify and monitor such risks.

Consumer Loans. Consumer loans made by the Company include direct A -credit automobile loans, recreational vehicle loans, boat loans, home improvement loans, personal loans (collateralized and uncollateralized) and deposit account collateralized loans. The terms of these loans typically range from 12 to

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180 months and vary based upon the nature of collateral and size of loan. Generally, consumer loans entail greater risk than do real estate secured loans, particularly in the case of consumer loans that are unsecured or collateralized by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws may limit the amount which can be recovered on such loans.

The contractual maturity ranges of the Company s loan portfolio by type of loan and the amount of such loans with predetermined interest rates and floating rates in each maturity range as of December 31, 2015 are summarized in the following table. Contractual maturities are based on contractual amounts outstanding and do not include loan purchase discounts of $94.7 million or loans held for sale of $23.9 million at December 31, 2015:

	One Year or Less	Through Five Years	After Five Years	Total
		(Dollars in thousands)		
Commercial and industrial	$ 731,217	$ 550,102	$ 448,385	$ 1,729,704
Real estate:				
Construction, land development and other land loans	392,126	203,575	480,272	1,075,973
1-4 family residential (includes home equity)	32,340	160,107	2,436,915	2,629,362
Commercial (includes multi-family residential)	132,036	397,469	2,637,566	3,167,071
Agriculture (includes farmland)	179,370	71,251	402,704	653,325
Consumer and other	91,853	87,907	74,171	253,931
Total	$ 1,558,942	$ 1,470,411	$ 6,480,013	$ 9,509,366
Loans with a predetermined interest rate	$ 452,884	$ 728,612	$ 2,721,442	$ 3,902,938
Loans with a floating interest rate	1,106,058	741,799	3,758,571	5,606,428
Total	$ 1,558,942	$ 1,470,411	$ 6,480,013	$ 9,509,366

Nonperforming Assets

Nonperforming assets include loans on nonaccrual status, accruing loans 90 days past due or more, and real estate which has been acquired through foreclosure and is awaiting disposition. Nonperforming assets do not include PCI loans unless the timing and amount of projected cash flows can no longer be reasonably estimated. PCI loans become subject to the Company s allowance for credit losses methodology when a deterioration in projected cash flows is identified.

The Company has several procedures in place to assist it in maintaining the overall quality of its loan portfolio. The Company has established underwriting guidelines to be followed by its officers, and the Company also monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company s loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

As part of the on-going monitoring of the Company s loan portfolio and the methodology for calculating the allowance for credit losses, management grades each loan from 1 to 9. Depending on the grade, loans in the same grade are aggregated and a loss factor is applied to the total loans in the group to determine the allowance for credit losses. For certain loans in risk grades 7 to 9, a specific reserve may be required.

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The Company generally places a loan on nonaccrual status and ceases accruing interest when the payment of principal or interest is delinquent for 90 days, or earlier in some cases, unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan.

The Company requires appraisals on loans collateralized by real estate. With respect to potential problem loans, an evaluation of the borrower s overall financial condition is made to determine the need, if any, for possible write-downs or appropriate additions to the allowance for credit losses.

The following table presents information regarding past due loans and nonperforming assets at the dates indicated:

	December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Nonaccrual loans (1)	$ 39,711	$ 31,422	$ 10,231	$ 5,382	$ 3,578
Accruing loans 90 or more days past due	614	2,193	4,947	331	
Total nonperforming loans	40,325	33,615	15,178	5,713	3,578
Repossessed assets	171	67	27	68	146
Other real estate	2,963	3,237	7,299	7,234	8,328
Total nonperforming assets	$ 43,459	$ 36,919	$ 22,504	$ 13,015	$ 12,052

(1) Includes troubled debt restructurings of $681 thousand, $911 thousand, $1.4 million, $3.6 million and $5.3 million for the years ended December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

The following tables present information regarding past due loans and nonperforming assets differentiated among legacy loans, acquired legacy loans, Non-PCI loans and PCI loans at the dates indicated:

	December 31, 2015				
			Acquired Loans		
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans	Total Loans
	(Dollars in thousands)				
Nonaccrual loans	$ 20,800	$ 7,361	$ 4,254	$ 7,296	$ 39,711
Accruing loans 90 or more days past due		614			614
Total nonperforming loans	20,800	7,975	4,254	7,296	40,325
Repossessed assets	5	10	56	100	171
Other real estate	657	110	1,743	453	2,963
Total nonperforming assets	$ 21,462	$ 8,095	$ 6,053	$ 7,849	$ 43,459
	0.31%	0.80%	0.44%	19.49%	0.46%

Nonperforming assets to total loans and other real estate by category

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	December 31, 2014				
			Acquired Loans		
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans	Total Loans
	(Dollars in thousands)				
Nonaccrual loans	$ 4,197	$ 11,194	$ 2,947	$ 13,084	$ 31,422
Accruing loans 90 or more days past due	377	1,816			2,193
Total nonperforming loans	4,574	13,010	2,947	13,084	33,615
Repossessed assets	12		55		67
Other real estate	1,608	23	1,556	50	3,237
Total nonperforming assets	$ 6,194	$ 13,033	$ 4,558	$ 13,134	$ 36,919
Nonperforming assets to total loans and other real estate by category	0.10%	1.15%	0.22%	22.96%	0.40%

The Company had $43.5 million in nonperforming assets at December 31, 2015 compared with $36.9 million at December 31, 2014 and $22.5 million at December 31, 2013. The nonperforming assets consisted of 147 separate credits or ORE properties at December 31, 2015, compared with 169 at December 31, 2014 and 203 at December 31, 2013. If interest on nonaccrual loans had been accrued under the original loan terms, approximately $3.9 million, $2.7 million and $440 thousand would have been recorded as income for the years ended December 31, 2015, 2014 and 2013, respectively.

At December 31, 2015, of the total nonperforming assets, $21.5 million resulted from legacy loans, $8.1 million resulted from acquired legacy loans, $6.1 million resulted from Non-PCI loans and $7.8 million resulted from PCI loans. At December 31, 2014, of the total nonperforming assets, $6.2 million resulted from legacy loans, $13.0 million resulted from acquired legacy loans, $4.6 million resulted from Non-PCI loans and $13.1 million from PCI loans. A PCI loan becomes impaired when there is a deterioration in projected cash flows after acquisition.

Nonperforming assets were 0.46% of total loans and other real estate at December 31, 2015 compared with 0.40% of total loans and other real estate at December 31, 2014. Nonperforming assets attributable to legacy loans were 0.31% of total legacy loans and other real estate at December 31, 2015 compared with 0.10% of total legacy loans and other real estate at December 31, 2014. Nonperforming assets attributable to acquired legacy loans were 0.80% of total acquired legacy loans and other real estate at December 31, 2015 compared with 1.15% of total acquired legacy loans and other real estate at December 31, 2014. Nonperforming assets attributable to Non-PCI loans were 0.44% of total Non-PCI loans and other real estate at December 31, 2015 compared with 0.22% of total Non-PCI loans and other real estate at December 31, 2014. Nonperforming assets attributable to PCI loans were 19.49% of total PCI loans and other real estate at December 31, 2015 compared with 22.96% of total PCI loans and other real estate at December 31, 2014.

The Company had three loans modified in troubled debt restructurings (TDRs) for the year ended December 31, 2015 with a recorded year end investment of $279 thousand and a balance of $650 thousand at date of restructure. Total TDRs outstanding totaled $681 thousand at December 31, 2015.

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Allowance for Credit Losses

The following table presents, as of and for the periods indicated, an analysis of the allowance for credit losses and other related data:

	Years Ended December 31, 2015	2014	2013	2012	2011
	(Dollars in thousands)				
Average loans outstanding	$ 9,200,765	$ 8,988,069	$ 6,202,897	$ 4,514,171	$ 3,648,701
Gross loans outstanding at end of period	$ 9,438,589	$ 9,244,183	$ 7,775,221	$ 5,179,940	$ 3,765,906
Allowance for credit losses at beginning of period	$ 80,762	$ 67,282	$ 52,564	$ 51,594	$ 51,584
Provision for credit losses	7,560	18,275	17,240	6,100	5,200
Charge-offs:					
Commercial and industrial	(7,696)	(818)	(672)	(674)	(1,694)
Real estate and agriculture	(1,150)	(3,458)	(1,423)	(4,337)	(3,927)
Consumer and other	(3,304)	(5,674)	(3,398)	(2,885)	(1,229)
Recoveries:					
Commercial and industrial	3,322	466	348	815	481
Real estate and agriculture	600	1,561	1,330	342	472
Consumer and other	1,290	3,128	1,293	1,609	707
Net charge-offs	(6,938)	(4,795)	(2,522)	(5,130)	(5,190)
Allowance for credit losses at end of period	$ 81,384	$ 80,762	$ 67,282	$ 52,564	$ 51,594
Ratio of allowance to end of period loans	0.86%	0.87%	0.87%	1.01%	1.37%
Ratio of net charge-offs to average loans	0.08%	0.05%	0.04%	0.11%	0.14%
Ratio of allowance to end of period nonperforming loans	201.8%	240.3%	443.3%	920.1%	1442.0%

The allowance for credit losses as a percentage of total nonperforming loans was 201.8% at December 31, 2015 and 240.3% at December 31, 2014.

The allowance for credit losses is a valuation established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company s loan portfolio. The amount of the allowance for credit losses is affected by the following: (1) charge-offs of loans that occur when loans are deemed uncollectible and decrease the allowance, (2) recoveries on loans previously charged off that increase the allowance and (3) provisions for credit losses charged to earnings that increase the allowance. Based on an evaluation of the loan portfolio and consideration of the factors listed below, management presents a quarterly review of the allowance for credit losses to the Bank s Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, further adjustments may be necessary if economic conditions differ from the assumptions used in making the initial determinations.

The Company s allowance for credit losses consists of two components: a specific valuation allowance based on probable losses on specifically identified loans and a general valuation allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company.

In setting the specific valuation allowance, the Company follows a loan review program to evaluate the credit risk in the total loan portfolio and assigns risk grades to each loan. Through this loan review process, the Company maintains an internal list of impaired loans which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for credit losses. All loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. For certain impaired loans, the Company allocates a specific loan loss reserve

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primarily based on the value of the collateral securing the impaired loan. The specific reserves are determined on an individual loan basis. Loans for which specific reserves are provided are excluded from the general valuation allowance described below.

In connection with this review of the loan portfolio, the Company considers risk elements attributable to particular loan types or categories in assessing the quality of individual loans. Some of the risk elements include:

- for 1-4 family residential mortgage loans, the borrower s ability to repay the loan, including a consideration of the debt to income ratio and employment and income stability, the loan to value ratio, and the age, condition and marketability of collateral;

- for commercial mortgage loans and multifamily residential loans, the debt service coverage ratio (income from the property in excess of operating expenses compared to loan payment requirements), operating results of the owner in the case of owner-occupied properties, the loan to value ratio, the age and condition of the collateral and the volatility of income, property value and future operating results typical of properties of that type;

- for construction, land development and other land loans, the perceived feasibility of the project including the ability to sell developed lots or improvements constructed for resale or the ability to lease property constructed for lease, the quality and nature of contracts for presale or prelease, if any, experience and ability of the developer and loan to value ratio;

- for commercial and industrial loans, the operating results of the commercial, industrial or professional enterprise, the borrower s business, professional and financial ability and expertise, the specific risks and volatility of income and operating results typical for businesses in that category and the value, nature and marketability of collateral;

- for agricultural real estate loans, the experience and financial capability of the borrower, projected debt service coverage of the operations of the borrower and loan to value ratio; and

- for non-real estate agricultural loans, the operating results, experience and financial capability of the borrower, historical and expected market conditions and the value, nature and marketability of collateral.

In addition, for each category, the Company considers secondary sources of income and the financial strength and credit history of the borrower and any guarantors.

In determining the amount of the general valuation allowance, management considers factors such as historical loan loss experience, concentration risk of specific loan types, the volume, growth and composition of the Company s loan portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the Company s loan portfolio through its internal loan review process, general economic conditions and other qualitative risk factors both internal and external to the Company and other relevant factors. Based on a review of these factors for each loan type, the Company applies an estimated percentage to the outstanding balance of each loan type, excluding any loan that has a specific reserve allocated to it. The Company uses this information to establish the amount of the general valuation allowance.

A change in the allowance for credit losses can be attributable to several factors, most notably (1) specific reserves identified for impaired loans, (2) historical credit loss information, (3) changes in environmental factors and (4) growth in the balance of legacy loans and the re-categorization of fair-valued acquired loans to acquired legacy loans, which subjects such loans to the allowance methodology.

Changes in the Company s asset quality are reflected in the allowance in several ways. Specific reserves that are calculated on a loan-by-loan basis and the qualitative assessment of all other loans reflect current changes in the credit quality of the loan portfolio. Historical credit losses, on the other hand, are based on a three-year look back period, which are then applied to estimate current credit losses inherent in the loan portfolio. A deterioration

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in the credit quality of the loan portfolio in the current period would increase the historical credit loss factor to be applied in future periods, just as an improvement in credit quality would decrease the historical credit loss factor.

The allowance for credit losses is further determined by the size of the loan portfolio subject to the allowance methodology and environmental factors that include Company-specific risk indicators and general economic conditions, both of which are constantly changing. The Company evaluates the economic and portfolio-specific factors on a quarterly basis to determine a qualitative component of the general valuation allowance. The factors include economic metrics, business conditions, delinquency trends, credit concentrations, nature and volume of the portfolio and other adjustments for items not covered by specific reserves and historical loss experience. Management s assessment of qualitative factors is a statistically based approach to determine the inherent probable loss associated with such factors. Based on the Company s actual historical loan loss experience relative to economic and loan portfolio-specific factors at the time the losses occurred, management is able to identify the probabilities of default and loss severity based on current economic conditions. The correlation of historical loss experience with current economic conditions provides an estimate of inherent and probable losses that has not been previously factored into the general valuation allowance by the determination of specific reserves and recent historical losses. Additionally, the Company considers qualitative factors not easily quantified and the possibility of model imprecision.

Utilizing the aggregation of specific reserves, historical loss experience and a qualitative component, management is able to determine the valuation allowance to reflect the full inherent probable loss.

In determining the allowance for credit losses, management also considers the type of loan (legacy or acquired) and the credit quality of the loan. The Company delineates between legacy loans and acquired legacy loans, which are accounted for under the contractual yield method, and fair-valued acquired loans consisting of Non-PCI loans and PCI loans, which are accounted for as purchased loans.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of inherent credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for credit losses is recorded for these loans at acquisition. When a fair-valued acquired loan is renewed at its maturity date, the loan is re-categorized as an acquired legacy loan. When a fair-valued acquired loan is modified after acquisition, the loan is independently evaluated subsequent to the modification decision to determine whether the modification was substantial, and therefore, requires that the loan be re-categorized as an acquired legacy loan. This determination is based on a discounted cash-flow analysis. Generally, when a change in discounted cash-flow of greater than 10% is identified, the fair-valued acquired loan becomes categorized as an acquired legacy loan. If and when a fair-valued acquired loan becomes an acquired legacy loan, the acquired legacy loan is evaluated at the time of renewal or modification in accordance with the Company s allowance for credit losses methodology described above.

Non-PCI loans which were not deemed impaired subsequent to the acquisition date are considered non-impaired and are evaluated as part of the general valuation allowance. Non-PCI loans that have not become impaired subsequent to acquisition are segregated into a pool for each acquisition for allowance calculation purposes. For each pool, the Company estimates a hypothetical allowance for credit losses also referred to as an indicated reserve that is calculated in accordance with GAAP requirements. The Company uses the acquired bank s past loss history adjusted for qualitative factors to establish the indicated reserve. The indicated reserve for each pool of Non-PCI loans is compared with the remaining discount for the respective pool to test for credit quality deterioration and the possible need for a loan loss provision. To the extent the remaining discount of the pool is greater than the indicated reserve, no additional allowance is necessary. In the event that the remaining discount of the pool is less than the indicated reserve, the difference results in an increase to the allowance recorded through a provision for credit losses.

Non-PCI loans that have deteriorated to an impaired status subsequent to acquisition are evaluated for a specific reserve on a quarterly basis which, when identified, is added to the allowance for credit losses. The

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Company reviews impaired Non-PCI loans on a loan-by-loan basis and determines the specific reserve based on the difference between the recorded investment in the loan and one of three factors: expected future cash flows, observable market price or fair value of the collateral. Because essentially all of the Company s impaired Non-PCI loans have been collateral-dependent, the amount of the specific reserve historically has been determined by comparing the fair value of the collateral securing the Non-PCI loan with the recorded investment in such loan. In the future, the Company will continue to analyze impaired Non-PCI loans on a loan-by-loan basis and may use an alternative measurement method to determine the specific reserve, as appropriate and in accordance with applicable accounting standards.

PCI loans are individually monitored on a quarterly basis to assess for deterioration subsequent to acquisition and are only subject to the Company s allowance methodology when a deterioration in projected cash flows is identified. In the event that a deterioration in cash flows is identified, an additional provision for credit losses is made. PCI loans were recorded at their acquisition date fair values, which were based on expected cash flows and included estimates of expected future credit losses. The Company s estimates of loan fair values at the acquisition date may be adjusted for a period of up to one year as the Company continues to evaluate its estimate of expected future cash flows at the acquisition date. If the Company determines that losses arose after the acquisition date, the additional losses will be reflected as a provision for credit losses. An allowance for credit losses is not calculated for PCI loans that have not experienced deterioration subsequent to the acquisition date. See Critical Accounting Policies above for more information.

As described in the section captioned Critical Accounting Policies above, the Company s determination of the allowance for credit losses involves a high degree of judgment and complexity. The Company s analysis of qualitative, or environmental, factors on pools of loans with common risk characteristics, in combination with the quantitative historical loss information and specific reserves, provides the Company with an estimate of inherent losses. The allowance must reflect changes in the balance of loans subject to the allowance methodology, as well as the estimated imminent losses associated with those loans. In the Company s case, the $622 thousand increase in the allowance for credit losses for the year ended December 31, 2015 was primarily attributable to specific reserves identified for loans with deteriorated credit quality and an increase in loans subject to the allowance methodology, partially offset by improved internal environmental factors.

The following table shows the allocation of the allowance for credit losses among various categories of loans and certain other information as of the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any loan category.

	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
	(Dollars in thousands)									
Balance of allowance for credit losses applicable										

to:										
Commercial and industrial	$ 33,409	17.9%	$ 30,002	19.5%	$ 8,167	16.5%	$ 5,777	14.9%	$ 3,826	10.8%
Real estate	42,769	72.5%	44,946	71.2%	56,234	73.9%	45,458	76.9%	46,587	85.3%
Agriculture and agriculture real estate	3,845	6.9%	3,722	6.0%	1,229	6.8%	764	5.5%	123	0.9%
Consumer and other	1,361	2.7%	2,092	3.3%	1,652	2.8%	565	2.7%	1,058	3.0%
Total allowance for credit losses	$ 81,384	100.0%	$ 80,762	100.0%	$ 67,282	100.0%	$ 52,564	100.0%	$ 51,594	100.0%

The Company further disaggregates its allowance for credit losses to distinguish between the portion of the allowance attributed to legacy loans and the portion attributed to acquired loans.

The following tables present, as of and for the periods indicated, information regarding the allowance for credit losses differentiated between legacy loans and acquired loans. The charge-offs and recoveries with respect

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to the acquired loans shown below are primarily from acquired legacy loans. Reported net charge-offs may include those from Non-PCI loans and PCI loans, but only if the total charge-off required is greater than the remaining discount.

	As of and for the Year Ended December 31, 2015		
	Legacy Loans	Acquired Loans	Total
		(Dollars in thousands)	
Average loans outstanding	$ 6,396,941	$ 2,803,824	$ 9,200,765
Gross loans outstanding at end of period	$ 7,012,970	$ 2,425,619	$ 9,438,589
Allowance for credit losses at beginning of period	$ 61,745	$ 19,017	$ 80,762
Provision for credit losses	5,173	2,387	7,560
Charge-offs:			
Commercial and industrial	(2,628)	(5,068)	(7,696)
Real estate and agriculture	(694)	(456)	(1,150)
Consumer and other	(3,222)	(82)	(3,304)
Recoveries:			
Commercial and industrial	2,709	613	3,322
Real estate and agriculture	539	61	600
Consumer and other	1,287	3	1,290
Net charge-offs	(2,009)	(4,929)	(6,938)
Allowance for credit losses at end of period	$ 64,909	$ 16,475	$ 81,384
Ratio of allowance to end of period loans	0.93%	0.68%	0.86%
Ratio of net charge-offs to average loans	0.03%	0.18%	0.08%
Ratio of allowance to end of period nonperforming loans	312.1%	84.4%	201.8%

	As of and for the Year Ended December 31, 2014		
	Legacy Loans	Acquired Loans	Total
		(Dollars in thousands)	
Average loans outstanding	$ 5,495,000	$ 3,493,069	$ 8,988,069
Gross loans outstanding at end of period	$ 5,956,469	$ 3,287,714	$ 9,244,183

Allowance for credit losses at beginning of period	$ 60,115	$ 7,167	$ 67,282
Provision for credit losses	2,715	15,560	18,275
Charge-offs:			
Commercial and industrial	(310)	(508)	(818)
Real estate and agriculture	(471)	(2,987)	(3,458)
Consumer and other	(5,276)	(398)	(5,674)
Recoveries:			
Commercial and industrial	359	107	466
Real estate and agriculture	1,557	4	1,561
Consumer and other	3,056	72	3,128
Net charge-offs	(1,085)	(3,710)	(4,795)
Allowance for credit losses at end of period	$ 61,745	$ 19,017	$ 80,762
Ratio of allowance to end of period loans	1.04%	0.58%	0.87%
Ratio of net charge-offs to average loans	0.02%	0.11%	0.05%
Ratio of allowance to end of period nonperforming loans	1349.9%	65.5%	240.3%

The Company had gross charge-offs on legacy loans of $6.5 million during the year ended December 31, 2015 compared with $6.1 million during the year ended December 31, 2014. Partially offsetting these charge-offs were recoveries on legacy loans of $4.5 million for the year ended December 31, 2015 compared with $5.0 million for the year ended December 31, 2014. Total charge-offs for the year ended December 31, 2015 were $12.2 million, partially offset by total recoveries of $5.2 million. Total charge-offs for the year ended December 31, 2014 were $10.0 million, partially offset by total recoveries of $5.2 million.

The following tables show the allocation of the allowance for credit losses among various categories of loans disaggregated between legacy loans, acquired legacy loans, Non-PCI loans and PCI loans at the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any loan category, regardless of whether allocated to a legacy loan or an acquired loan.

	December 31, 2015					
		Acquired Loans				
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans	Total Allowance	Percent of Loans to Total Loans
	(Dollars in thousands)					
Balance of allowance for credit losses applicable to:						
Commercial and industrial	$ 21,660	$ 8,969	$ 1,944	$ 836	$ 33,409	17.9%
Real estate	39,321	3,133	315		42,769	72.5%
Agriculture and agriculture real estate	2,645	1,162	38		3,845	6.9%
Consumer and other	1,283	59	19		1,361	2.7%
Total allowance for credit losses	$ 64,909	$ 13,323	$ 2,316	$ 836	$ 81,384	100.0%

	December 31, 2014					
		Acquired Loans				
	Legacy Loans	Acquired Legacy Loans	Non-PCI Loans	PCI Loans	Total Allowance	Percent of Loans to Total Loans
	(Dollars in thousands)					
Balance of allowance for credit losses applicable to:						
Commercial and industrial	$ 17,511	$ 11,818	$ 673	$	$ 30,002	19.5%
Real estate	40,138	4,580	228		44,946	71.2%
Agriculture and agriculture real estate	2,278	1,440	4		3,722	6.0%
Consumer and other	1,818	123	151		2,092	3.3%
Total allowance for credit losses	$ 61,745	$ 17,961	$ 1,056	$	$ 80,762	100.0%

At December 31, 2015, the allowance for credit losses totaled $81.4 million or 0.86% of total loans. At December 31, 2014, the allowance for credit losses totaled $80.8 million or 0.87% of total loans, and at December 31, 2013, the allowance totaled $67.3 million or 0.87% of total loans. The allowance for credit losses totaled $81.4 million at December 31, 2015 compared with $80.8 million at December 31, 2014, an increase of $622 thousand or 0.8%.

At December 31, 2015, $64.9 million of the allowance was attributable to legacy loans, an increase of $3.2 million or 5.1% compared with the allowance of $61.7 million attributable to legacy loans at December 31, 2014. This increase was primarily attributable to specific reserves identified for an impaired commercial and industrial loan and an increase in loans subject to the allowance methodology, partially offset by improved internal environmental factors.

At December 31, 2015 $13.3 million of the allowance was attributable to acquired legacy loans compared with $18.0 million of the allowance at December 31, 2014, a decrease of $4.6 million or 25.8%. This decrease was primarily due to improved internal environmental factors and a decline in the dollar balance of acquired legacy loans.

At December 31, 2015, $2.3 million of the allowance was attributable to Non-PCI loans compared with $1.1 million of the allowance at December 31, 2014, an increase of $1.3 million or 119.3%. This increase was primarily attributable to specific reserves identified for a commercial and industrial participation loan that had deteriorated in credit quality, partially offset by improved internal environmental factors.

At December 31, 2015, $836 thousand of the allowance was attributable to PCI loans compared with no allowance at December 31, 2014. This increase was primarily due to specific reserves identified for a commercial and industrial loan that had deteriorated in credit quality, partially offset by improved internal environmental factors.

At December 31, 2015, the Company had $94.7 million of total outstanding discounts on Non-PCI and PCI loans, of which $60.4 million was accretable.

The Company believes that the allowance for credit losses at December 31, 2015 is adequate to cover estimated losses in the loan portfolio as of such date. There can be no assurance, however, that the Company will not sustain losses in future periods, which could be substantial in relation to the size of the allowance at December 31, 2015.

Securities

The Company uses its securities portfolio to manage interest rate risk and as a source of income and liquidity for cash requirements. At December 31, 2015, the carrying amount of investment securities totaled $9.50 billion, an increase of $456.7 million or 5.0% compared with $9.05 billion at December 31, 2014. The increase in the securities portfolio during 2015 was primarily due to excess liquidity throughout the year. At December 31, 2015, securities represented 43.1% of total assets compared with 42.1% of total assets at December 31, 2014.

At the date of purchase, the Company is required to classify debt and equity securities into one of three categories: held to maturity, trading or available for sale. At each reporting date, the appropriateness of the classification is reassessed. Investments in debt securities are classified as held to maturity and measured at amortized cost in the financial statements only if management has the positive intent and ability to hold those securities to maturity. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading and measured at fair value in the financial statements with unrealized gains and losses included in earnings. Investments not classified as either held to maturity or trading are classified as available for sale and measured at fair value in the financial statements with unrealized gains and losses reported, net of tax, in a separate component of shareholders equity until realized.

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The following table summarizes the carrying value by classification of securities as of the dates shown:

	December 31,					
	2015		2014		2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
Available for Sale						
States and political subdivisions	$ 5,463	$ 5,485	$ 14,402	$ 14,585	$ 28,578	$ 29,375
Collateralized mortgage obligations	25,991	25,916	33,519	33,573	483	489
Mortgage-backed securities	55,884	58,971	79,153	84,483	108,316	115,137
Other securities	12,588	12,692	12,588	12,758	12,589	12,477
Total	$ 99,926	$ 103,064	$ 139,662	$ 145,399	$ 149,966	$ 157,478
Held to Maturity						
U.S. Treasury securities and obligations of U.S. Government agencies	$ 47,598	$ 48,396	$ 52,353	$ 52,639	$ 62,931	$ 62,042
States and political subdivisions	363,505	370,043	404,356	409,081	439,235	441,345
Corporate debt securities					513	518
Collateralized mortgage obligations	2,107	2,122	19,585	19,792	50,034	50,993
Mortgage-backed securities	8,986,153	8,972,614	8,424,083	8,467,180	7,514,257	7,432,444
Total	$ 9,399,363	$ 9,393,175	$ 8,900,377	$ 8,948,692	$ 8,066,970	$ 7,987,342

Certain investment securities are valued at less than their historical cost. Management evaluates securities for other-than-temporary impairment (OTTI) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation.

In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

As of December 31, 2015, management does not have the intent to sell any of the securities classified as available for sale and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. As of December 31, 2015, management believes any impairment in the Company s securities is temporary and no impairment loss has been realized in the Company s consolidated statement of income. The Company recorded no other-than-temporary impairment charges in 2015, 2014 or 2013.

The following table summarizes the contractual maturity of securities and their weighted average yields as of December 31, 2015. The contractual maturity of a mortgage-backed security is the date at which the last underlying mortgage matures. Available for sale securities are shown at fair value and held to maturity securities

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are shown at amortized cost. For purposes of the table below, tax-exempt states and political subdivisions are calculated on a tax equivalent basis.

	December 31, 2015									
	Within One Year		After One Year but Within Five Years		After Five Years but Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Total	Yield
	(Dollars in thousands)									
U.S. Treasury securities and obligations of U.S. government agencies	$ 3,511	0.69%	$ 44,087	0.81%	$		$		$ 47,598	2.03%
States and political subdivisions	30,431	2.59%	139,770	2.56%	148,189	2.62%	50,600	-0.19%	368,990	2.21%
Other Securities	12,692	2.29%							12,692	2.29%
Collateralized mortgage obligations					1,294	2.62%	26,729	0.51%	28,023	0.61%
Mortgage-backed securities	56	4.73%	319,118	3.93%	1,127,043	2.78%	7,598,907	2.14%	9,045,124	2.28%
Total	$ 46,690	2.37%	$ 502,975	3.39%	$ 1,276,526	2.76%	$ 7,676,236	2.12%	$ 9,502,427	2.28%

The contractual maturity of mortgage-backed securities and collateralized mortgage obligations is not a reliable indicator of their expected life because borrowers have the right to prepay their obligations at any time. Mortgage-backed securities monthly pay downs cause the average lives of the securities to be much different than their stated lives. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and consequently, the average life of this security will be lengthened. If interest rates begin to fall, prepayments may increase, thereby shortening the estimated life of this security. The weighted average life of the Company’s complete portfolio is 4.15 years with a modified duration of 3.83 years at December 31, 2015.

At December 31, 2015 and 2014, the Company did not own securities of any one issuer (other than the U.S. government and its agencies) for which aggregate adjusted cost exceeded 10% of the consolidated shareholders’ equity at such respective dates.

The average tax equivalent yield of the securities portfolio was 2.28% as of December 31, 2015 compared with 2.33% as of December 31, 2014 and 2.39% as of December 31, 2013. The decrease in yields were primarily due to the Company reinvesting funds at lower rates in 2015 and 2014 compared with 2014 and 2013, respectively. The average yield excluding the tax equivalent adjustment was 2.03% for the year ended December 31, 2015 compared with 2.16% for the year ended December 31, 2014 and 2.05% for the year ended December 31, 2013. The overall non-acquisition growth in the average securities portfolio over the comparable periods was primarily funded by average deposit growth and other borrowings.

Mortgage-backed securities are securities that have been developed by pooling a number of real estate mortgages and which are principally issued by federal agencies such as Government National Mortgage Association (Ginnie Mae), Fannie Mae and Freddie Mac. These securities are deemed to have high credit ratings, and minimum regular monthly cash flows of principal and interest are guaranteed by the issuing agencies.

Unlike U.S. Treasury and U.S. government agency securities, which have a lump sum payment at maturity, mortgage-backed securities provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. Premiums and discounts on mortgage-backed securities are amortized over the expected life of the security and may be impacted by prepayments. As such, mortgage-backed securities which are purchased at a premium will generally suffer decreasing net yields as interest rates drop because home owners tend to refinance their mortgages resulting in prepayments and an acceleration of premium amortization. Securities purchased at a discount will obtain higher net yields in a decreasing interest rate environment as prepayments result in a acceleration of discount accretion. At December 31, 2015, 84.0% of the mortgage-backed securities held by the Company had contractual final maturities of more than ten years with a weighted average life of 4.52 years.

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Collateralized mortgage obligations (CMOs) are bonds that are backed by pools of mortgages. The pools can be Ginnie Mae, Fannie Mae or Freddie Mac pools or they can be private-label pools. CMOs are designed so that the mortgage collateral will generate a cash flow sufficient to provide for the timely repayment of the bonds. The mortgage collateral pool can be structured to accommodate various desired bond repayment schedules, provided that the collateral cash flow is adequate to meet scheduled bond payments. This is accomplished by dividing the bonds into classes to which payments on the underlying mortgage pools are allocated in different order. The bond s cash flow, for example, can be dedicated to one class of bondholders at a time, thereby increasing call protection to bondholders. In private-label CMOs, losses on underlying mortgages are directed to the most junior of all classes and then to the classes above in order of increasing seniority, which means that the senior classes have enough credit protection to be given the highest credit rating by the rating agencies.

Deposits

The Company s lending and investing activities are primarily funded by deposits. The Company offers a variety of deposit accounts having a wide range of interest rates and terms including demand, savings, money market and time accounts. The Company relies primarily on competitive pricing policies and customer service to attract and retain these deposits.

Total deposits at December 31, 2015, were $17.68 billion, a decrease of $12.0 million or 0.1% compared with $17.69 billion at December 31, 2014. Total deposits at December 31, 2014 were $17.69 billion, an increase of $2.40 billion or 15.7% compared with $15.29 billion at December 31, 2013 due primarily to the F&M acquisition completed during 2014 which added approximately $2.27 billion in deposits at acquisition date. Excluding deposits from this acquisition, deposits increased 2.2% for the year ended December 31, 2014, compared with their level at December 31, 2013. Noninterest-bearing deposits at December 31, 2015 were $5.14 billion compared with $4.94 billion at December 31, 2014, an increase of $200.2 million or 4.1%. Noninterest-bearing deposits at December 31, 2014 were $4.94 billion compared with $4.11 billion at December 31, 2013, an increase of $827.6 million or 20.1%. Interest-bearing deposits at December 31, 2015 were $12.54 billion, a decrease of $212.2 million or 1.7% compared with $12.76 billion at December 31, 2014. Interest-bearing deposits at December 31, 2014, were $12.76 billion, an increase of $1.58 billion or 14.1% compared with $11.18 billion at December 31, 2013.

The daily average balances and weighted average rates paid on deposits for each of the years ended December 31, 2015, 2014 and 2013 are presented below:

	Years Ended December 31,					
	2015		2014		2013	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(Dollars in thousands)					
Interest-bearing checking	$ 3,873,495	0.23%	$ 3,516,987	0.24%	$ 2,651,320	0.30%
Regular savings	1,859,257	0.20	1,688,541	0.20	1,398,274	0.21
Money market savings	3,646,267	0.27	3,667,426	0.27	2,839,049	0.32
Time deposits	2,754,466	0.50	3,129,710	0.51	2,530,065	0.61
Total interest-bearing deposits	12,133,485	0.30	12,002,664	0.32	9,418,708	0.37
Noninterest-bearing deposits	5,024,379		4,687,680		3,345,594	

Total deposits	$ 17,157,864	0.21%	$ 16,690,344	0.23%	$ 12,764,302	0.28%

The Company s ratio of average noninterest-bearing deposits to average total deposits for the years ended December 31, 2015, 2014 and 2013 was 29.3%, 28.1% and 26.2%, respectively.

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The following table sets forth the amount of the Company s certificates of deposit that are $100,000 or greater by time remaining until maturity at December 31, 2015 (dollars in thousands):

Three months or less	$ 434,680	29.9%
Over three through six months	316,201	21.7
Over six through 12 months	354,227	24.3
Over 12 months	351,601	24.1
Total	$ 1,456,709	100.0%

Other Borrowings

The Company utilizes borrowings to supplement deposits to fund its lending and investment activities. Borrowings consist of funds from the Federal Home Loan Bank (FHLB) and securities sold under repurchase agreements.

The following table presents the Company s borrowings at December 31, 2015 and 2014:

	FHLB Advances	FHLB Long-Term Notes Payable	Securities Sold Under Repurchase Agreements
		(Dollars in thousands)	
December 31, 2015			
Amount outstanding at year-end	$ 485,000	$ 6,399	$ 315,253
Weighted average interest rate at year-end	0.31%	5.64%	0.25%
Maximum month-end balance during the year	$ 920,000	$ 8,655	$ 351,436
Average balance outstanding during the year	$ 616,534	$ 6,906	$ 329,745
Weighted average interest rate during the year	0.18%	5.62%	0.25%
December 31, 2014			
Amount outstanding at year-end	$	$ 8,724	$ 315,523
Weighted average interest rate at year-end		5.43%	0.26%
Maximum month-end balance during the year	$ 910,000	$ 10,689	$ 432,640
Average balance outstanding during the year	$ 134,370	$ 10,200	$ 361,025
Weighted average interest rate during the year	0.17%	5.35%	0.26%

FHLB advances and long-term notes payable The Company has an available line of credit with the FHLB of Dallas, which allows the Company to borrow on a collateralized basis. The Company s FHLB advances are typically considered short-term, overnight borrowings used to manage liquidity as needed. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At December 31, 2015, the Company had total funds of $5.25 billion available under this agreement, of which a total amount of $491.4 million was outstanding. Short-term overnight FHLB advances were $485.0 million at December 31, 2015 with a weighted average interest rate of 0.31%. Long-term notes payable were $6.4 million at December 31, 2015, with an average interest rate of 5.64%. The maturity dates on the FHLB notes payable range from the years 2016 to 2028 and have interest rates ranging from 4.51% to 6.10%.

Securities sold under repurchase agreements with Company customers At December 31, 2015, the Company had $315.3 million in securities sold under repurchase agreements compared with $315.5 million at December 31, 2014, with weighted average rates paid of 0.25% and 0.26% for the years ended December 31, 2015 and 2014, respectively. Repurchase agreements are generally settled on the following business day; however, approximately $10.9 million of repurchase agreements outstanding at December 31, 2015 have maturity dates ranging from 10 to 24 months. All securities sold under agreements to repurchase are collateralized by certain pledged securities.

Junior Subordinated Debentures

During the first quarter of 2015, the Company redeemed all of its outstanding junior subordinated debentures. Accordingly, as of December 31, 2015, the Company had no junior subordinated debentures outstanding compared with $167.5 million outstanding at December 31, 2014.

Interest Rate Sensitivity and Market Risk

The Company s asset liability and funds management policy provides management with the guidelines for effective funds management, and the Company has established a measurement system for monitoring its net interest rate sensitivity position. The Company manages its sensitivity position within established guidelines.

As a financial institution, the Company s primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Company s assets and liabilities, and the market value of all interest-earning assets and interest-bearing liabilities, other than those which have a short term to maturity. Interest rate risk is the potential of economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while at the same time maximizing income.

The Company manages its exposure to interest rates by structuring its balance sheet in the ordinary course of business. The Company does not enter into instruments such as leveraged derivatives, interest rate swaps, financial options, financial future contracts or forward delivery contracts for the purpose of reducing interest rate risk. Based upon the nature of the Company s operations, with the exception of how commodity prices may impact the Company s borrowers ability to repay loans, the Company is not subject to foreign exchange or commodity price risk. The Company does not own any trading assets.

The Company s exposure to interest rate risk is managed by the Asset Liability Committee (ALCO), which is composed of senior officers of the Company, in accordance with policies approved by the Company s Board of Directors. The ALCO formulates strategies based on appropriate levels of interest rate risk. In determining the appropriate level of interest rate risk, the ALCO considers the impact on earnings and capital of the current outlook on interest rates, potential changes in interest rates, regional economies, liquidity, business strategies and other factors. The ALCO meets regularly to review, among other things, the sensitivity of assets and liabilities to interest rate changes, the book and market values of assets and liabilities, unrealized gains and losses, purchase and sale activities, commitments to originate loans and the maturities of investments and borrowings. Additionally, the ALCO reviews liquidity, cash flow flexibility, maturities of deposits and consumer and commercial deposit activity. Management uses two methodologies to manage interest rate risk: (1) an analysis of relationships between interest-earning assets and interest-bearing liabilities; and (2) an interest rate shock simulation model. The Company has traditionally managed its business to reduce its overall exposure to changes in interest rates.

The Company uses an interest rate risk simulation model and shock analysis to test the interest rate sensitivity of net interest income and the balance sheet, respectively. Contractual maturities and repricing opportunities of loans are incorporated in the model as are prepayment assumptions, maturity data and call options within the investment portfolio. Assumptions based on past experience are incorporated into the model for nonmaturity deposit accounts. The assumptions used are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model s simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

The Company utilizes static balance sheet rate shocks to estimate the potential impact on net interest income of changes in interest rates under various rate scenarios. This analysis estimates a percentage of change in the metric from the stable rate base scenario versus alternative scenarios of rising and falling market interest rates by instantaneously shocking a static balance sheet. The following table summarizes the simulated change in net interest income at the 12-month horizon as of December 31, 2015.

Change in Interest Rates (Basis Points)	Percent Change in Net Interest Income
+200	(1.0)%
+100	(0.1)%
Base	0.0%
-100	(7.1)%

The results are significantly influenced by the behavior of demand, money market and savings deposits during such rate fluctuations. The Company has found that, historically, interest rates on these deposits change more slowly than changes in the discount and federal funds rates. This assumption is incorporated into the simulation model and is generally not fully reflected in a GAP analysis. The assumptions incorporated into the model are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model s simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various strategies.

Liquidity

Liquidity involves the Company s ability to raise funds to support asset growth and acquisitions or reduce assets to meet deposit withdrawals and other payment obligations, to maintain reserve requirements and otherwise to operate the Company on an ongoing basis and manage unexpected events. During 2015 and 2014, the Company s liquidity needs have primarily been met by growth in core deposits, security and loan maturities and amortizing investment and loan portfolios. Although access to purchased funds from correspondent banks and overnight advances from the FHLB of Dallas are available and have been utilized on occasion to take advantage of investment opportunities, the Company does not generally rely on these external funding sources.

The following table illustrates, during the years presented, the mix of the Company s funding sources and the average assets in which those funds are invested as a percentage of the Company s average total assets for the periods indicated. Average assets totaled $21.62 billion for 2015 compared with $20.60 billion for 2014.

	2015	2014
Source of Funds:		
Deposits:		
Noninterest-bearing	23.24%	22.76%
Interest-bearing	56.12	58.27
Junior subordinated debentures	0.14	0.75
Securities sold under repurchase agreements	1.53	1.75
Other borrowings	2.88	0.70
Other noninterest-bearing liabilities	0.51	0.81
Shareholders equity	15.58	14.96

Total	100.00%	100.00%
Uses of Funds:		
Loans	42.56%	43.64%
Securities	44.13	42.35
Federal funds sold and other interest-earning assets	0.54	0.70
Other noninterest-earning assets	12.77	13.31
Total	100.00%	100.00%
Average noninterest-bearing deposits to average deposits	29.28%	28.09%
Average loans to average deposits	53.62%	53.85%

The Company s largest source of funds is deposits and its largest uses of funds are securities and loans. The Company does not expect a change in the source or use of its funds in the foreseeable future. The Company s average loans increased 2.4% for the year ended December 31, 2015 compared with the year ended December 31, 2014. The Company predominantly invests excess deposits in government backed securities until the funds are needed to fund loan growth. The Company s securities portfolio has a weighted average life of 4.15 years and a modified duration of 3.83 years at December 31, 2015.

As of December 31, 2015, the Company had outstanding $1.96 billion in commitments to extend credit and $94.3 million in commitments associated with outstanding standby letters of credit. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the total outstanding may not necessarily reflect the actual future cash funding requirements.

As of December 31, 2015, the Company had no exposure to future cash requirements associated with known uncertainties or capital expenditures of a material nature.

As of December 31, 2015, the Company had cash and cash equivalents of $564.0 million compared with $677.9 million at December 31, 2014. The decrease was primarily due to the purchase of $10.15 billion of securities, the redemption of $167.5 million of junior subordinated debentures, a net increase in loans held for investment of $136.8 million and dividends paid of $78.3 million. This decrease was partially offset by proceeds from the maturities and repayments of securities of $9.63 billion, net proceeds from short-term borrowings of $485.0 million and net income of $286.6 million.

Contractual Obligations

The following table summarizes the Company s contractual obligations and other commitments to make future payments as of December 31, 2015 (other than deposit obligations and securities sold under repurchase agreements). The Company s future cash payments associated with its contractual obligations pursuant to its FHLB notes payable and operating leases as of December 31, 2015 are summarized below. The future interest payments were calculated using the current rate in effect at December 31, 2015. Payments for FHLB notes payable include interest of $1.0 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
		(Dollars in thousands)			
Federal Home Loan Bank notes payable	$ 485,978	$ 5,201	$ 980	$ 277	$ 492,436
Operating leases	6,123	8,810	5,717	7,183	27,833
Total	$ 492,101	$ 14,011	$ 6,697	$ 7,460	$ 520,269

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included in its consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company s commitments associated with outstanding standby letters of credit and commitments to extend credit expiring by period as of December 31, 2015 are summarized below. Since commitments associated

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with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the actual future cash funding requirements.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
			(Dollars in thousands)		
Standby letters of credit	$ 89,258	$ 3,912	$ 1,116	$	$ 94,286
Commitments to extend credit	1,054,490	337,416	69,908	497,332	1,959,146
Total	$ 1,143,748	$ 341,328	$ 71,024	$ 497,332	$ 2,053,432

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Company to guarantee the payment by or performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

Commitments to Extend Credit. The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses.

Capital Resources

Capital management consists of providing equity to support the Company s current and future operations. The Company is subject to capital adequacy requirements imposed by the Federal Reserve Board and the Bank is subject to capital adequacy requirements imposed by the FDIC. Both the Federal Reserve Board and the FDIC have adopted risk-based capital requirements for assessing bank holding company and bank capital adequacy. These standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, adjusted for credit risk.

In July 2013, the Federal Reserve Board and the FDIC published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules, among other things, (1) introduced a new capital measure called Common Equity Tier 1 (CET1), (2) specified that Tier 1 capital consists of CET1 and Additional Tier 1 capital instruments meeting specified requirements, (3) defined CET1 narrowly by requiring that most deductions/ adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (4) expanded the scope of the deductions/ adjustments as compared to existing regulations.

The initial minimum capital ratios under the Basel III Capital Rules that became effective as of January 1, 2015 are (1) 4.5% CET1 to risk-weighted assets, (2) 6.0% Tier 1 capital to risk-weighted assets, (3) 8.0% Total capital to risk-weighted assets, and (4) 4.0% Tier 1 capital to average quarterly assets as reported on consolidated financial statements (known as the leverage ratio).

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company to maintain an additional capital conservation buffer of 2.5% CET1, effectively resulting in minimum ratios of (1) CET1 to

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risk-weighted assets of at least 7.0%, (2) Tier 1 capital to risk-weighted assets of at least 8.5%, (3) Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 10.5% and (4) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets. The Bank is subject to capital adequacy guidelines of the FDIC that are substantially similar to the Federal Reserve Board s guidelines. Also pursuant to FDICIA, the FDIC has promulgated regulations setting the levels at which an insured institution such as the Bank would be considered well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under the FDIC s regulations, the Bank is classified well-capitalized for purposes of prompt corrective action.

Total shareholders equity increased to $3.46 billion at December 31, 2015, compared with $3.24 billion at December 31, 2014, an increase of $218.1 million or 6.7%. This increase was primarily the result of net income of $286.6 million, partially offset by dividends paid on the common stock of $78.3 million.

The following table provides a comparison of the Company s and the Bank s leverage and risk-weighted capital ratios as of December 31, 2015 to the minimum and well-capitalized regulatory standards:

	Minimum Required For Capital Adequacy Purposes	To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	Actual Ratio at December 31, 2015
The Company			
CET1 capital ratio	4.50%	N/A	13.55%
Tier 1 risk-based capital ratio	6.00%	N/A	13.55%
Total risk-based capital ratio	8.00%	N/A	14.25%
Leverage ratio	4.00% (1)	N/A	7.97%
The Bank			
CET1 capital ratio	4.50%	6.50%	13.10%
Tier 1 risk-based capital ratio	6.00%	8.00%	13.10%
Total risk-based capital ratio	8.00%	10.00%	13.80%
Leverage ratio	4.00% (2)	5.00%	7.70%

(1) The Federal Reserve Board may require the Company to maintain a leverage ratio above the required minimum.
(2) The FDIC may require the Bank to maintain a leverage ratio above the required minimum.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding the market risk of the Company s financial instruments, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation Financial Condition Interest Rate Sensitivity and Market Risk. The Company s principal market risk exposure is to changes in interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements, the report thereon, the notes thereto and supplementary data commence at page 64 of this Annual Report on Form 10-K.

The following table presents certain unaudited consolidated quarterly financial information concerning the Company s results of operations for each of the two years indicated below. The information should be read in conjunction with the historical consolidated financial statements of the Company and the notes thereto appearing elsewhere in this Annual Report on Form 10-K.

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CONSOLIDATED QUARTERLY FINANCIAL DATA OF THE COMPANY

	Quarter Ended 2015			
	December 31	September 30	June 30	March 31
	(Dollars in thousands, except per share data) (unaudited)			
Interest income	$ 162,572	$ 165,543	$ 167,981	$ 173,605
Interest expense	9,314	9,435	9,742	10,700
Net interest income	153,258	156,108	158,239	162,905
Provision for credit losses	500	5,310	500	1,250
Net interest income after provision	152,758	150,798	157,739	161,655
Noninterest income	30,283	31,780	30,297	28,421
Noninterest expense	77,909	76,430	79,735	79,462
Income before income taxes	105,132	106,148	108,301	110,614
Provision for income taxes	34,657	35,550	36,369	36,973
Net income	$ 70,475	$ 70,598	$ 71,932	$ 73,641
Earnings per share (1):				
Basic	$ 1.01	$ 1.01	$ 1.03	$ 1.05
Diluted	$ 1.01	$ 1.01	$ 1.03	$ 1.05

	Quarter Ended 2014			
	December 31	September 30	June 30	March 31
	(Dollars in thousands, except per share data) (unaudited)			
Interest income	$ 186,578	$ 187,466	$ 186,503	$ 154,248
Interest expense	8,827	11,809	12,448	10,557
Net interest income	177,751	175,657	174,055	143,691
Provision for credit losses	6,350	5,000	6,325	600
Net interest income after provision	171,401	170,657	167,730	143,091
Noninterest income	29,380	30,191	32,597	28,664
Noninterest expense	84,036	85,540	87,292	71,094
Income before income taxes	116,745	115,308	113,035	100,661
Provision for income taxes	38,517	38,738	37,529	33,524
Net income	$ 78,228	$ 76,570	$ 75,506	$ 67,137

Earnings per share (1):								
Basic	$	1.12	$	1.10	$	1.08	$	1.01
Diluted	$	1.12	$	1.10	$	1.08	$	1.01

(1) Earnings per share are computed independently for each of the quarters presented and therefore may not total earnings per share for the year.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply judgment in evaluating its controls and procedures. Based on this evaluation, the Company s Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), were effective as of the end of the period covered by this report.

Changes in internal control over financial reporting. There were no changes in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended December 31, 2015, that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control over financial reporting is a process designed under the supervision of the Company s Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company s financial statements for external purposes in accordance with generally accepted accounting principles.

As of December 31, 2015, management assessed the effectiveness of the Company s internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control Integrated Framework, issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission (2013 Framework). This assessment included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2015.

Deloitte & Touche LLP the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on the Company s internal control over financial reporting as of December 31, 2015. The report is included in this Item under the heading Report of Independent Registered Public Accounting Firm.

Compliance with Designated Laws and Regulations

Management is also responsible for ensuring compliance with the federal laws and regulations concerning loans to insiders and the federal and state laws and regulations concerning dividend restrictions, both of which are designated by the FDIC as safety and soundness laws and regulations.

Management assessed its compliance with the designated safety and soundness laws and regulations and has maintained records of its determinations and assessments as required by the FDIC. Based on this assessment, management believes that the Company has complied with the designated safety and soundness laws and regulations for the year ended December 31, 2015.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Prosperity Bancshares, Inc.

Houston, Texas

We have audited the internal control over financial reporting of Prosperity Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2015, based on criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because management s assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), management s assessment and our audit of the Company s internal control over financial reporting included controls over the preparation of the schedules equivalent to the basic financial statements in accordance with the instructions for the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have not examined and, accordingly, we do not express an opinion or any other form of assurance on management s statement referring to compliance with laws and regulations.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2015 of the Company and our report dated February 29, 2016 expressed an unqualified opinion on those consolidated financial statements.

/s/ Deloitte & Touche LLP

Houston, Texas

February 29, 2016

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ITEM 9B. OTHER INFORMATION

None.

PART III.

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to the information under the captions Election of Directors, Continuing Directors and Executive Officers, Section 16(a) Beneficial Ownership Reporting Compliance, Corporate Governance Committees of the Board Audit Committee, Corporate Governance Director Nomination Process and Corporate Governance Code of Ethics in the Company s definitive Proxy Statement for its 2016 Annual Meeting of Shareholders (the 2016 Proxy Statement) to be filed with the Commission pursuant to Regulation 14A under the Exchange Act within 120 days of the Company s fiscal year end.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to the information under the captions Executive Compensation and Other Matters and Director Compensation in the 2016 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Certain information required by this Item 12 is included under Securities Authorized for Issuance under Equity Compensation Plans in Part II, Item 5 of this Annual Report on Form 10-K. The other information required by this Item is incorporated herein by reference to the information under the caption Beneficial Ownership of Common Stock by Management of the Company and Principal Shareholders in the 2016 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to the information under the captions Corporate Governance Director Independence and Certain Relationships and Related Transactions in the 2016 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated herein by reference to the information under the caption Fees and Services of Independent Registered Public Accounting Firm in the 2016 Proxy Statement.

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PART IV.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Consolidated Financial Statements. Reference is made to the Consolidated Financial Statements, the report thereon and the notes thereto commencing at page 64 of this Annual Report on Form 10-K. Set forth below is a list of such Consolidated Financial Statements:

2. Financial Statement Schedules. All supplemental schedules are omitted as inapplicable or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. The exhibits to this Annual Report on Form 10-K listed below have been included only with the copy of this report filed with the Securities and Exchange Commission. The Company will furnish a copy of any exhibit to shareholders upon written request to the Company and payment of a reasonable fee not to exceed the Company s reasonable expense.

Each exhibit marked with an asterisk is filed or furnished with this Annual Report on Form 10-K as noted below.

hares, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company s Registration Statement on Form S-1 (Registration No. 33
ration of Prosperity Bancshares, Inc. (incorporated herein by reference to Exhibit 3.2 to the Company s Quarterly Report on Form 10-
orated herein by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed April 23, 2015)
common stock (incorporated herein by reference to Exhibit 4 to the Company s Registration Statement on Form S-1 (Registration No.
herein by reference to Exhibit 10.3 to the Company s Registration Statement on Form S-4 (Registration No. 333-121767))
herein by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on April 23, 2012)
uary 1, 2009 by and among Prosperity Bancshares, Inc., Prosperity Bank and David Zalman (incorporated herein by reference to Exhib

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tive February 22, 2012 by and among Prosperity Bancshares, Inc., Prosperity Bank and H. E. Timanus, Jr. (incorporated herein by refer

nd among Prosperity Bancshares, Inc., Prosperity Bank and H. E. Timanus, Jr. (incorporated herein by reference to Exhibit 10.4 to the

ng Prosperity Bancshares, Inc., Prosperity Bank and David Hollaway (incorporated herein by reference to Exhibit 10.2 to the Company

d American State Financial Corporation dated February 26, 2012 (incorporated herein by reference to Exhibit 2.1 to the Company s Cu

en W.R. Collier and Prosperity Bank (incorporated herein by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-

d Prosperity Bank (incorporated herein by reference to Exhibit 10.10 to the Company s Annual Report on Form 10-K for the year ende

effective as of January 1, 2005, as assumed by Prosperity Bank (incorporated herein by reference to Exhibit 10.11 to the Company s A

ward Z. Safady (incorporated herein by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q filed on August 7,

rosperity Bank and Edward Safady (incorporated herein by reference to Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q

ween Prosperity Bank and Edward Safady (incorporated herein by reference to Exhibit 10.3 to the Company s Quarterly Report on For

s Exchange Act of 1934, as amended

s Exchange Act of 1934, as amended

ed pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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escription

ertification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley A

nteractive financial data

Management contract or compensatory plan or arrangement.

* Filed with this Annual Report on Form 10-K.

** Furnished with this Annual Report on Form 10-K.

(1) The Company has other long-term debt agreements that meet the exclusion set forth in Section 601(b)(4)(iii)(A) of Regulation S-K. The Company hereby agrees to furnish a copy of such agreements to the Commission upon request.

(b) Exhibits. See the exhibit list included in Item 15(a)3 of this Annual Report on Form 10-K.

(c) Financial Statement Schedules. See Item 15(a)2 of this Annual Report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the registrant, has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 29, 2016

PROSPERITY BANCSHARES, INC.®
(Registrant)

BY: /s/ DAVID ZALMAN
David Zalman

Chairman of the Board and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Positions	Date
/s/ DAVID ZALMAN **David Zalman**	Chairman of the Board and Chief Executive Officer (principal executive officer); Director	February 29, 2016
/s/ DAVID HOLLAWAY **David Hollaway**	Chief Financial Officer (principal financial officer and principal accounting officer)	February 29, 2016
/s/ JAMES A. BOULIGNY **James A. Bouligny**	Director	February 29, 2016
/s/ W. R. COLLIER **W. R. Collier**	Director	February 29, 2016
/s/ LEAH HENDERSON **Leah Henderson**	Director	February 29, 2016
/s/ NED S. HOLMES	Director	February 29, 2016

Ned S. Holmes		
/s/ WILLIAM T. LUEDKE IV	Director	February 29, 2016
William T. Luedke IV		
/s/ PERRY MUELLER, JR., D.D.S.	Director	February 29, 2016
Perry Mueller, Jr., D.D.S.		
/s/ HARRISON STAFFORD II	Director	February 29, 2016
Harrison Stafford II		
/s/ ROBERT STEELHAMMER	Director	February 29, 2016
Robert Steelhammer		
/s/ H.E. TIMANUS, JR.	Director	February 29, 2016
H.E. Timanus, Jr.		

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Prosperity Bancshares, Inc.

Houston, Texas

We have audited the accompanying consolidated balance sheets of Prosperity Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in shareholders equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Prosperity Bancshares, Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2015, based on the criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2016 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Houston, Texas

February 29, 2016

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2015	December 31, 2014
	(Dollars in thousands)	
ASSETS		
Cash and due from banks	$ 562,544	$ 677,285
Federal funds sold	1,418	569
Total cash and cash equivalents	563,962	677,854
Available for sale securities, at fair value	103,064	145,399
Held to maturity securities, at cost (fair value of $9,393,175 and $8,948,692 respectively)	9,399,363	8,900,377
Total securities	9,502,427	9,045,776
Loans held for sale	23,933	8,602
Loans held for investment	9,414,656	9,235,581
Total loans	9,438,589	9,244,183
Less: allowance for credit losses	(81,384)	(80,762)
Loans, net	9,357,205	9,163,421
Accrued interest receivable	51,924	51,941
Goodwill	1,868,827	1,874,191
Core deposit intangibles, net	49,417	58,947
Bank premises and equipment, net	267,996	281,549
Other real estate owned	2,963	3,237
Bank owned life insurance (BOLI)	235,429	230,095
Federal Home Loan Bank of Dallas stock	68,413	15,432
Other assets	68,653	105,290
TOTAL ASSETS	$ 22,037,216	$ 21,507,733
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 5,136,579	$ 4,936,420
Interest-bearing	12,544,540	12,756,738
Total deposits	17,681,119	17,693,158
Fed funds purchased and other borrowings	491,399	8,724
Securities sold under repurchase agreements	315,253	315,523
Junior subordinated debentures		167,531
Accrued interest payable	1,896	3,190

Other liabilities	84,639	74,781
Total liabilities	18,574,306	18,262,907
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY:		
Preferred stock, $1 par value; 20,000,000 shares authorized; none issued or outstanding		
Common stock, $1 par value; 200,000,000 shares authorized; 70,058,761 and 69,816,653 shares issued at December 31, 2015 and December 31, 2014, respectively; 70,021,673 and 69,779,565 shares outstanding at December 31, 2015 and December 31, 2014, respectively	70,059	69,817
Capital surplus	2,036,378	2,025,235
Retained earnings	1,355,040	1,146,652
Accumulated other comprehensive income net unrealized gain on available for sale securities, net of tax of $1,098 and $2,008, respectively	2,040	3,729
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders equity	3,462,910	3,244,826
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 22,037,216	$ 21,507,733

See notes to consolidated financial statements.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended December 31,		
	2015	2014	2013
	(Dollars in thousands, except per share data)		
INTEREST INCOME:			
Loans, including fees	$ 475,427	$ 525,716	$ 376,117
Securities	194,003	188,744	162,993
Federal funds sold	271	335	187
Total interest income	669,701	714,795	539,297
INTEREST EXPENSE:			
Deposits	36,074	37,871	35,222
Other borrowings	1,508	772	1,497
Securities sold under repurchase agreements	818	938	1,201
Junior subordinated debentures	791	4,060	2,551
Total interest expense	39,191	43,641	40,471
NET INTEREST INCOME	630,510	671,154	498,826
PROVISION FOR CREDIT LOSSES	7,560	18,275	17,240
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	622,950	652,879	481,586
NONINTEREST INCOME:			
Nonsufficient funds (NSF) fees	34,284	37,048	35,173
Credit card, debit card and ATM card income	23,534	22,889	22,463
Service charges on deposit accounts	17,095	16,452	12,864
Trust income	8,030	8,108	4,356
Mortgage income	5,720	4,264	4,038
Brokerage income	5,953	5,868	1,518
Net gain (loss) on sale of assets	2,403	4,658	(13)
Other	23,762	21,545	15,028
Total noninterest income	120,781	120,832	95,427
NONINTEREST EXPENSE:			
Salaries and employee benefits	192,872	199,270	148,494
Net occupancy and equipment	23,638	24,756	18,934
Credit and debit card, data processing and software amortization	15,782	15,790	11,908
Regulatory assessments and FDIC insurance	14,433	15,017	10,261

Core deposit intangibles amortization	9,530	9,940	6,145
Depreciation	12,959	13,730	10,593
Communications	11,121	11,609	9,471
Other real estate expense	625	1,019	711
Other	32,576	36,831	30,679
Total noninterest expense	313,536	327,962	247,196
INCOME BEFORE INCOME TAXES	430,195	445,749	329,817
PROVISION FOR INCOME TAXES	143,549	148,308	108,419
NET INCOME	$ 286,646	$ 297,441	$ 221,398
EARNINGS PER SHARE:			
Basic	$ 4.09	$ 4.32	$ 3.66
Diluted	$ 4.09	$ 4.32	$ 3.65

See notes to consolidated financial statements.

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PROSPERITY BANCSHARES, INC. ® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Net income	$ 286,646	$ 297,441	$ 221,398
Other comprehensive loss, before tax:			
Securities available for sale:			
Change in unrealized gain during period	(2,599)	(1,776)	(6,312)
Total other comprehensive loss	(2,599)	(1,776)	(6,312)
Deferred tax benefit related to other comprehensive income	910	622	2,209
Other comprehensive loss, net of tax	(1,689)	(1,154)	(4,103)
Comprehensive income	$ 284,957	$ 296,287	$ 217,295

See notes to consolidated financial statements.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

	Common Stock Shares	Common Stock Amount	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders Equity
	(In thousands, except share and per share data)						
BALANCE AT DECEMBER 31, 2012	56,484,234	$ 56,484	$ 1,274,290	$ 750,236	$ 8,986	$ (607)	$ 2,089,389
Net income				221,398			221,398
Other comprehensive loss					(4,103)		(4,103)
Common stock issued in connection with the exercise of stock options and restricted stock awards	240,620	240	5,139				5,379
Common stock issued in connection with the acquisition of East Texas Financial Services, Inc.	530,940	531	21,769				22,300
Common stock issued in connection with the acquisition of Coppermark Bancshares, Inc.	3,258,718	3,259	151,172				154,431
Common stock issued in connection with the acquisition of FVNB Corp.	5,570,667	5,571	342,317				347,888
Stock based compensation expense			4,175				4,175
Cash dividends declared, $0.8850 per share				(54,039)			(54,039)
BALANCE AT DECEMBER 31, 2013	66,085,179	66,085	1,798,862	917,595	4,883	(607)	2,786,818
Net income				297,441			297,441
Other comprehensive loss					(1,154)		(1,154)
Common stock issued in connection with the	433,452	434	3,271				3,705

exercise of stock options and restricted stock awards							
Common stock issued in connection with the acquisition of F&M Bancorporation Inc.	3,298,022	3,298	214,866				218,164
Stock based compensation expense			8,236				8,236
Cash dividends declared, $0.9925 per share				(68,384)			(68,384)
BALANCE AT DECEMBER 31, 2014	69,816,653	69,817	2,025,235	1,146,652	3,729	(607)	3,244,826
Net income				286,646			286,646
Other comprehensive loss					(1,689)		(1,689)
Common stock issued in connection with the exercise of stock options and restricted stock awards	242,108	242	48				290
Stock based compensation expense			11,095				11,095
Cash dividends declared, $1.1175 per share				(78,258)			(78,258)
BALANCE AT DECEMBER 31, 2015	70,058,761	$ 70,059	$ 2,036,378	$ 1,355,040	$ 2,040	$ (607)	$ 3,462,910

See notes to consolidated financial statements.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31, 2015	2014	2013
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 286,646	$ 297,441	$ 221,398
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and core deposit intangibles amortization	22,489	23,670	16,738
Provision for credit losses	7,560	18,275	17,240
Deferred income tax expense	34,999	45,713	19,884
Net amortization of premium on investments	58,229	51,680	68,703
(Gain) loss on sale or write down of premises, equipment and other real estate	(2,437)	(3,974)	549
Net amortization of premium on deposits	(1,055)	(2,556)	(388)
Net accretion of discount on loans	(52,122)	(95,876)	(62,723)
Proceeds from sale of loans held for sale	233,535	182,138	168,784
Originations of loans held for sale	(248,866)	(188,530)	(163,072)
Stock based compensation expense	11,095	8,236	4,175
(Increase) decrease in accrued interest receivable and other assets	(44,756)	9,786	24,793
Increase (decrease) in accrued interest payable and other liabilities	5,497	2,258	(8,424)
Net cash provided by operating activities	310,814	348,261	307,657
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturities and principal paydowns of held to maturity securities	1,654,471	1,365,005	2,125,086
Purchase of held to maturity securities	(2,211,731)	(2,218,105)	(2,702,521)
Proceeds from maturities, sales and principal paydowns of available for sale securities	7,974,775	7,050,232	3,523,871
Purchase of available for sale securities	(7,934,994)	(6,999,997)	(3,454,998)
Net (increase) decrease in loans held for investment	(136,829)	219,952	(47,889)
Purchase of bank premises and equipment	(9,357)	(12,075)	(24,007)
Proceeds from the sale of Bankers Credit Card Services, Inc.		6,440	
Proceeds from sale of bank premises, equipment and other real estate	13,037	28,765	12,359
Net cash and cash equivalents acquired in the purchase of East Texas Financial Services, Inc.			3,471
Net cash and cash equivalents acquired in the purchase of Coppermark Banchares, Inc.			288,795
Net cash and cash equivalents acquired in the purchase of FVNB Corp.			284,683
		487,599	

Net cash and cash equivalents acquired in the purchase of F&M Bancorporation Inc.			
Net cash (used in) provided by investing activities	(650,628)	(72,184)	8,850
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in noninterest-bearing deposits	200,159	176,477	177,362
Net decrease in interest-bearing deposits	(211,143)	(40,612)	(10,221)
Net proceeds (repayments of) from other short-term borrowings	485,000		(245,000)
Repayments of other long-term borrowings	(2,325)	(1,965)	(41,357)
Net decrease in securities sold under repurchase agreements	(270)	(48,834)	(93,545)
Redemption of junior subordinated debentures	(167,531)		
Proceeds from stock option exercises	290	3,705	5,379
Payments of cash dividends	(78,258)	(68,384)	(54,039)
Net cash provided by (used in) financing activities	225,922	20,387	(261,421)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(113,892)	296,464	55,086
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	677,854	381,390	326,304
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 563,962	$ 677,854	$ 381,390
NONCASH ACTIVITIES:			
Stock issued in connection with the East Texas Financial Services, Inc. acquisition	$	$	$ 22,300
Stock issued in connection with the Coppermark Bancshares, Inc. acquisition			154,431
Stock issued in connection with the FVNB Corp. acquisition			347,888
Stock issued in connection with the F&M Bancorporation Inc. acquisition		218,164	
Acquisition of real estate through foreclosure of collateral	2,591	6,914	3,119
SUPPLEMENTAL INFORMATION:			
Income taxes paid	$ 103,116	$ 105,852	$ 92,226
Interest paid	44,277	43,209	39,687

See notes to consolidated financial statements.

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PROSPERITY BANCSHARES, INC.® AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Nature of Operations Prosperity Bancshares, Inc.® (Bancshares) and its subsidiary, Prosperity Bank® (the Bank , collectively referred to as the Company), provide retail and commercial banking services.

As of December 31, 2015, the Bank operated 241 full-service banking locations; with 60 in the Houston area, including The Woodlands; 30 in the South Texas area including Corpus Christi and Victoria; 36 in the Dallas/Fort Worth, Texas area; 22 in the East Texas area; 29 in the Central Texas area, including Austin and San Antonio; 34 in the West Texas area including Lubbock, Midland-Odessa and Abilene; 16 in the Bryan/College Station area; 6 in the Central Oklahoma area and 8 in the Tulsa, Oklahoma area.

Summary of Significant Accounting and Reporting Policies The accounting and reporting policies of the Company conform to generally accepted accounting principles (GAAP) and the prevailing practices within the financial services industry. A summary of significant accounting and reporting policies are as follows:

Basis of Presentation The consolidated financial statements include the accounts of Bancshares and its subsidiaries. Intercompany transactions have been eliminated in consolidation. Operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, all of the Company s banking operations are considered by management to be aggregated in one reportable operating segment. Because the overall banking operations comprise the vast majority of the consolidated operations, no separate segment disclosures are presented.

Use of Estimates The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include, but are not limited to certain fair value measures including the calculation of stock-based compensation, the valuation of goodwill and available for sale and held to maturity securities and the calculation of allowance for credit losses. Actual results could differ from these estimates.

Securities Securities held to maturity are carried at cost, adjusted for the amortization of premiums and the accretion of discounts. Management has the positive intent and the Company has the ability to hold these assets until their estimated maturities.

Securities available for sale are carried at fair value. Unrealized gains and losses are excluded from earnings and reported, net of tax, as a separate component of shareholders equity until realized. Securities within the available for sale portfolio may be used as part of the Company s asset/liability strategy and may be sold in response to changes in interest rate risk, prepayment risk or other similar economic factors.

For debt securities, when other-than-temporary impairment (OTTI) occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment s amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit-related portion of the impairment loss (credit loss) and the noncredit portion of the impairment loss (noncredit portion). The amount of the total OTTI related to the credit loss is

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determined based on the difference between the present value of cash flows expected to be collected and the amortized cost basis and such difference is recognized in earnings. The amount of the total OTTI related to the noncredit portion is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment.

Premiums and discounts are amortized and accreted to operations using the level-yield method of accounting, adjusted for prepayments as applicable. The specific identification method of accounting is used to compute gains or losses on the sales of these assets. Interest earned on these assets is included in interest income.

Loans Held for Sale Loans held for sale are carried at the lower of aggregate cost or market value. Premiums, discounts and loan fees (net of certain direct loan origination costs) on loans held for sale are deferred until the related loans are sold or repaid. Gains or losses on loan sales are recognized at the time of sale and determined using the specific identification method.

Loans Held for Investment Loans originated and held for investment are stated at the principal amount outstanding, net of unearned fees. The related interest income for multipayment loans is recognized principally by the simple interest method; for single payment loans, such income is recognized using the straight-line method.

The Company has two general categories of loans in its portfolio. Loans originated by the Bank and made pursuant to the Company s loan policy and procedures in effect at the time the loan was made are referred to as legacy loans and loans acquired in a business combination are referred to as acquired loans. Acquired loans are initially recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, interest rates, projected default rates, loss given default, and recovery rates with no carryover of any existing allowance for credit losses. Those acquired loans that are renewed or substantially modified after the date of the business combination, which therefore causes them to become subject to the Company s allowance for credit losses methodology, are referred to as acquired legacy loans. Modifications are reviewed for determination of troubled debt restructuring status independently of this process. In certain instances, acquired loans to one borrower may be combined or otherwise re-originated such that they are re-categorized as legacy loans. Acquired loans with a fair value discount or premium at the date of the business combination that remained at the reporting date are referred to as fair-valued acquired loans. All fair-valued acquired loans are further categorized into Non-PCI loans and PCI loans (purchased credit impaired loans). Acquired loans with evidence of credit quality deterioration at acquisition are reviewed to determine if it is probable that the Company will not be able to collect all contractual amounts due, including both principal and interest. When both conditions exist, such loans are accounted for as PCI loans.

The Company estimates the total cash flows expected to be collected from the PCI loans, which include undiscounted expected principal and interest, using credit risk, interest rate and prepayment risk assessments that incorporate management s best estimate of current key assumptions such as default rates, loss severity and payment speeds. The excess of the undiscounted total cash flows expected to be collected over the fair value of the related PCI loans represents the accretable yield, which is recognized as interest income on a level-yield basis over the life of the related loan. The difference between the undiscounted contractual principal and interest and the undiscounted total cash flows expected to be collected is the nonaccretable difference, which reflects the impact of estimated credit losses and other factors. Subsequent increases in expected cash flows will result in a recovery of any previously recorded allowance for credit losses, to the extent applicable, and a reclassification from nonaccretable difference to accretable yield, which is recognized prospectively over the then remaining life of the loan. Subsequent decreases in expected cash flows will result in an impairment charge to the provision for credit losses, resulting in an addition to the allowance for credit losses, and a reclassification from accretable yield to nonaccretable difference.

A loan disposal, which may include a loan sale, receipt of payment in full from the borrower or foreclosure, results in removal of the loan from the balance sheet at its allocated carrying amount and accretion of any remaining fair value discount to income.

Nonrefundable Fees and Costs Associated with Lending Activities Loan origination fees in excess of the associated costs are recognized over the life of the related loan as an adjustment to yield using the interest method.

Loan commitment fees and loan origination costs are deferred and recognized as an adjustment of yield by the interest method over the related loan life or, if the commitment expires unexercised, recognized in income upon expiration of the commitment.

Nonperforming and Past Due Loans Included in the nonperforming loan category are loans which have been categorized by management as nonaccrual because collection of interest is doubtful and loans which have been restructured to provide a reduction in the interest rate or a deferral of interest or principal payments. When the payment of principal or interest on a loan is delinquent for 90 days, or earlier in some cases, the loan is placed on nonaccrual status unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan. If the decision is made to continue accruing interest on the loan, periodic reviews are made to confirm the accruing status of the loan. When a loan is placed on nonaccrual status, interest accrued but not yet collected prior to the determination of uncollectibility is charged to operations. Interest accrued during prior periods is charged to the allowance for credit losses. Any payments received on nonaccrual loans are applied first to outstanding principal of the loan amount, next to the recovery of charged-off loan amounts and finally, any excess is treated as recovery of lost interest.

Restructured loans are those loans on which concessions in terms have been granted because of a borrower s financial difficulty. Interest is generally not accrued on such loans in accordance with the new terms.

Allowance for Credit Losses The allowance for credit losses is a valuation allowance available for losses incurred on loans. All losses are charged to the allowance when the loss actually occurs or when a determination is made that such a loss is probable. Recoveries are credited to the allowance at the time of recovery.

Throughout the year, management estimates the probable level of losses to determine whether the allowance for credit losses is adequate to absorb losses inherent in the loan portfolio. Based on these estimates, an amount is charged to the provision for credit losses and credited to the allowance for credit losses in order to adjust the allowance to a level determined to be adequate to absorb losses.

In making its evaluation of the adequacy of the allowance for credit losses, management considers factors such as historical loan loss experience, the amount of nonperforming assets and related collateral, the volume, growth and composition of the Company s loan portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the Company s loan portfolio through its internal loan review process and other relevant factors.

Estimates of credit losses involve an exercise of judgment. While it is possible that in the short term the Company may sustain losses which are substantial in relation to the allowance for credit losses, it is the judgment of management that the allowance for credit losses reflected in the consolidated balance sheets is adequate to absorb probable losses that exist in the loan portfolio as of December 31, 2015.

The Company s allowance for credit losses consists of two elements: (1) specific valuation allowances based on probable losses on impaired loans; and (2) a general valuation allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company. A loan is defined as impaired if, based on current information and events, it is probable that a creditor will be unable to collect all amounts due, both interest and principal, according to the contractual terms of the loan agreement. The allowance for credit losses related to impaired loans is determined based on the difference of carrying value of loans and the present value of expected cash flows discounted at the loan s effective interest rate or, as a practical expedient, the loan s observable market price or the fair value of the collateral if the loan is collateral dependent.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for credit losses is recorded for these loans at acquisition. These fair value estimates associated with acquired loans, based on a discounted cash flow model, include estimates related to market interest rates and undiscounted projections of future cash flows that incorporate expectations of prepayments and the amount and timing of principal, interest and other cash flows, as well as any shortfalls thereof. At period-end after acquisition, the fair-valued acquired loans from each acquisition are reassessed to determine whether an addition to the allowance for credit losses is appropriate due to further credit quality deterioration. Methods utilized to estimate any subsequently required allowance for acquired loans not deemed credit impaired at acquisition are similar to originated loans; however, the estimate of loss is based on the unpaid principal balance and then compared to any remaining unaccreted purchase discount. To the extent that the calculated loss is greater than the remaining unaccreted purchase discount, an allowance is recorded for such difference.

Premises and Equipment Premises and equipment are carried at cost less accumulated depreciation. Depreciation expense is computed principally using the straight-line method over the estimated useful lives of the assets which range from three to 39 years. Leasehold improvements are amortized using the straight-line method over the periods of the leases or the estimated useful lives, whichever is shorter.

Goodwill Goodwill is annually assessed for impairment or when events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Under Accounting Standards Codification (ASC) topic 350-20, Intangibles Goodwill and Other Goodwill companies have the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining the need to perform step one of the annual test for goodwill impairment. An entity has an unconditional option to bypass the qualitative assessment described in the preceding paragraph for any reporting unit in any period and proceed directly to performing the first step of the goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period.

If the Company bypasses the qualitative assessment, a two-step goodwill impairment test is performed. The first step of the goodwill impairment test compares the estimated fair value of the Company s reporting unit to its carrying value. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill of the reporting unit is not impaired. If the estimated fair value of the reporting unit is less than the carrying value, the second step must be performed to determine the implied fair value of the reporting unit s goodwill and the amount of goodwill impairment, if any.

Estimating the fair value of the Company s reporting unit is a subjective process involving the use of estimates and judgments, particularly related to future cash flows of the reporting units, discount rates (including market risk premiums) and market multiples. Material assumptions used in the valuation tools included the comparable public company price multiples used in the terminal value, future cash flows and the market risk premium component of the discount rate. The estimated fair value of the reporting unit is determined using a blend of two commonly used valuation techniques: the market approach and the income approach. The Company gives consideration to both valuation techniques, as either technique can be an indicator of value. For the market approach, valuation is based on an analysis of relevant price multiples in market trades in companies with similar characteristics. For the income approach, estimated future cash flows (derived from internal forecasts and economic expectations) and terminal value (value at the end of the cash flow period, based on price multiples) are discounted. The discount rate was based on the imputed cost of equity capital.

Amortization of Core Deposit Intangibles Core deposit intangibles are being amortized on a non-pro rata basis over an estimated life of 10 to 15 years.

Income Taxes The Company files a consolidated federal income tax return and a consolidated Oklahoma state income tax return.

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Deferred tax assets and liabilities are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are recorded in other assets on the Company s consolidated balance sheets. The Company records uncertain tax positions in accordance with ASC 740 on the basis of a two-step process whereby (1) the Company determines whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, the Company recognizes the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

Realization of net deferred tax assets is based upon the level of historical income and on estimates of future taxable income. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax assets will be realized.

Stock-Based Compensation The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting. The expense associated with stock-based compensation is recognized over the vesting period of each individual arrangement. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. This model requires the input of subjective assumptions. The fair value of restricted stock awards is based on the current market price on the date of grant.

Cash and Cash Equivalents For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks as well as federal funds sold that mature in three days or less.

Earnings Per Common Share Basic earnings per common share are calculated using the two-class method. The two-class method provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of basic earnings per share.

Diluted earnings per common share is computed using the weighted-average number of shares determined for the basic earnings per common share computation plus the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock using the treasury stock method. Outstanding stock options issued by the Company represent the only dilutive effect reflected in diluted weighted average shares.

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The following table illustrates the computation of basic and diluted earnings per share:

	Year Ended December 31,					
	2015		2014		2013	
	(Amounts in thousands, except per share data)					
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Net income	$ 286,646		$ 297,441		$ 221,399	
Basic:						
Weighted average shares outstanding	70,033	$ 4.09	68,855	$ 4.32	60,421	$ 3.66
Diluted:						
Add incremental shares for:						
Effect of dilutive securities options	16		56		157	
Total	70,049	$ 4.09	68,911	$ 4.32	60,578	$ 3.65

There were no stock options exercisable at December 31, 2015, 2014 and 2013 that would have had an anti-dilutive effect on the above computation.

New Accounting Standards

Accounting Standards Updates (ASU)

ASU 2016-01 Financial Instruments Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 (i) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (iv) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (v) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (vi) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vii) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity s other deferred tax assets. The amendments in this update affect all entities that hold financial assets or owe financial liabilities. ASU 2016-01 is effective for the Company beginning January 1, 2018, and is not expected to have a significant impact on the Company s financial statements.

ASU 2015-16, Business Combinations (Topic 805) Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The acquirer must record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. Additionally, the entity is required to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU 2015-16 became effective for the Company beginning January 1, 2016 and is not expected to have a significant impact on the Company s financial statements.

ASU 2015-01, Income Statement Extraordinary and Unusual Items (Subtopic 225-20) Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. ASU 2015-01 eliminates from GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 became effective for the Company on January 1, 2016 and is not expected to have a significant impact on the Company s financial statements.

ASU 2014-12 Compensation-Stock Compensation (Topic 718) Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. ASU 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 became effective for the Company on January 1, 2016 and is not expected to have a significant impact on the Company s financial statements.

ASU 2014-11 Transfers and Servicing (Topic 860) Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosure. ASU 2014-11 changes the accounting for repurchase-to-maturity transactions to secured borrowing accounting. It also requires separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting and disclosure for the repurchase agreement. ASU 2014-11 became effective for the Company on January 1, 2016 and is not expected to have a significant impact on the Company s financial statements.

ASU 2014-09 Revenue from Contract with Customers (Topic 606). ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605), and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, ASU 2014-09 supersedes some cost guidance included in Revenue Recognition Construction-Type and Production-Type Contracts (Subtopic 605-35). In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer are amended to be consistent with the guidance on recognition and measurement. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for the Company beginning January 1, 2018, with retrospective application to each prior reporting period presented. The Company is currently evaluating the requirements of ASU 2014-09, but it is not expected to have a significant impact on the Company s financial statements.

ASU 2014-04 Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40) Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. ASU 2014-04 intends to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU 2014-04 became effective for the Company on January 1, 2015 and did not have a significant impact on the Company s financial statements.

2. ACQUISITIONS

Acquisitions are an integral part of the Company s growth strategy. All acquisitions were accounted for using the acquisition method of accounting. Accordingly, the assets and liabilities of the acquired entities were recorded at their fair values at the acquisition date. The excess of the purchase price over the estimated fair value of the net assets for tax-free acquisitions was recorded as goodwill, none of which is deductible for tax purposes. The excess of the purchase price over the estimated fair value of the net assets for taxable acquisitions was also recorded as goodwill, and is deductible for tax purposes. The identified core deposit intangibles for each acquisition are being amortized using a non-pro rata basis over an estimated life of 10 to 15 years. The results of operations for each acquisition have been included in the Company s consolidated financial results beginning on the respective acquisition date.

The measurement period for the Company to determine the fair values of acquired identifiable assets and assumed liabilities will end at the earlier of (1) twelve months from the date of the acquisition or (2) as soon as the Company receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. The following acquisitions were completed on the dates indicated:

2014 Acquisition

Acquisition of F&M Bancorporation Inc. On April 1, 2014, the Company completed the acquisition of F&M Bancorporation Inc. (FMBC) and its wholly-owned subsidiary The F&M Bank & Trust Company (collectively, F&M) headquartered in Tulsa, Oklahoma. F&M operated 13 banking locations: 9 in Tulsa, Oklahoma and surrounding areas; 1 (a loan production office) in Oklahoma City, Oklahoma; and 3 in Dallas, Texas. The Company acquired FMBC to further expand its Oklahoma and Dallas, Texas area markets. The acquisition is not considered significant to the Company s financial statements and therefore pro forma financial data is not included.

The Company acquired loans and deposits with fair values of $1.60 billion and $2.27 billion, respectively, at acquisition date. Under the terms of the definitive agreement, Bancshares issued 3,298,022 shares of its common stock plus $34.2 million in cash for all outstanding shares of FMBC capital stock for total merger consideration of $252.4 million based on Bancshares closing stock price of $66.15. During 2014, the Company recognized goodwill of $198.2 million. As of December 31, 2015, total goodwill related to the FMBC acquisition was $192.9 million, after recording $5.3 million of net measurement period adjustments during 2015. Goodwill is calculated as the excess of both the consideration exchanged and liabilities assumed as compared to the fair value of identifiable assets acquired, none of which is expected to be deductible for tax purposes. Additionally, the Company recognized $27.1 million of core deposit intangibles.

Merger Related Expenses: The Company incurred $3.1 million of pre-tax merger related expenses during 2014. The merger expenses are reflected on the Company s income statement for the applicable periods and are reported primarily in the categories of salaries and benefits, data processing and professional and legal fees. Merger related costs incurred during 2014 are presented in the table below by acquisition (dollars in thousands).

FVNB Corp.	$ 604

F&M Bancorporation Inc.	2,476
All other	34
	$ 3,114

2013 Acquisitions

Acquisition of East Texas Financial Services, Inc. On January 1, 2013, the Company completed the acquisition of East Texas Financial Services, Inc. (OTC BB: FFBT) and its wholly-owned subsidiary, First Federal Bank Texas (collectively, East Texas Financial Services). East Texas Financial Services operated 4 banking offices in the Tyler MSA, including 3 locations in Tyler, Texas and 1 location in Gilmer, Texas. The Company acquired East Texas Financial Services to increase its market share in the East Texas area. The acquisition is not considered significant to the Company s financial statements and therefore pro forma financial data is not included.

The Company acquired loans and deposits with fair values of $122.1 million and $112.4 million, respectively, at acquisition date. Under the terms of the acquisition agreement, Bancshares issued 530,940 shares of its common stock for all outstanding shares of East Texas Financial Services capital stock, for total merger consideration of $22.3 million based on Bancshares closing stock price of $42.00. During 2013, the Company recognized goodwill of $15.0 million, to which no adjustments were made.

Acquisition of Coppermark Bancshares, Inc. On April 1, 2013, the Company completed the acquisition of Coppermark Bancshares, Inc. and its wholly-owned subsidiary, Coppermark Bank (collectively, Coppermark). Coppermark operated 9 full-service banking offices: 6 in Oklahoma City, Oklahoma and surrounding areas and 3 in the Dallas, Texas area. The Company acquired Coppermark to expand its market into Oklahoma. The acquisition is not considered significant to the Company s financial statements and therefore pro forma financial data is not included.

The Company acquired loans and deposits with fair values of $801.9 million and $1.12 billion, respectively, at acquisition date. Under the terms of the acquisition agreement, Bancshares issued 3,258,718 shares of its common stock plus $60.0 million in cash for all outstanding shares of Coppermark Bancshares, Inc. capital stock, for total merger consideration of $214.4 million based on Bancshares closing stock price of $47.39. During 2013, the Company recognized goodwill of $117.5 million. As of December 31, 2015, total goodwill related to the Coppermark acquisition was $117.7 million, after recording a $109 thousand measurement period adjustment during the first quarter of 2014. Additionally, the Company recognized $1.5 million of core deposit intangibles.

Acquisition of FVNB Corp. On November 1, 2013, the Company completed the acquisition of FVNB Corp. and its wholly owned subsidiary, First Victoria National Bank (collectively, FVNB) headquartered in Victoria, Texas. FVNB operated 33 banking locations: 4 in Victoria, Texas; 7 in the South Texas area including Corpus Christi; 6 in the Bryan/College Station area; 5 in the Central Texas area including New Braunfels; and 11 in the Houston area including The Woodlands. The Company acquired FVNB to expand its Central and South Texas markets. The acquisition is not considered significant to the Company s financial statements and therefore pro forma financial data is not included.

The Company acquired loans and deposits with fair values of $1.57 billion and $2.26 billion, respectively, at acquisition date. Under the terms of the acquisition agreement, Bancshares issued 5,570,667 shares of its common stock plus $91.3 million in cash for all outstanding shares of FVNB Corp. capital stock for total merger consideration of $439.2 million based on Bancshares closing stock price of $62.45. During 2013, the Company recognized goodwill of $323.0 million. As of December 31, 2015, total goodwill related to the FVNB acquisition was $327.3 million, after recording a $4.3 million measurement period adjustment during 2014. Additionally, the Company recognized $18.4 million of core deposit intangibles.

Merger Related Expenses: The Company incurred $3.2 million of pre-tax merger related expenses during 2013. The merger expenses are reflected on the Company s income statement for the applicable periods and are

reported primarily in the categories of salaries and benefits, data processing and professional and legal fees. Merger related costs incurred during 2013 are presented in the table below by acquisition (dollars in thousands).

East Texas Financial Services, Inc.	$ 84
Coppermark Bancshares, Inc.	853
FVNB Corp.	2,000
All other	266
	$ 3,203

Acquired Loans

Acquired loans were preliminarily recorded at fair value based on a discounted cash flow valuation methodology that considers, among other things, interest rates, projected default rates, loss given default, and recovery rates (no allowance for credit losses was carried over from acquisitions completed during 2014). During the valuation process, the Company identified PCI and Non-PCI loans in the acquired loan portfolios. PCI loan identification considers the following factors: payment history and past due status, debt service coverage, loan grading, collateral values and other factors that may indicate deterioration of credit quality since origination. Non-PCI loan identification considers the following factors: account types, remaining terms, annual interest rates or coupons, current market rates, interest types, past delinquencies, timing of principal and interest payments, loan to value ratios, loss exposures and remaining balances. Accretion of purchased discounts on PCI loans will be based on estimated future cash flows, regardless of contractual maturities. Accretion of purchased discounts on Non-PCI loans will be recognized on a level-yield basis based on contractual maturity of individual loans.

PCI Loans. The carrying amount of PCI loans included in the consolidated balance sheets and the related outstanding balances at December 31, 2015 and 2014 are presented in the table below. The outstanding balance represents the total amount owed as of December 31, 2015 and 2014, including accrued but unpaid interest and any amounts previously charged off.

	December 31, 2015	**December 31, 2014**
	(Dollars in thousands)	
PCI loans:		
Outstanding balance	$ 79,802	$ 129,412
Less: discount	39,976	72,270
Recorded investment	$ 39,826	$ 57,142

Changes in the accretable yield for PCI loans for the years ended December 31, 2015 and 2014 were as follows:

	Year Ended December 31,	
	2015	**2014**

	(Dollars in thousands)	
Balance at beginning of period	$ 9,867	$ 9,855
Additions		7,158
Reclassifications from nonaccretable	13,691	24,074
Accretion	(17,894)	(31,220)
Balance at December 31	$ 5,664	$ 9,867

Income recognition on PCI loans is subject to the Company s ability to reasonably estimate both the timing and amount of future cash flows. PCI loans for which the Company is accruing interest income are not considered non-performing or impaired. The non-accretable difference represents contractual principal and interest the Company does not expect to collect.

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Non-PCI Loans. The carrying amount of Non-PCI loans included in the consolidated balance sheets and the related outstanding balances at December 31, 2015 and 2014 are presented in the table below. The outstanding balance represents the total amount owed as of December 31, 2015 and 2014, including accrued but unpaid interest and any amounts previously charged off.

	December 31, 2015	December 31, 2014
	(Dollars in thousands)	
Non-PCI loans:		
Outstanding balance	$ 1,430,501	$ 2,186,111
Less: discount	54,734	89,105
Recorded investment	$ 1,375,767	$ 2,097,006

Changes in the discount accretion for Non-PCI loans for the years ended December 31, 2015 and 2014 were as follows:

	Year Ended December 31, 2015	2014
	(Dollars in thousands)	
Balance at beginning of period	$ 89,105	$ 87,798
Additions		65,962
Accretion charge-offs	(143)	
Accretion	(34,228)	(64,655)
Balance at December 31	$ 54,734	$ 89,105

At December 31, 2015, the Company had $94.7 million of total outstanding discounts on Non-PCI and PCI loans, of which $60.4 million was accretable.

3. GOODWILL AND CORE DEPOSIT INTANGIBLES

Changes in the carrying amount of the Company s goodwill and core deposit intangibles for fiscal years 2015 and 2014 were as follows:

	Goodwill	Core Deposit Intangibles
	(Dollars in thousands)	
Balance as of December 31, 2013	$ 1,671,520	$ 42,049
Less:		
Amortization		(9,940)
Add:		

Measurement period adjustments	4,426	(302)
Acquisition of F&M Bancorporation Inc.	198,245	27,140
Balance as of December 31, 2014	1,874,191	58,947
Less:		
Amortization		(9,530)
Add:		
Measurement period adjustments	(5,364)	
Balance as of December 31, 2015	$ 1,868,827	$ 49,417

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Management performs an evaluation annually and more frequently if a triggering event occurs, of whether any impairment of the goodwill and other intangibles has occurred. If any such impairment is determined, a write down is recorded. As of December 31, 2015, there was no impairment recorded on goodwill and other intangibles.

Core deposit intangibles are being amortized on a non-pro rata basis over their estimated lives, which the Company believes is between 10 and 15 years. The estimated aggregate future amortization expense for core deposit intangibles remaining as of December 31, 2015 is as follows (dollars in thousands):

2016	$ 8,519
2017	6,327
2018	5,400
2019	4,546
Thereafter	24,625
Total	$ 49,417

4. CASH AND DUE FROM BANKS

The Federal Reserve Bank requires banks to maintain minimum average reserve balances. The amount of the required reserve balance for the Bank was $96.5 million and $167.5 million at December 31, 2015 and 2014, respectively.

5. SECURITIES

The amortized cost and fair value of investment securities were as follows:

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
States and political subdivisions	$ 5,463	$ 22	$	$ 5,485
Collateralized mortgage obligations	25,991	25	(100)	25,916
Mortgage-backed securities	55,884	3,098	(11)	58,971
Other securities	12,588	150	(46)	12,692
Total	$ 99,926	$ 3,295	$ (157)	$ 103,064
Held to Maturity				
U.S. Treasury securities and obligations of				
U.S. Government agencies	$ 47,598	$ 798	$	$ 48,396
States and political subdivisions	363,505	7,080	(542)	370,043
Collateralized mortgage obligations	2,107	17	(2)	2,122

Mortgage-backed securities	8,986,153	68,868	(82,407)	8,972,614
Total	$ 9,399,363	$ 76,763	$ (82,951)	$ 9,393,175

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	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
Available for Sale				
States and political subdivisions	$ 14,402	$ 183	$	$ 14,585
Collateralized mortgage obligations	33,519	91	(37)	33,573
Mortgage-backed securities	79,153	5,344	(14)	84,483
Other securities	12,588	201	(31)	12,758
Total	$ 139,662	$ 5,819	$ (82)	$ 145,399
Held to Maturity				
U.S. Treasury securities and obligations of U.S. Government agencies	$ 52,353	$ 360	$ (74)	$ 52,639
States and political subdivisions	404,356	6,147	(1,422)	409,081
Collateralized mortgage obligations	19,585	215	(8)	19,792
Mortgage-backed securities	8,424,083	96,650	(53,553)	8,467,180
Total	$ 8,900,377	$ 103,372	$ (55,057)	$ 8,948,692

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI analysis. Investment securities classified as available for sale or held to maturity are evaluated for OTTI under Financial Accounting Standards Board (FASB): ASC Topic 320, *Investments Debt and Equity Securities.*

In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the other-than-temporary impairment recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss.

As of December 31, 2015, management does not have the intent to sell any of its securities and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. The fair value is expected to recover as the securities approach their maturity date or repricing date or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2015, management believes any impairment in the Company s securities is temporary and no impairment loss has been realized in the Company s consolidated statements of income.

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Securities with unrealized losses segregated by length of time such securities have been in a continuous loss position were as follows:

	December 31, 2015					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
Collateralized mortgage obligations	$ 14,331	$ (100)	$ 1	$	$ 14,332	$ (100)
Mortgage-backed securities	793	(1)	2,465	(10)	3,258	(11)
Other securities			1,691	(46)	1,691	(46)
Total	$ 15,124	$ (101)	$ 4,157	$ (56)	$ 19,281	$ (157)
Held to Maturity						
U.S. Treasury securities and obligations of U.S. government agencies	$	$	$	$	$	$
States and political subdivisions	15,700	(82)	45,952	(460)	61,652	(542)
Collateralized mortgage obligations	156		94	(2)	250	(2)
Mortgage-backed securities	3,233,601	(36,016)	1,662,482	(46,391)	4,896,083	(82,407)
Total	$ 3,249,457	$ (36,098)	$ 1,708,528	$ (46,853)	$ 4,957,985	$ (82,951)

	December 31, 2014					
	Less than 12 Months		More than 12 Months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(Dollars in thousands)					
Available for Sale						
Collateralized mortgage obligations	$ 6,675	$ (36)	$ 45	$ (1)	$ 6,720	$ (37)
Mortgage-backed securities	358		2,837	(14)	3,195	(14)
Other securities	1,706	(31)			1,706	(31)
Total	$ 8,739	$ (67)	$ 2,882	$ (15)	$ 11,621	$ (82)
Held to Maturity						
U.S. Treasury securities and obligations of						

U.S. government agencies	$ 17,098	$ (74)	$	$	$ 17,098	$ (74)
States and political subdivisions	45,680	(425)	44,760	(997)	90,440	(1,422)
Collateralized mortgage obligations	670	(5)	322	(3)	992	(8)
Mortgage-backed securities	1,149,380	(2,600)	2,349,143	(50,953)	3,498,523	(53,553)
Total	$ 1,212,828	$ (3,104)	$ 2,394,225	$ (51,953)	$ 3,607,053	$ (55,057)

At December 31, 2015, there were 474 securities in an unrealized loss position for more than 12 months.

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The amortized cost and fair value of investment securities at December 31, 2015, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations at any time with or without call or prepayment penalties.

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$ 33,942	$ 34,057	$ 12,588	$ 12,692
Due after one year through five years	180,550	182,802	3,290	3,307
Due after five years through ten years	146,011	150,029	2,173	2,178
Due after ten years	50,600	51,551		
Subtotal	411,103	418,439	18,051	18,177
Mortgage-backed securities and collateralized mortgage obligations	8,988,260	8,974,736	81,875	84,887
Total	$ 9,399,363	$ 9,393,175	$ 99,926	$ 103,064

The Company recorded no gain or loss on the sale of securities for the year ended December 31, 2015. The Company recorded a net gain on the sale of securities of $7 thousand for the year ended December 31, 2014. The net gain was the result of a loss of $41 thousand on the sale of eight non-agency collateralized mortgage obligations with a total book value of $1.2 million offset by a gain of $48 thousand on the sale of an available for sale mortgage-backed security with a total book value of $490 thousand. The Company recorded no gain or loss on the sale of securities for the year ended December 31, 2013.

At December 31, 2015 and 2014, the Company did not own securities of any one issuer (other than the U.S. government and its agencies) for which aggregate adjusted cost exceeded 10% of the consolidated shareholders equity at such respective dates.

Securities with an amortized cost of $5.81 billion and $5.08 billion and a fair value of $5.79 billion and $5.10 billion at December 31, 2015 and 2014, respectively, were pledged to collateralize public deposits and for other purposes required or permitted by law.

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6. LOANS AND ALLOWANCE FOR CREDIT LOSSES

The loan portfolio consists of various types of loans made principally to borrowers located within the states of Texas and Oklahoma and is categorized by major type as follows:

	December 31, 2015	December 31, 2014
	(Dollars in thousands)	
Residential mortgage loans held for sale	$ 23,933	$ 8,602
Commercial and industrial	1,692,246	1,806,267
Real estate:		
Construction, land development and other land loans	1,073,198	1,026,475
1-4 family residential (including home equity)	2,616,732	2,513,579
Commercial real estate (including multi-family residential)	3,131,083	3,030,340
Farmland	434,349	361,943
Agriculture	214,469	189,703
Consumer and other	252,579	307,274
Total loans held for investment	9,414,656	9,235,581
Total	$ 9,438,589	$ 9,244,183

Loan Origination/Risk Management. The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions. Loans to borrowers with aggregate debt relationships over $1.0 million and below $3.5 million are evaluated and acted upon on a daily basis by two of the company-wide loan concurrence officers. Loans to borrowers with aggregate debt relationships above $3.5 million are evaluated and acted upon by an officers loan committee which meets weekly. In addition to the officers loan committee evaluation, loans to borrowers with aggregate debt relationships from $25.0 million to $50.0 million are evaluated and acted upon by the directors loan committee which consists of three directors of the Bank and meets as necessary. Loans to borrowers with aggregate debt relationships over $50.0 million are evaluated and acted upon by the Bank s board of directors either at a regularly scheduled monthly board meeting or by teleconference or written consent.

The Company maintains an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company s policies and procedures.

(i) Commercial and Industrial Loans. In nearly all cases, the Company s commercial loans are made in the Company s market areas and are underwritten on the basis of the borrower s ability to service the debt from income. As a general practice, the Company takes as collateral a lien on any available real estate, equipment or other assets owned by the borrower and obtains a personal guaranty of the borrower or principal. Working capital loans are primarily collateralized by short-term assets whereas term loans are primarily collateralized by long-term assets. In general, commercial loans involve more credit risk than residential mortgage loans and commercial mortgage loans and, therefore, usually yield a higher return. The increased risk in commercial loans is due to the type of collateral securing these loans as well as the expectation that commercial loans generally will be serviced principally from the operations of the business, and those operations may not be successful.

Historical trends have shown these types of loans to have higher delinquencies than mortgage loans. As a result of these additional complexities, variables and risks, commercial loans require more thorough underwriting and servicing than other types of loans.

(ii) Commercial Real Estate. The Company makes commercial real estate loans collateralized by owner-occupied and nonowner-occupied real estate to finance the purchase of real estate. The Company s commercial real estate loans are collateralized by first liens on real estate, typically have variable interest rates (or five year or less fixed rates) and amortize over a 15-to 20-year period. Payments on loans secured by nonowner-occupied properties are often dependent on the successful operation or management of the properties. Accordingly, repayment of these loans may be subject to adverse conditions in the real estate market or the economy to a greater extent than other types of loans. The Company seeks to minimize these risks in a variety of ways, including giving careful consideration to the property s operating history, future operating projections, current and projected occupancy, location and physical condition in connection with underwriting these loans. The underwriting analysis also includes credit verification, analysis of global cash flow, appraisals and a review of the financial condition of the borrower. At December 31, 2015, the Company had total commercial real estate loans totaling $3.57 billion which include farmland and multi-family residential loans. At December 31, 2015, approximately 39.9% of the outstanding principal balance of the Company s commercial real estate loans were secured by owner-occupied properties.

(iii) 1-4 Family Residential Loans. The Company s lending activities also include the origination of 1-4 family residential mortgage loans (including home equity loans) collateralized by owner-occupied residential properties located in the Company s market areas. The Company offers a variety of mortgage loan portfolio products which generally are amortized over five to 25 years. Loans collateralized by 1-4 family residential real estate generally have been originated in amounts of no more than 89% of appraised value or have mortgage insurance. The Company requires mortgage title insurance and hazard insurance. The Company retains these portfolio loans for its own account rather than selling them into the secondary market. By doing so, the Company incurs interest rate risk as well as the risks associated with nonpayments on such loans. The Company s Home Loan Center offers a variety of mortgage loan products which are generally amortized over 30 years, including FHA and VA loans. The Company sells the loans originated by the Home Loan Center into the secondary market.

(iv) Construction, Land Development and Other Land Loans. The Company makes loans to finance the construction of residential and, to a lesser extent, nonresidential properties. Construction loans generally are collateralized by first liens on real estate and have floating interest rates. The Company conducts periodic inspections, either directly or through an agent, prior to approval of periodic draws on these loans. Underwriting guidelines similar to those described above are also used in the Company s construction lending activities. Construction loans involve additional risks attributable to the fact that loan funds are advanced upon the security of a project under construction, and the project is of uncertain value prior to its completion. Because of uncertainties inherent in estimating construction costs, the market value of the completed project and the effects of governmental regulation on real property, it can be difficult to accurately evaluate the total funds required to complete a project and the related loan to value ratio. As a result of these uncertainties, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the ultimate project rather than the ability of a borrower or guarantor to repay the loan. If the Company is forced to foreclose on a project prior to completion, there is no assurance that the Company will be able to recover all of the unpaid portion of the loan. In addition, the Company may be required to fund additional amounts to complete a project and may have to hold the property for an indeterminate period of time. While the Company has underwriting procedures designed to identify what it believes to be acceptable levels of risks in construction lending, no assurance can be given that these procedures will prevent losses from the risks described above.

(v) Agriculture Loans. The Company provides agriculture loans for short-term beef and crop production, including rice, cotton, milo and corn, farm equipment financing and agriculture real estate financing. The Company evaluates agriculture borrowers primarily based on their historical profitability, level of experience in their particular agriculture industry, overall financial capacity and the availability of secondary collateral to withstand economic and natural variations common to the industry. Because agriculture loans present a higher level of risk associated with events caused by nature, the Company routinely makes on-site visits and inspections in order to identify and monitor such risks.

(vi) Consumer Loans. Consumer loans made by the Company include direct A -credit automobile loans, recreational vehicle loans, boat loans, home improvement loans, personal loans (collateralized and uncollateralized), credit cards and deposit account collateralized loans. The terms of these loans typically range from 12 to 180 months and vary based upon the nature of collateral and size of loan. Generally, consumer loans entail greater risk than do real estate secured loans, particularly in the case of consumer loans that are unsecured or collateralized by rapidly depreciating assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan balance. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws may limit the amount which can be recovered on such loans.

The contractual maturity ranges of the Company s loan portfolio by type of loan and the amount of such loans with predetermined interest rates and floating rates in each maturity range as of December 31, 2015 are summarized in the following table. Contractual maturities are based on contractual amounts outstanding and do not include loan purchase discounts of $94.7 million or loans held for sale of $23.9 million at December 31, 2015:

	One Year or Less	Through Five Years	After Five Years	Total
		(Dollars in thousands)		
Commercial and industrial	$ 731,217	$ 550,102	$ 448,385	$ 1,729,704
Real estate:				
Construction, land development and other land loans	392,126	203,575	480,272	1,075,973
1-4 family residential (includes home equity)	32,340	160,107	2,436,915	2,629,362
Commercial (includes multi-family residential)	132,036	397,469	2,637,566	3,167,071
Agriculture (includes farmland)	179,370	71,251	402,704	653,325
Consumer and other	91,853	87,907	74,171	253,931
Total	$ 1,558,942	$ 1,470,411	$ 6,480,013	$ 9,509,366
Loans with a predetermined interest rate	$ 452,884	$ 728,612	$ 2,721,442	$ 3,902,938
Loans with a floating interest rate	1,106,058	741,799	3,758,571	5,606,428
Total	$ 1,558,942	$ 1,470,411	$ 6,480,013	$ 9,509,366

Concentrations of Credit. Most of the Company s lending activity occurs within the states of Texas and Oklahoma. The majority of the Company s loan portfolio consists of commercial and industrial, commercial real estate and 1-4 family residential loans. As of December 31, 2015 and 2014, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

Foreign Loans. The Company has U.S. dollar denominated loans and commitments to borrowers in Mexico. The outstanding balance of these loans and the unfunded amounts available under these commitments was not significant at December 31, 2015 or 2014.

Related Party Loans. As of December 31, 2015 and 2014, loans outstanding to directors, officers and their affiliates totaled $4.1 million and $4.9 million, respectively. All transactions entered into between the Company and such related parties are done in the ordinary course of business and made on the same terms and conditions as similar transactions with unaffiliated persons.

An analysis of activity with respect to these related-party loans is as follows:

	December 31, 2015	December 31, 2014
	(Dollars in thousands)	
Beginning balance on January 1	$ 4,940	$ 6,187
New loans	428	4,913
Repayments and reclassified related loans	(1,305)	(6,160)
Ending balance	$ 4,063	$ 4,940

Nonperforming Assets and Nonaccrual and Past Due Loans. The Company has several procedures in place to assist it in maintaining the overall quality of its loan portfolio. The Company has established underwriting guidelines to be followed by its officers, and the Company also monitors its delinquency levels for any negative or adverse trends. There can be no assurance, however, that the Company s loan portfolio will not become subject to increasing pressures from deteriorating borrower credit due to general economic conditions.

The Company generally places a loan on nonaccrual status and ceases accruing interest when the payment of principal or interest is delinquent for 90 days, or earlier in some cases, unless the loan is in the process of collection and the underlying collateral fully supports the carrying value of the loan.

The Company requires appraisals on loans collateralized by real estate. With respect to potential problem loans, an evaluation of the borrower s overall financial condition is made to determine the need, if any, for possible writedowns or appropriate additions to the allowance for credit losses.

An aging analysis of past due loans, segregated by category of loan, in presented below:

	December 31, 2015					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Construction, land development and other land loans	$ 4,097	$	$ 4,097	$ 134	$ 1,068,967	$ 1,073,198
Agriculture and agriculture real estate (includes farmland)	946		946	208	647,664	648,818
1-4 family (includes home equity) (1)	4,748	220	4,968	1,894	2,633,803	2,640,665
Commercial real estate (includes multi-family	12,922		12,922	15,535	3,102,626	3,131,083

residential)						
Commercial and industrial	4,793	394	5,187	21,692	1,665,367	1,692,246
Consumer and other	1,274		1,274	248	251,057	252,579
Total	$ 28,780	$ 614	$ 29,394	$ 39,711	$ 9,369,484	$ 9,438,589

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	December 31, 2014					
	Loans Past Due and Still Accruing					
	30-89 Days	90 or More Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
	(Dollars in thousands)					
Construction, land development and other land loans	$ 7,667	$	$ 7,667	$ 526	$ 1,018,282	$ 1,026,475
Agriculture and agriculture real estate (includes farmland)	2,995	377	3,372	96	548,178	551,646
1-4 family (includes home equity) (1)	2,261	82	2,343	3,570	2,516,268	2,522,181
Commercial real estate (includes multi-family residential)	12,679	65	12,744	6,340	3,011,256	3,030,340
Commercial and industrial	18,305	869	19,174	20,537	1,766,556	1,806,267
Consumer and other	612	800	1,412	353	305,509	307,274
Total	$ 44,519	$ 2,193	$ 46,712	$ 31,422	$ 9,166,049	$ 9,244,183

(1) Includes $23.9 million and $8.6 million of residential mortgage loans held for sale at December 31, 2015 and December 31, 2014, respectively.

The following table presents information regarding nonperforming assets at the dates indicated:

	December 31,				
	2015	2014	2013	2012	2011
	(Dollars in thousands)				
Nonaccrual loans (1)	$ 39,711	$ 31,422	$ 10,231	$ 5,382	$ 3,578
Accruing loans 90 or more days past due	614	2,193	4,947	331	
Total nonperforming loans	40,325	33,615	15,178	5,713	3,578
Repossessed assets	171	67	27	68	146
Other real estate	2,963	3,237	7,299	7,234	8,328
Total nonperforming assets	$ 43,459	$ 36,919	$ 22,504	$ 13,015	$ 12,052
Nonperforming assets to total loans and other real estate	0.46%	0.40%	0.29%	0.25%	0.32%

(1) Includes troubled debt restructurings of $681 thousand, $911 thousand, $1.4 million, $3.6 million and $5.3 million for the years ended December 31, 2015, 2014, 2013, 2012 and 2011, respectively.

The Company had $43.5 million in nonperforming assets at December 31, 2015 compared with $36.9 million at December 31, 2014 and $22.5 million at December 31, 2013. Nonperforming assets were 0.46% of total loans and other real estate at December 31, 2015 compared with 0.40% of total loans and other real estate at December 31, 2014. The nonperforming assets consisted of 147 separate credits or ORE properties at December 31, 2015, compared with 169 at December 31, 2014 and 203 at December 31, 2013. These results are reflective of the Company s conservative lending approach.

If interest on nonaccrual loans had been accrued under the original loan terms, approximately $3.9 million, $2.7 million, and $440 thousand would have been recorded as income for the years ended December 31, 2015, 2014 and 2013, respectively.

Impaired Loans. Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. If a loan is impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan s existing rate or at the fair value of collateral if repayment is expected

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solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Year-end impaired loans are set forth in the following tables. No interest income was recognized on impaired loans subsequent to their classification as impaired. The average recorded investment presented in the tables below is reported on a year-to-date basis.

	December 31, 2015			
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
	(Dollars in thousands)			
With no related allowance recorded:				
Construction, land development and other land loans	$ 33	$ 346	$	$ 142
Agriculture and agriculture real estate (includes farmland)	20	23		10
1-4 family (includes home equity)	1,206	1,365		1,458
Commercial real estate (includes multi-family residential)	15,115	15,398		10,104
Commercial and industrial	1,354	1,630		5,419
Consumer and other	58	131		4,101
Total	17,786	18,893		21,234
With an allowance recorded:				
Construction, land development and other land loans	7	11	2	141
Agriculture and agriculture real estate (includes farmland)	189	201	52	118
1-4 family (includes home equity)	379	386	93	902
Commercial real estate (includes multi-family residential)	262	1,857	262	162
Commercial and industrial	14,594	16,413	7,082	8,524
Consumer and other	181	220	44	208
Total	15,612	19,088	7,535	10,055
Total:				
Construction, land development and other land loans	40	357	2	283
Agriculture and agriculture real estate (includes farmland)	209	224	52	128
1-4 family (includes home equity)	1,585	1,751	93	2,360
	15,377	17,255	262	10,266

Commercial real estate (includes multi-family residential)				
Commercial and industrial	15,948	18,043	7,082	13,943
Consumer and other	239	351	44	4,309
	$ 33,398	$ 37,981	$ 7,535	$ 31,289

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	December 31, 2014			
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
	(Dollars in thousands)			
With no related allowance recorded:				
Construction, land development and other land loans	$ 250	$ 256	$	$ 264
Agriculture and agriculture real estate (includes farmland)				7
1-4 family (includes home equity)	1,710	1,831		1,147
Commercial real estate (includes multi-family residential)	5,093	5,126		3,792
Commercial and industrial	9,485	9,678		4,794
Consumer and other	8,144	8,161		4,080
Total	24,682	25,052		14,084
With an allowance recorded:				
Construction, land development and other land loans	276	276	225	138
Agriculture and agriculture real estate (includes farmland)	46	55	24	34
1-4 family (includes home equity)	1,426	1,473	418	1,973
Commercial real estate (includes multi-family residential)	62	63	24	838
Commercial and industrial	2,454	4,182	1,597	1,783
Consumer and other	234	251	205	164
Total	4,498	6,300	2,493	4,930
Total:				
Construction, land development and other land loans	526	532	225	402
Agriculture and agriculture real estate (includes farmland)	46	55	24	41
1-4 family (includes home equity)	3,136	3,304	418	3,120
Commercial real estate (includes multi-family residential)	5,155	5,189	24	4,630
Commercial and industrial	11,939	13,860	1,597	6,577
Consumer and other	8,378	8,412	205	4,244
	$ 29,180	$ 31,352	$ 2,493	$ 19,014

Credit Quality Indicators. As part of the on-going monitoring of the credit quality of the Company s loan portfolio and methodology for calculating the allowance for credit losses, management assigns and tracks loan grades to be used as credit quality indicators.

The following is a general description of the loan grades used:

Grade 1 Credits in this category have risk potential that is virtually nonexistent. These loans may be secured by insured certificates of deposit, insured savings accounts, U.S. Government securities and highly rated municipal bonds.

Grade 2 Credits in this category are of the highest quality. These borrowers represent top rated companies and individuals with unquestionable financial standing with excellent global cash flow coverage, net worth, liquidity and collateral coverage.

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Grade 3 Credits in this category are not immune from risk but are well protected by the collateral and paying capacity of the borrower. These loans may exhibit a minor unfavorable credit factor, but the overall credit is sufficiently strong to minimize the possibility of loss.

Grade 4 Credits in this category are considered to be of acceptable credit quality with moderately greater risk than Grade 3 and receiving closer monitoring. Loans in this category have sources of repayment that remain sufficient to preclude a larger than normal probability of default and secondary sources are likewise currently of sufficient quantity, quality, and liquidity to protect the Company against loss of principal and interest. These borrowers have specific risk factors, but the overall strength of the credit is acceptable based on other mitigating credit and/or collateral factors and can repay the debt in the normal course of business.

Grade 5 Credits in this category constitute an undue and unwarranted credit risk; however the factors do not rise to a level of substandard. These credits have potential weaknesses and/or declining trends that, if not corrected, could expose the Bank to risk at a future date. These loans are monitored on the Bank s internally-generated watch list and evaluated on a quarterly basis.

Grade 6 Credits in this category are considered substandard but non-impaired loans in accordance with regulatory guidelines. Loans in this category have well-defined weakness that, if not corrected, could make default of principal and interest possible. Loans in this category are still accruing interest and may be dependent upon secondary sources of repayment and/or collateral liquidation.

Grade 7 Credits in this category are deemed substandard and impaired pursuant to regulatory guidelines. As such, the Bank has determined that it is probable that less than 100% of the contractual principal and interest will be collected. These loans are individually evaluated for a specific reserve and will typically have the accrual of interest stopped.

Grade 8 Credits in this category include doubtful loans in accordance with regulatory guidance. Such loans are no longer accruing interest and factors indicate a loss is imminent. These loans are also deemed impaired. While a specific reserve may be in place while the loan and collateral is being evaluated these loans are typically charged down to an amount the Bank estimates is collectible.

Grade 9 Credits in this category are deemed a loss in accordance with regulatory guidelines and have been charged off or charged down. The Bank may continue collection efforts and may have partial recovery in the future.

The following table presents risk grades and PCI loans by category of loan at December 31, 2015. Impaired loans include loans in risk grades 7, 8 and 9, as well as any PCI loan that has a specific reserve allocated to it.

	Construction, Land Development and Other Land Loans	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity) (1)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
	(Dollars in thousands)						
Grade 1	$	$ 12,733	$	$	$ 57,625	$ 44,389	$ 114,747
Grade 2	3,975	5,603	27,272	24,965	27,755	34,668	124,238
Grade 3	1,034,792	553,782	2,539,282	2,861,872	1,355,887	162,892	8,508,507

Grade 4	29,831	67,453	58,172	164,924	123,772	3,395	447,547
Grade 5	2,431	7,191	1,261	20,078	68,618	6,908	106,487
Grade 6	1,209	1,452	7,824	26,237	28,005	88	64,815
Grade 7	40	209	1,526	15,377	12,487	239	29,878
Grade 8			59		2,485		2,544
Grade 9							
PCI Loans (2)	920	395	5,269	17,630	15,612		39,826
Total	$ 1,073,198	$ 648,818	$ 2,640,665	$ 3,131,083	$ 1,692,246	$ 252,579	$ 9,438,589

(1) Includes $23.9 million of residential mortgage loans held for sale at December 31, 2015.
(2) Of the total PCI loans, $7.3 million were classified as substandard at December 31, 2015, which includes $976 thousand with specific reserves allocated to them.

The following table presents risk grades and PCI loans by category of loan at December 31, 2014. Impaired loans include loans in risk grades 7, 8 and 9.

	Construction, Land Development and Other Land Loans	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity) (1)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
				(Dollars in thousands)			
Grade 1	$	$ 13,507	$	$	$ 61,697	$ 41,240	$ 116,444
Grade 2							
Grade 3	1,022,002	528,400	2,503,679	2,965,455	1,698,558	257,588	8,975,682
Grade 4							
Grade 5	497	4,265	1,174	10,424	3,266	18	19,644
Grade 6	2,308	4,921	8,266	25,839	4,707	50	46,091
Grade 7	526	46	3,136	5,155	11,834	8,378	29,075
Grade 8					105		105
Grade 9							
PCI Loans (2)	1,142	507	5,926	23,467	26,100		57,142
Total	$ 1,026,475	$ 551,646	$ 2,522,181	$ 3,030,340	$ 1,806,267	$ 307,274	$ 9,244,183

(1) Includes $8.6 million of residential mortgage loans held for sale at December 31, 2014.
(2) Of the total PCI loans, $32.0 million were classified as substandard at December 31, 2014.

Allowance for Credit Losses. The allowance for credit losses is a valuation established through charges to earnings in the form of a provision for credit losses. Management has established an allowance for credit losses which it believes is adequate for estimated losses in the Company s loan portfolio. The amount of the allowance for credit losses is affected by the following: (1) charge-offs of loans that occur when loans are deemed uncollectible and decrease the allowance, (2) recoveries on loans previously charged off that increase the allowance and (3) provisions for credit losses charged to earnings that increase the allowance. Based on an evaluation of the loan portfolio and consideration of the factors listed below, management presents a quarterly review of the allowance for credit losses to the Bank s Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. Although management believes it uses the best information available to make determinations with respect to the allowance for credit losses, future adjustments may be necessary if economic conditions or the borrower s performance differ from the assumptions used in making the initial determinations.

The Company s allowance for credit losses consists of two components: a specific valuation allowance based on probable losses on specifically identified loans and a general valuation allowance based on historical loan loss experience, general economic conditions and other qualitative risk factors both internal and external to the Company.

In setting the specific valuation allowance, the Company follows a loan review program to evaluate the credit risk in the total loan portfolio and assigns risk grades to each loan. Through this loan review process, the Company maintains an internal list of impaired loans which, along with the delinquency list of loans, helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for credit losses. All loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific reserve is required. For certain impaired loans, the Company allocates a specific loan loss reserve primarily based on the value of the collateral securing the impaired loan in accordance with ASC Topic 310-10, *Receivables.* The specific reserves are determined on an individual loan basis. Loans for which specific reserves are provided are excluded from the general valuation allowance described below.

In connection with this review of the loan portfolio, the Company considers risk elements attributable to particular loan types or categories in assessing the quality of individual loans. Some of the risk elements include:

- for 1-4 family residential mortgage loans, the borrower s ability to repay the loan, including a consideration of the debt to income ratio and employment and income stability, the loan to value ratio, and the age, condition and marketability of collateral;

- for commercial real estate loans and multifamily residential loans, the debt service coverage ratio (income from the property in excess of operating expenses compared to loan payment requirements), operating results of the owner in the case of owner-occupied properties, the loan to value ratio, the age and condition of the collateral and the volatility of income, property value and future operating results typical of properties of that type;

- for construction, land development and other land loans, the perceived feasibility of the project including the ability to sell developed lots or improvements constructed for resale or the ability to lease property constructed for lease, the quality and nature of contracts for presale or prelease, if any, experience and ability of the developer and loan to value ratio;

- for commercial and industrial loans, the operating results of the commercial, industrial or professional enterprise, the borrower s business, professional and financial ability and expertise, the specific risks and volatility of income and operating results typical for businesses in that category and the value, nature and marketability of collateral;

- for agricultural real estate loans, the experience and financial capability of the borrower, projected debt service coverage of the operations of the borrower and loan to value ratio; and

- for non-real estate agricultural loans, the operating results, experience and financial capability of the borrower, historical and expected market conditions and the value, nature and marketability of collateral.

In determining the amount of the general valuation allowance, management considers factors such as historical loan loss experience, concentration risk of specific loan types, the volume, growth and composition of the Company s loan portfolio, current economic conditions that may affect the borrower s ability to pay and the value of collateral, the evaluation of the Company s loan portfolio through its internal loan review process, general economic conditions and other qualitative risk factors both internal and external to the Company and other relevant factors in accordance with ASC Topic 450, *Contingencies.* Based on a review of these factors for each loan type, the Company applies an estimated percentage to the outstanding balance of each loan type, excluding any loan that has a specific reserve allocated to it. The Company uses this information to establish the amount of the general valuation allowance.

In addition, for each category, the Company considers secondary sources of income and the financial strength and credit history of the borrower and any guarantors.

A change in the allowance for credit losses can be attributable to several factors, most notably (1) specific reserves identified for impaired loans, (2) historical credit loss information, (3) changes in environmental factors and (4) growth in the balance of legacy loans and the renewal or substantial modification of acquired loans (Non-PCI and PCI loans as discussed in Note 2) into the loan portfolio subject to the allowance methodology.

Changes in the Company s asset quality are reflected in the allowance in several ways. Specific reserves that are calculated on a loan-by-loan basis and the qualitative assessment of all other loans reflect current changes in the credit quality of the loan portfolio. Historical credit losses, on the other hand, are based on a three-year look back period, which are then applied to estimate current credit losses inherent in the loan portfolio. A deterioration in the credit quality of the loan portfolio in the current period would increase the historical credit loss factor to be applied in future periods, just as an improvement in credit quality would decrease the historical credit loss factor.

The allowance for credit losses is further determined by the size of the loan portfolio subject to the allowance methodology and environmental factors that include Company-specific risk indicators and general economic conditions, both of which are constantly changing. The Company evaluates the economic and portfolio-specific factors on a quarterly basis to determine a qualitative component of the general valuation allowance. The factors include economic metrics, business conditions, delinquency trends, credit concentrations, nature and volume of the portfolio and other adjustments for items not covered by specific reserves and historical loss experience. Management s assessment of qualitative factors is a statistically based approach to determine the inherent probable loss associated with such factors. Based on the Company s actual historical loan loss experience relative to economic and loan portfolio-specific factors at the time the losses occurred, management is able to identify the probabilities of default and loss severity based on current economic conditions. The correlation of historical loss experience with current economic conditions provides an estimate of inherent and probable losses that has not been previously factored into the general valuation allowance by the determination of specific reserves and recent historical losses. Additionally, the Company considers qualitative factors not easily quantified and the possibility of model imprecision.

Utilizing the aggregation of specific reserves, historical loss experience and a qualitative component, management is able to determine the valuation allowance to reflect the full inherent probable loss.

Loans acquired in business combinations are initially recorded at fair value, which includes an estimate of inherent credit losses expected to be realized over the remaining lives of the loans, and therefore no corresponding allowance for credit losses is recorded for these loans at acquisition. When a fair-valued acquired loan is renewed at its maturity date, the loan is re-categorized and is subject to the allowance methodology. When a fair-valued acquired loan is modified after acquisition, the loan is independently evaluated subsequent to the modification decision to determine whether the modification was, substantial, and therefore, requires that the loan be re-categorized as an acquired legacy loan. The determination is based on a discounted cash-flow analysis. Generally, when a change in discounted cash-flow of greater than 10% is identified, the fair-valued acquired loan becomes re-categorized and is evaluated at the time of renewal or modification in accordance with the Company s allowance for credit losses methodology described above.

Non-PCI loans which were not deemed impaired subsequent to the acquisition date are considered non-impaired and are evaluated as part of the general valuation allowance. Non-PCI loans that have not become impaired subsequent to acquisition are segregated into a pool for each acquisition for allowance calculation purposes. For each pool, the Company estimates a hypothetical allowance for credit losses also referred to as an indicated reserve that is calculated in accordance with GAAP requirements. The Company uses the acquired bank s past loss history adjusted for qualitative factors to establish the indicated reserve. The indicated reserve for each pool of Non-PCI loans is compared with the remaining discount for the respective pool to test for credit quality deterioration and the possible need for a loan loss provision. To the extent the remaining discount of the pool is greater than the indicated reserve, no additional allowance is necessary. In the event that the remaining discount of the pool is less than the indicated reserve, the difference results in an increase to the allowance recorded through a provision for credit losses.

Non-PCI loans that have deteriorated to an impaired status subsequent to acquisition are evaluated for a specific reserve on a quarterly basis which, when identified, is added to the allowance for credit losses. The Company reviews impaired Non-PCI loans on a loan-by-loan basis and determines the specific reserve based on the difference between the recorded investment in the loan and one of three factors: expected future cash flows, observable market price or fair value of the collateral. Because essentially all of the Company s impaired Non-PCI loans have been collateral-dependent, the amount of the specific reserve historically has been determined by comparing the fair value of the collateral securing the Non-PCI loan with the recorded investment in such loan. In the future, the Company will continue to analyze impaired Non-PCI loans on a loan-by-loan basis and may use

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an alternative measurement method to determine the specific reserve, as appropriate and in accordance with applicable accounting standards.

PCI loans are individually monitored on a quarterly basis to assess for deterioration subsequent to acquisition and are only subject to the Company s allowance methodology when a deterioration in projected cash flows is identified. In the event that a deterioration in cash flows is identified, an additional provision for credit losses is made. PCI loans were recorded at their acquisition date fair values, which were based on expected cash flows and included estimates of expected future credit losses. The Company s estimates of loan fair values at the acquisition date may be adjusted for a period of up to one year as the Company continues to evaluate its estimate of expected future cash flows at the acquisition date. If the Company determines that losses arose after the acquisition date, the additional losses will be reflected as a provision for credit losses. An allowance for credit losses is not calculated for PCI loans that have not experienced deterioration subsequent to the acquisition date.

At December 31, 2015, the allowance for credit losses totaled $81.4 million or 0.86% of total loans, including acquired loans with discounts. At December 31, 2014, the allowance for credit losses totaled $80.8 million or 0.87% of total loans, and at December 31, 2013, the allowance aggregated $67.3 million or 0.87% of total loans, both including acquired loans with discounts. The allowance for credit losses totaled $81.4 million at December 31, 2015 compared with $80.8 million at December 31, 2014, an increase of $622 thousand or 0.8%.

The following table details the recorded investment in loans, excluding $23.9 million and $8.6 million of residential mortgage loans held for sale, and activity in the allowance for credit losses by category of loan for the years ended December 31, 2015 and 2014, respectively. During the fourth quarter of 2014, the Company enhanced its allowance for credit losses methodology. Under the enhanced methodology, qualitative environmental factors have been more precisely aligned to portfolio segments based on a statistical analysis which was undertaken by management. Such enhancement captures inherent probable loss in the portfolio associated with qualitative factors based on empirical data which includes various economic indicators, loss history, and levels of concentration. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Construction, Land Development and Other Land Loans	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
				(Dollars in thousands)			
Allowance for credit losses:							
Balance January 1, 2015	$ 15,825	$ 3,722	$ 16,377	$ 12,744	$ 30,002	$ 2,092	$ 80,762
Provision for credit losses	(736)	(137)	(1,277)	646	7,781	1,283	7,560
Charge-offs	(366)	(24)	(262)	(498)	(7,696)	(3,304)	(12,150)
Recoveries	159	284	53	104	3,322	1,290	5,212
Net charge-offs	(207)	260	(209)	(394)	(4,374)	(2,014)	(6,938)

Balance December 31, 2015	$ 14,882	$ 3,845	$ 14,891	$ 12,996	$ 33,409	$ 1,361	$ 81,384
Allowance for credit losses related to:							
December 31, 2015							
Individually evaluated for impairment	$ 2	$ 52	$ 93	$ 262	$ 7,082	$ 44	$ 7,535
Collectively evaluated for impairment	14,880	3,793	14,798	12,734	25,491	1,317	73,013
PCI loans					836		836
Total allowance for credit losses	$ 14,882	$ 3,845	$ 14,891	$ 12,996	$ 33,409	$ 1,361	$ 81,384
Recorded investment in loans:							
December 31, 2015							
Individually evaluated for impairment	$ 40	$ 209	$ 1,585	$ 15,377	$ 15,948	$ 239	$ 33,398
Collectively evaluated for impairment	1,072,238	648,214	2,609,878	3,098,076	1,660,686	252,340	9,341,432
PCI loans	920	395	5,269	17,630	15,612		39,826
Total loans evaluated for impairment	$ 1,073,198	$ 648,818	$ 2,616,732	$ 3,131,083	$ 1,692,246	$ 252,579	$ 9,414,656

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	Construction, Land Development and Other Land Loans	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
				(Dollars in thousands)			
Allowance for credit losses:							
Balance January 1, 2014	$ 14,353	$ 1,229	$ 17,046	$ 24,835	$ 8,167	$ 1,652	$ 67,282
Provision for credit losses	1,541	1,503	358	(10,300)	22,187	2,986	18,275
Charge-offs	(155)	(71)	(1,223)	(2,009)	(818)	(5,674)	(9,950)
Recoveries	86	1,061	196	218	466	3,128	5,155
Net charge-offs	(69)	990	(1,027)	(1,791)	(352)	(2,546)	(4,795)
Balance December 31, 2014	$ 15,825	$ 3,722	$ 16,377	$ 12,744	$ 30,002	$ 2,092	$ 80,762
Allowance for credit losses related to:							
December 31, 2014							
Individually evaluated for impairment	$ 225	$ 24	$ 418	$ 24	$ 1,597	$ 205	$ 2,493
Collectively evaluated for impairment	15,600	3,698	15,959	12,720	28,405	1,887	78,269
PCI loans							
Total allowance for credit losses	$ 15,825	$ 3,722	$ 16,377	$ 12,744	$ 30,002	$ 2,092	$ 80,762
Recorded investment in loans:							
December 31, 2014							
Individually evaluated for impairment	$ 526	$ 46	$ 3,136	$ 5,155	$ 11,939	$ 8,378	$ 29,180
Collectively evaluated for	1,024,807	551,093	2,504,517	3,001,718	1,768,228	298,896	9,149,259

impairment							
PCI loans	1,142	507	5,926	23,467	26,100		57,142
Total loans evaluated for impairment	$ 1,026,475	$ 551,646	$ 2,513,579	$ 3,030,340	$ 1,806,267	$ 307,274	$ 9,235,581

An analysis of activity in the allowance for credit losses for the year ended December 31, 2013 is as follows (dollars in thousands):

	Construction, Land Development and Other Land Loans	Agriculture and Agriculture Real Estate (includes Farmland)	1-4 Family (includes Home Equity)	Commercial Real Estate (includes Multi-Family Residential)	Commercial and Industrial	Consumer and Other	Total
			(Dollars in thousands)				
Allowance for credit losses:							
Balance January 1, 2013	$ 11,909	$ 764	$ 13,942	$ 19,607	$ 5,777	$ 565	$ 52,564
Provision for credit losses	2,470	399	3,277	5,189	2,714	3,191	17,240
Charge-offs	(271)	(48)	(211)	(894)	(672)	(3,397)	(5,493)
Recoveries	245	114	38	933	348	1,293	2,971
Net charge-offs	(26)	66	(173)	39	(324)	(2,104)	(2,522)
Balance December 31, 2013	$ 14,353	$ 1,229	$ 17,046	$ 24,835	$ 8,167	$ 1,652	$ 67,282
Allowance for credit losses related to:							
December 31, 2013							
Individually evaluated for impairment	$	$ 18	$ 890	$ 445	$ 1,029	$ 77	$ 2,459
Collectively evaluated for impairment	14,353	1,211	16,156	24,390	7,138	1,575	64,823
PCI loans							
Total allowance for credit losses	$ 14,353	$ 1,229	$ 17,046	$ 24,835	$ 8,167	$ 1,652	$ 67,282
Recorded investment in							

loans:							
December 31, 2013							
Individually evaluated for impairment	$ 277	$ 35	$ 3,103	$ 4,103	$ 1,214	$ 110	$ 8,842
Collectively evaluated for impairment	861,469	530,616	2,122,329	2,722,778	1,272,337	213,048	7,722,577
PCI loans	3,765	607	4,078	26,916	6,226		41,592
Total loans evaluated for impairment	$ 865,511	$ 531,258	$ 2,129,510	$ 2,753,797	$ 1,279,777	$ 213,158	$ 7,773,011

Troubled Debt Restructurings. The restructuring of a loan is considered a troubled debt restructuring if both (1) the borrower is experiencing financial difficulties and (2) 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. Under ASC topic 310-40 *Receivables Troubled Debt Restructurings by Creditors*, the Company evaluates all loan modifications for identification as troubled debt restructurings. The following table presents information regarding the recorded investment at December 31, 2015 and 2014 of loans modified in a troubled debt restructuring during the years ended December 31, 2015 and 2014:

	Years Ended December 31,					
	2015			2014		
	Number of Loans	Recorded Investment at Date of Restructure	Recorded Investment at Year-End	Number of Loans	Recorded Investment at Date of Restructure	Recorded Investment at Year-End
	(Dollars in thousands)					
Troubled Debt Restructurings						
Construction, land development and other land loans	1	$ 390	$ 20		$	$
Agriculture and agriculture real estate						
1-4 Family (includes home equity)						
Commercial real estate (commercial mortgage and multi-family)				1	35	35
Commercial and industrial	1	250	250	2	34	33
Consumer and other	1	10	9			
Total	3	$ 650	$ 279	3	$ 69	$ 68

As of December 31, 2015, there have been no defaults on any loans that were modified as troubled debt restructurings during the preceding twelve months. Default is determined at 90 or more days past due. The modifications primarily related to extending the amortization periods of the loans, which includes loans modified during bankruptcy. The Company did not grant principal reductions on any restructured loans. At December 31, 2015 and 2014, the Company had $681 thousand and $911 thousand, respectively, in outstanding troubled debt restructurings. For the year ended December 31, 2015, the Company added 3 loans totaling $650 thousand as new troubled debt restructurings of which $279 thousand was still outstanding on December 31, 2015. These modifications did not have a material impact on the Company s determination of the allowance for credit losses.

7. FAIR VALUE

The Company uses fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair values represent the estimated price that would be received from selling an asset or paid to transfer a liability, otherwise known as an exit price. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve application of lower-of-cost-or-market accounting or write downs of individual assets. ASC Topic 820, *Fair Value Measurements and Disclosures* establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Fair Value Hierarchy

The Company groups financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1	Quoted prices in active markets for identical assets or liabilities.
Level 2	Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities) or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The fair value of an asset or liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability.

The fair value disclosures below represent the Company s estimates based on relevant market information and information about the financial instruments. Fair value estimates are based on judgments regarding current economic conditions, risk characteristics of the various instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in the above methodologies and assumptions could significantly affect the estimates.

The following tables present fair values for assets measured at fair value on a recurring basis:

	As of December 31, 2015			
	Level 1	**Level 2**	**Level 3**	**Total**
	(Dollars in thousands)			
Available for sale securities:				
States and political subdivisions	$	$ 5,485	$	$ 5,485
Collateralized mortgage obligations		25,916		25,916
Mortgage-backed securities		58,971		58,971
Other securities	12,692			12,692

	As of December 31, 2014			
	Level 1	**Level 2**	**Level 3**	**Total**
	(Dollars in thousands)			
Available for sale securities:				
States and political subdivisions	$	$ 14,585	$	$ 14,585
Collateralized mortgage obligations		33,573		33,573
Mortgage-backed securities		84,483		84,483
Other securities	12,758			12,758

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). These instruments include other real estate owned, repossessed assets, held to maturity debt securities, loans held for sale, and impaired loans. For the year ended December 31, 2015, the Company had additions to other real estate owned of $2.6 million, of which $1.4 million were outstanding as of December 31, 2015. For the year ended December 31, 2015, the Company had additions to impaired loans of $31.7 million, of which $23.8 million were outstanding as of December 31, 2015. The remaining financial assets and liabilities measured at fair value on a non-recurring basis that were recorded in 2015 and remained outstanding at December 31, 2015 were not significant.

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The following tables summarize the carrying values and estimated fair values of certain financial instruments not recorded at fair value on a recurring basis:

	Carrying Amount	As of December 31, 2015 Estimated Fair Value Level 1	Level 2	Level 3	Total
		(Dollars in thousands)			
Assets					
Cash and due from banks	$ 562,544	$ 562,544	$	$	$ 562,544
Federal funds sold	1,418	1,418			1,418
Held to maturity securities	9,399,363		9,393,175		9,393,175
Loans held for sale	23,933		23,933		23,933
Loans held for investment, net of allowance	9,333,272			9,365,758	9,365,758
Other real estate owned	2,963		2,963		2,963
Liabilities					
Deposits:					
Noninterest-bearing	$ 5,136,579	$	$ 5,136,579	$	$ 5,136,579
Interest-bearing	12,544,540		12,548,050		12,548,050
Other borrowings	491,399		492,061		492,061
Securities sold under repurchase agreements	315,253		315,241		315,241
Junior subordinated debentures					

	Carrying Amount	As of December 31, 2014 Estimated Fair Value Level 1	Level 2	Level 3	Total
		(Dollars in thousands)			
Assets					
Cash and due from banks	$ 677,285	$ 677,285	$	$	$ 677,285
Federal funds sold	569	569			569
Held to maturity securities	8,900,377		8,948,692		8,948,692
Loans held for sale	8,602		8,602		8,602
Loans held for investment, net of allowance	9,154,819			9,192,231	9,192,231
Other real estate owned	3,237		3,237		3,237
Liabilities					
Deposits:					
Noninterest-bearing	$ 4,936,420	$	$ 4,936,420	$	$ 4,936,420
Interest-bearing	12,756,738		12,767,961		12,767,961
Other borrowings	8,724		10,000		10,000
Securities sold under repurchase agreements	315,523		315,543		315,543
Junior subordinated debentures	167,531		159,740		159,740

Entities may choose to measure eligible financial instruments at fair value at specified election dates. The fair value measurement option (1) may be applied instrument by instrument, with certain exceptions, (2) is generally irrevocable and (3) is applied only to entire instruments and not to portions of instruments. Unrealized gains and losses on items for which the fair value measurement option has been elected must be reported in earnings at each subsequent reporting date. During the reported periods, the Company had no financial instruments measured at fair value under the fair value measurement option.

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The fair value estimates presented herein are based on pertinent information available to management as of the dates indicated. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since those dates and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value, non-financial assets and non-financial liabilities, and for estimating fair value for financial instruments not recorded at fair value:

Cash and due from banks For these short-term instruments, the carrying amount is a reasonable estimate of fair value. The Company classifies the estimated fair value of these instruments as Level 1.

Federal funds sold For these short-term instruments, the carrying amount is a reasonable estimate of fair value. The Company classifies the estimated fair value of these instruments as Level 1.

Securities Fair value measurements based upon quoted prices are considered Level 1 inputs. Level 1 securities consist of U.S. Treasury securities and certain equity securities which are included in the available for sale portfolio. For all other available for sale and held to maturity securities, if quoted prices are not available, fair values are measured using Level 2 inputs. For these securities, the Company generally obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things. The Company reviews the prices supplied by the independent pricing service, as well as their underlying pricing methodologies, for reasonableness.

Securities available for sale are recorded at fair value on a recurring basis.

Loans held for sale Loans held for sale are carried at the lower of cost or estimated fair value. Fair value for consumer mortgages held for sale is based on commitments on hand from investors or prevailing market prices. As such, the Company classifies loans subjected to nonrecurring fair value adjustments as Level 2.

Loans held for investment The Company does not record loans at fair value on a recurring basis. As such, valuation techniques discussed herein for loans are primarily for estimating fair value disclosures. However, from time to time, the Company records nonrecurring fair value adjustments to impaired loans to reflect (1) partial write downs that are based on the observable market price or current appraised value of the collateral, or (2) the full charge-off of the loan carrying value. Where appraisals are not available, estimated cash flows are discounted using a rate commensurate with the credit risk associated with those cash flows. Assumptions regarding credit risk, cash flows and discount rates are judgmentally determined using available market information and specific borrower information.

The estimated fair value approximates carrying value for variable-rate loans that reprice frequently and with no significant change in credit risk. The fair value of fixed-rate loans and variable-rate loans which reprice on an infrequent basis is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality. An overall valuation adjustment is made for specific credit risks as well as general portfolio credit risk. The Company classifies the estimated fair value of loans held for investment as Level 3.

Other real estate owned Other real estate owned is primarily foreclosed properties securing residential loans and commercial real estate. Foreclosed assets are adjusted to fair value less estimated costs to sell upon transfer of the loans to other real estate owned. Subsequently, these assets are carried at the lower of carrying value or fair value less estimated costs to sell. Other real estate carried at fair value based on an observable market price or a current appraised value is classified by the Company as Level 2. When management determines that the fair value of other real estate requires additional adjustments, either as a result of a non-current appraisal or when there is no observable market price, the Company classifies the other real estate as Level 3.

Deposits The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. Deposits fair value measurements utilize Level 2 inputs.

Other borrowings Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of other borrowings using a discounted cash flows methodology and are measured utilizing Level 2 inputs.

Securities sold under repurchase agreements The fair value of securities sold under repurchase agreements is the amount payable on demand at the reporting date and are measured utilizing Level 2 inputs.

Junior subordinated debentures The fair value of the junior subordinated debentures was calculated using the quoted market prices, if available. If quoted market prices are not available, fair value is estimated using quoted market prices for similar subordinated debentures. Junior subordinated debentures fair value measurements utilize Level 2 inputs.

Off-balance sheet financial instruments The fair value of commitments to extend credit and standby letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the present creditworthiness of the counterparties. The Company has reviewed the unfunded portion of commitments to extend credit as well as standby and other letters of credit, and has determined that the fair value of such financial instruments is not material. The Company classifies the estimated fair value of credit-related financial instruments as Level 3.

8. PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	December 31,	
	2015	2014
	(Dollars in thousands)	
Land	$ 88,897	$ 91,491
Buildings	202,555	204,904
Furniture, fixtures and equipment	63,212	60,296
Construction in progress	1,998	2,409
Total	356,662	359,100
Less accumulated depreciation	(88,666)	(77,551)
Premises and equipment, net	$ 267,996	$ 281,549

Depreciation expense was $13.0 million, $13.7 million and $10.6 million for the years ended December 31, 2015, 2014 and 2013, respectively.

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9. DEPOSITS

Included in interest-bearing deposits are certificates of deposit in amounts of $100,000 or more. These certificates and their remaining maturities at December 31, 2015 were as follows (dollars in thousands):

Three months or less	$ 434,680	29.9%
Over three through six months	316,201	21.7
Over six through 12 months	354,227	24.3
Over 12 months	351,601	24.1
Total	$ 1,456,709	100.0%

Interest expense for certificates of deposit in excess of $100,000 was $9.6 million, $11.6 million and $9.4 million, for the years ended December 31, 2015, 2014 and 2013, respectively.

As of December 31, 2015, the Company had $148.3 million of deposits classified as brokered deposits for regulatory purposes, and there are no major concentrations of deposits with any one depositor.

10. OTHER BORROWINGS AND SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

The Company utilizes borrowings to supplement deposits to fund its lending and investment activities. Borrowings consist of funds from the Federal Home Loan Bank (FHLB) and securities sold under repurchase agreements.

The following table presents the Company s borrowings at December 31, 2015 and 2014:

	December 31,	
	2015	2014
	(Dollars in thousands)	
FHLB advances	$ 485,000	$
FHLB long-term notes payable	6,399	8,724
Total other borrowings	491,399	8,724
Securities sold under repurchase agreements	315,253	315,523
Total	$ 806,652	$ 324,247

FHLB advances and long-term notes payable The Company has an available line of credit with the FHLB of Dallas, which allows the Company to borrow on a collateralized basis. FHLB advances are considered short-term, overnight borrowings and used to manage liquidity as needed. Maturing advances are replaced by drawing on available cash, making additional borrowings or through increased customer deposits. At December 31, 2015, the Company had total funds of $5.25 billion available under this agreement, of which a total amount of $491.4 million was outstanding at December 31, 2015. Short-term overnight FHLB advances were $485.0 million at December 31, 2015, with a weighted average interest rate of 0.31%. Long-term notes payable were $6.4 million at December 31, 2015, with a weighted average interest rate of 5.64%. The maturity dates on the FHLB notes payable range from the years 2016 to

2028 and have interest rates ranging from 4.51% to 6.10%.

Securities sold under repurchase agreements with Company customers At December 31, 2015, the Company had $315.3 million in securities sold under repurchase agreements compared with $315.5 million at December 31, 2014, with average rates paid of 0.25% and 0.26% for the years ended December 31, 2015 and 2014, respectively. Repurchase agreements are generally settled on the following business day; however, approximately $10.9 million of repurchase agreements outstanding at December 31, 2015 have maturity dates ranging from 10 to 24 months. All securities sold under agreements to repurchase are collateralized by certain pledged securities.

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11. INCOME TAXES

The components of the provision for federal income taxes are as follows:

	Year Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Current	$ 108,550	$ 102,595	$ 88,535
Deferred	34,999	45,713	19,884
Total	$ 143,549	$ 148,308	$ 108,419

The provision for federal income taxes differs from the amount computed by applying the federal income tax statutory rate of 35% to income before income taxes as follows:

	Year Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Taxes calculated at statutory rate	$ 150,568	$ 156,012	$ 115,436
(Decrease) increase resulting from:			
Tax-exempt interest	(6,351)	(7,102)	(6,360)
Qualified School Construction Bond credit	(1,239)	(794)	(530)
Non taxable death benefits	(60)	(677)	
BOLI income	(1,917)	(1,788)	(1,244)
Qualified stock options	2	6	12
Merger related expenses		86	185
State tax, net	1,193	1,898	864
Other, net	1,353	667	56
Total	$ 143,549	$ 148,308	$ 108,419

Deferred tax assets and liabilities are as follows:

	December 31,	
	2015	2014
	(Dollars in thousands)	
Deferred tax assets:		
Loan purchase discounts	$ 33,149	$ 56,553
Allowance for credit losses	25,847	27,324
Accrued liabilities	4,364	8,704
Restricted stock	9,423	6,620
Deferred compensation	3,873	3,755

Certificates of Deposit	244	613
Net operating losses	688	5,055
ORE write-downs	30	1,418
Investments in partnerships	215	95
Other	560	1,428
Total deferred tax assets	78,393	111,565

	December 31, 2015	December 31, 2014
	(Dollars in thousands)	
Deferred tax liabilities:		
Goodwill and core deposit intangibles	(34,579)	(31,868)
Bank premises and equipment	(11,312)	(9,325)
Securities	(2,176)	(4,405)
Unrealized gain on available for sale securities	(1,098)	(2,008)
Prepaid expenses	(1,396)	(1,260)
Deferred loan fees and costs	(3,202)	(1,299)
Total deferred tax liabilities	(53,763)	(50,165)
Net deferred tax assets	$ 24,630	$ 61,400

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and estimates of future taxable income over the periods for which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences at December 31, 2015.

Net operating loss carryforwards expire on various dates beginning in 2027 through 2032.

Benefits from tax positions are recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met. The Company had no tax positions at December 31, 2015 or December 31, 2014 that did not meet the more-likely-than not recognition threshold. ASC Topic 740 also provides guidance on the accounting for and disclosure of unrecognized tax benefits, interest and penalties. The Company s policy for recording interest and penalties associated with audits is to record such items as a component of income before taxes. Penalties are recorded in other (gains) losses and interest paid or received is recorded in interest expense or interest income, respectively, in the consolidated statement of income. As of December 31, 2015 and 2014, the Company has not accrued any interest and penalties related to unrecognized tax benefits. The Company has identified its federal tax return and its state tax returns in Texas and Oklahoma as major tax jurisdictions, as defined. The periods subject to examination for the Company s federal return are the 2012 through 2015 tax years. The Company has assumed to net operating loss carryforwards, acquired NOLs , through its acquisitions. The tax periods of the acquired entities from which these acquired NOLs originated are considered open years for purposes of adjusting the amount of the acquired NOLs used in the Company s open years.

The Company is currently under two Internal Revenue Service examinations. One is related to F&M s federal income tax return for the final short period ended April 1, 2014 and for tax years 2013 and 2012. The second is related to the Company s federal income tax return for the tax year 2013.

12. STOCK INCENTIVE PROGRAMS

At December 31, 2015, the Company had two stock-based employee compensation plans with awards outstanding. One of these plans adopted by the Company has expired and therefore no additional awards may be

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issued under that plan. The Company accounts for stock-based employee compensation plans using the fair value-based method of accounting. The Company recognized stock-based compensation expense of $11.1 million, $8.2 million and $4.2 million for the years ended December 31, 2015, 2014 and 2013, respectively. There was approximately $3.9 million, $2.9 million and $1.5 million of income tax benefit recorded for the stock-based compensation expense for the same periods, respectively.

In December 2004, Bancshares Board of Directors established the Prosperity Bancshares, Inc. 2004 Stock Incentive Plan (the 2004 Plan), which was approved by Bancshares shareholders on February 23, 2005. The 2004 Plan authorized the issuance of up to 1,250,000 shares of common stock upon the exercise of options granted under the 2004 Plan or upon the grant or exercise, as the case may be, of other awards granted under the 2004 Plan. The 2004 Plan provided for the granting of incentive and nonqualified stock options to employees and nonqualified stock options to directors who are not employees. The 2004 Plan also provided for the granting of shares of restricted stock, stock appreciation rights, phantom stock awards and performance awards on substantially similar terms. A total of 191,625 options and 844,801 shares of restricted stock have been granted under the 2004 Plan as of December 31, 2015. Options to purchase a total of 28,800 shares of common stock of Bancshares granted under the 2004 Plan were outstanding at December 31, 2015, all of which were exercisable. The 2004 Plan has expired and therefore no additional shares may be issued from the 2004 Plan.

On February 22, 2012, Bancshares Board of Directors adopted the Prosperity Bancshares, Inc. 2012 Stock Incentive Plan (the 2012 Plan), which was approved by Bancshares shareholders on April 17, 2012. The 2012 Plan authorizes the issuance of up to 1,250,000 shares of common stock upon the exercise of options granted under the 2012 Plan or pursuant to the grant or exercise, as the case may be, of other awards granted under the 2012 Plan, including restricted stock, stock appreciation rights, phantom stock awards and performance awards. A total of 301,751 shares of restricted stock have been granted under the 2012 Plan as of December 31, 2015.

Stock Options

Stock options are issued at the current market price on the date of the grant, subject to a pre-determined vesting period with a contractual term of 10 years. Options assumed in connection with acquisitions have contractual terms as established in the original option grant agreements entered into prior to acquisition. The fair value of stock options granted is estimated at the date of grant using the Black-Scholes option-pricing model. The Black-Scholes pricing model utilizes certain assumptions including expected life of the option, risk free interest rate, volatility and dividend yield. Stock-based compensation expense is recognized ratably over the requisite service period for all awards. There were no options issued for the years ended December 31, 2015, 2014 and 2013.

A summary of changes in outstanding vested and unvested options during the three year period ended December 31, 2015 is set forth below:

	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Options outstanding, January 1, 2013	386	$ 28.39	3.20	$ 5,247
Options granted				

Options forfeited	(4)		30.97		
Options exercised	(194)		27.69		
Options outstanding, December 31, 2013	188	$	28.88	3.70	6,500
Options granted					
Options forfeited	(5)		23.88		
Options exercised	(130)		28.46		

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	Number of Options (In thousands)	Weighted Average Exercise Price	Weighted Average Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Options outstanding, December 31, 2014	53	$ 27.68	2.69	1,473
Options granted				
Options forfeited	(15)	27.15		
Options exercised	(9)	29.92		
Options outstanding, December 31, 2015	29	$ 32.14	2.60	$ 453
Shares vested or expected to vest, December 31, 2015	28	$ 32.07	2.61	$ 441
Shares exercisable, December 31, 2015	29	$ 32.14	2.60	$ 453

The total intrinsic value of the options exercised during the year ended December 31, 2015 and 2014 was $174 thousand and $3.5 million, respectively. The total fair value of options vested during the year ended December 31, 2015 was $88 thousand. There were no unvested options forfeited during the years ended December 31, 2015 and 2014. The total fair value of unvested options forfeited during the year ended December 31, 2013 were $26 thousand.

The Company received $290 thousand, $3.7 million and $5.4 million in cash from the exercise of stock options during the years ended December 31, 2015, 2014 and 2013, respectively. There was no tax benefit realized from exercises of the stock-based compensation arrangements during the years ended December 31, 2015, 2014 and 2013.

Restricted Stock

The Company has granted shares of restricted stock pursuant to the 2004 and 2012 Plans. These shares of restricted stock generally vest over a period of one to five years. The Company accounts for restricted stock grants by recording the fair value of the grant as compensation expense over the vesting period. Compensation expense related to restricted stock was $11.1 million, $8.2 million and $4.2 million for the years ended December 31, 2015, 2014 and 2013, respectively.

A summary of the status of nonvested shares of restricted stock as of December 31, 2015, and changes during the year then ended is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
	(Shares in thousands)	
	446	$ 57.97

Nonvested share awards outstanding, December 31, 2014			
Share awards granted	308		54.92
Unvested share awards forfeited	(75)		58.02
Share awards vested	(62)		51.60
Nonvested shares outstanding, December 31, 2015	617	$	57.31

The total fair value of restricted stock awards that fully vested during the year ended December 31, 2015 was $3.3 million.

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As of December 31, 2015, there was $19.2 million of total unrecognized compensation expense related to stock-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 1.54 years.

13. OTHER NONINTEREST INCOME AND EXPENSE

Other noninterest income and expense totals are more fully detailed in the following tables. Any components of these totals exceeding 1% of the aggregate of total net interest income and total noninterest income for any of the years presented, as well as amounts the Company elected to present, are stated separately.

	Years Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Other noninterest income			
Banking related service fees	$ 4,690	$ 4,796	$ 3,502
Bank Owned Life Insurance (BOLI)	5,548	5,189	3,635
Rental income	2,594	2,378	1,990
Other	10,930	9,182	5,901
Total	$ 23,762	$ 21,545	$ 15,028
Other noninterest expense			
Advertising	$ 2,974	$ 3,016	$ 2,642
Losses	3,361	4,143	2,138
Printing and supplies	2,158	2,427	2,616
Professional and legal fees	3,044	5,636	3,573
Property taxes	7,028	7,410	5,827
Travel and development	4,434	4,848	3,629
Other	9,577	9,351	10,254
Total	$ 32,576	$ 36,831	$ 30,679

14. PROFIT SHARING PLAN

The Company has adopted a profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code whereby the participants may contribute a percentage of their compensation as permitted under the Code. Matching contributions are made at the discretion of the Company. Presently, the Company matches 50% of an employee s contributions, up to 15% of such employee s compensation, not to exceed the maximum allowable pursuant to the Internal Revenue Code and excluding catch-up contributions. Such matching contributions were approximately $4.3 million, $4.6 million and $3.3 million for the years ended December 31, 2015, 2014 and 2013, respectively.

15. OFF-BALANCE SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

The following table summarizes the Company s contractual obligations and other commitments to make future payments as of December 31, 2015 (other than deposit obligations and securities sold under repurchase agreements). The Company s future cash payments associated with its contractual obligations pursuant to its FHLB notes payable and operating leases as of December 31, 2015 are summarized below. Payments for FHLB

notes payable include interest of $1.0 million that will be paid over the future periods. Payments related to leases are based on actual payments specified in underlying contracts.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
			(Dollars in thousands)		
Federal Home Loan Bank notes payable	$ 485,978	$ 5,201	$ 980	$ 277	$ 492,436
Operating leases	6,123	8,810	5,717	7,183	27,833
Total	$ 492,101	$ 14,011	$ 6,697	$ 7,460	$ 520,269

Off-Balance Sheet Items

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included in its consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

The Company s commitments associated with outstanding standby letters of credit and commitments to extend credit expiring by period as of December 31, 2015 are summarized below.

	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
			(Dollars in thousands)		
Standby letters of credit	$ 89,258	$ 3,912	$ 1,116	$	$ 94,286
Commitments to extend credit	1,054,490	337,416	69,908	497,332	1,959,146
Total	$ 1,143,748	$ 341,328	$ 71,024	$ 497,332	$ 2,053,432

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Company to guarantee the payment by or performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company s policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

Commitments to Extend Credit. The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the

Company s commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for credit losses. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts disclosed above do not necessarily represent future cash funding requirements. At December 31, 2015, $253.2 million of commitments to extend credit have fixed rates ranging from 1.4% to 21.0%.

The Company evaluates customer creditworthiness on a case-by-case basis. The amount of collateral obtained, if considered necessary by the Company upon extension of credit, is based on management s credit evaluation of the customer.

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Leases The following table presents a summary of non-cancelable future operating lease commitments as of December 31, 2015 (dollars in thousands):

2016	$ 6,123
2017	4,908
2018	3,902
2019	3,244
2020	2,473
Thereafter	7,183
	$ 27,833

It is expected that in the normal course of business, expiring leases will be renewed or replaced by leases on other property or equipment.

Rent expense under all noncancelable operating lease obligations aggregated approximately $7.4 million for the year ended December 31, 2015, $7.5 million for the year ended December 31, 2014 and $5.8 million for the year ended December 31, 2013.

Litigation The Company and the Bank are defendants, from time to time, in legal actions arising from transactions conducted in the ordinary course of business. The Company and the Bank believe, after consultations with legal counsel, that the ultimate liability, if any, arising from such actions will not have a material adverse effect on their financial statements.

16. OTHER COMPREHENSIVE (LOSS) INCOME

	For the Years Ended December 31,								
	2015			2014			2013		
	Before Tax Amount	Tax Benefit	Net of Tax Amount	Before Tax Amount	Tax Benefit	Net of Tax Amount	Before Tax Amount	Tax Benefit	Net of Tax Amount
	(Dollars in thousands)								
Other comprehensive loss:									
Securities available for sale:									
Change in unrealized gain during period	$ (2,599)	$ 910	$ (1,689)	$ (1,776)	$ 622	$ (1,154)	$ (6,312)	$ 2,209	$ (4,103)
Total securities available for sale	(2,599)	910	(1,689)	(1,776)	622	(1,154)	(6,312)	2,209	(4,103)
Total other comprehensive loss	$ (2,599)	$ 910	$ (1,689)	$ (1,776)	$ 622	$ (1,154)	$ (6,312)	$ 2,209	$ (4,103)

Activity in accumulated other comprehensive income, net of tax, was as follows:

	Securities Available for Sale	Accumulated Other Comprehensive Income
	(Dollars in thousands)	
Balance at January 1, 2015	$ 3,729	$ 3,729
Other comprehensive loss	(1,689)	(1,689)
Balance at December 31, 2015	$ 2,040	$ 2,040
Balance at January 1, 2014	$ 4,883	$ 4,883
Other comprehensive loss	(1,154)	(1,154)
Balance at December 31, 2014	$ 3,729	$ 3,729

	Securities Available for Sale	Accumulated Other Comprehensive Income
	(Dollars in thousands)	
Balance at January 1, 2013	$ 8,986	$ 8,986
Other comprehensive loss	(4,103)	(4,103)
Balance at December 31, 2013	$ 4,883	$ 4,883

17. REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Any institution that fails to meet its minimum capital requirements is subject to actions by regulators that could have a direct material effect on the Company s financial statements. Under the capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines based on the Bank s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company s and the Bank s capital amounts and the Bank s classification under the regulatory framework for prompt corrective action are also subject to qualitative judgments by the regulators about the components, risk weightings and other factors.

The Basel III Capital Rules adopted by the federal regulatory authorities in 2013 substantially revised the risk-based capital requirements applicable to the Company and the Bank. The Basel III Capital Rules became effective for the Company and the bank on January 1, 2015, subject to a phase-in period for certain provisions. Among other things, the Basel III Capital Rules introduced a new capital measure called Common Equity Tier 1 (CET1), which is a comparison of the sum of certain equity capital components to total risk-weighted assets, and revised the risk-weighting approach of the capital ratios with a more risk-sensitive approach that expanded the risk-weighting categories from the previous Basel I derived categories to a much larger and more risk-sensitive number of categories, depending on the nature of the assets.

To meet the capital adequacy requirements, the Company and the Bank must maintain minimum capital amounts and ratios of CET1, Tier 1 and Total capital to risk weighted assets, and of Tier 1 capital to adjusted quarterly average assets as defined in the regulations. As of December 31, 2015, the Company and the Bank met all capital adequacy requirements to which they were subject.

The CET1, Tier 1 and total capital ratios are calculated by dividing the respective capital amounts by risk weighted assets. Risk weighted assets include total assets, excluding goodwill and other intangible assets, allocated by risk weight category, and certain off-balance-sheet items. The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, excluding goodwill and other intangible assets.

As of December 31, 2015, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since that notification which management believes have changed the Bank s category. To be categorized as well capitalized the Bank must maintain minimum CET1 risk-based, Tier 1 risk-based, total risk-based and Tier 1 leverage ratios as set forth in the table below.

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The following is a summary of the Company s and the Bank s capital ratios at December 31, 2015 and 2014:

	Actual		For Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
CONSOLIDATED:						
As of December 31, 2015 (1)						
CET1 Capital (to Risk Weighted Assets) (2)	$ 1,578,312	13.55%	$ 524,089	4.50%	N/A	N/A
Tier 1 Capital (to Risk Weighted Assets)	1,578,312	13.55%	698,785	6.00%	N/A	N/A
Total Capital (to Risk Weighted Assets)	1,659,695	14.25%	931,714	8.00%	N/A	N/A
Tier 1 Capital (to Average Tangible Assets)	1,578,312	7.97%	792,102	4.00%	N/A	N/A
As of December 31, 2014 (3)						
Tier 1 Capital (to Risk Weighted Assets)	1,475,321	13.80%	$ 427,545	4.00%	N/A	N/A
Total Capital (to Risk Weighted Assets)	$ 1,556,083	14.56%	855,091	8.00%	N/A	N/A
Tier 1 Capital (to Average Tangible Assets)	1,475,321	7.69%	767,086	4.00%	N/A	N/A
PROSPERITY BANK® ONLY:						
As of December 31, 2015 (1)						
CET1 Capital (to Risk Weighted Assets) (2)	1,524,298	13.10%	$ 523,660	4.50%	756,398	6.50%
Tier 1 Capital (to Risk Weighted Assets)	1,524,298	13.10%	698,214	6.00%	930,952	8.00%
Total Capital (to Risk Weighted Assets)	$ 1,605,682	13.80%	930,952	8.00%	$ 1,163,689	10.00%
Tier 1 Capital (to Average Tangible Assets)	1,524,298	7.70%	791,721	4.00%	989,652	5.00%
As of December 31, 2014 (3)						
Tier 1 Capital (to Risk Weighted Assets)	1,437,141	13.46%	$ 427,119	4.00%	640,678	6.00%
Total Capital (to Risk Weighted Assets)	$ 1,517,903	14.22%	854,237	8.00%	$ 1,067,797	10.00%
Tier 1 Capital (to Average Tangible Assets)	1,437,141	7.50%	766,664	4.00%	958,329	5.00%

(1) Calculated pursuant to the phase-in provisions of the Basel III Capital Rules.
(2) CET1 capital ratio is required under the Basel III Capital Rules effective January 1, 2015.
(3) Calculated pursuant to prior capital rules in effect at December 31, 2014.

Dividends paid by Bancshares and the Bank are subject to restrictions by certain regulatory agencies. Dividends paid by Bancshares during the years ended December 31, 2015, 2014 and 2013 were $78.3 million, $68.4 million and $54.0 million, respectively. Dividends paid by the Bank to Bancshares during the years ended December 31, 2015, 2014 and 2013 were $258.3 million, $103.1 million and $203.5 million, respectively.

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18. PARENT COMPANY ONLY FINANCIAL STATEMENTS

PROSPERITY BANCSHARES, INC.

(Parent Company Only)

CONDENSED BALANCE SHEETS

	December 31, 2015	December 31, 2014
	(Dollars in thousands)	
ASSETS		
Cash	$ 40,157	$ 21,334
Investment in subsidiary	3,404,913	3,370,227
Investment in capital and statutory trusts		5,031
Goodwill	3,982	3,982
Other assets	13,858	12,092
TOTAL	$ 3,462,910	$ 3,412,666
LIABILITIES AND SHAREHOLDERS EQUITY		
LIABILITIES:		
Accrued interest payable and other liabilities	$	$ 309
Junior subordinated debentures		167,531
Total liabilities		167,840
SHAREHOLDERS EQUITY:		
Common stock	70,059	69,817
Capital surplus	2,036,378	2,025,235
Retained earnings	1,355,040	1,146,652
Unrealized gain on available for sale securities, net of tax benefit	2,040	3,729
Less treasury stock, at cost, 37,088 shares	(607)	(607)
Total shareholders equity	3,462,910	3,244,826
TOTAL	$ 3,462,910	$ 3,412,666

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PROSPERITY BANCSHARES, INC.

(Parent Company Only)

CONDENSED STATEMENTS OF INCOME

	For the Years Ended December 31, 2015	2014	2013
	(Dollars in thousands)		
OPERATING INCOME:			
Dividends from subsidiary	$ 258,250	$ 103,100	$ 203,500
Other income	69	159	115
Total income	258,319	103,259	203,615
OPERATING EXPENSE:			
Junior subordinated debentures interest expense	791	4,060	2,551
Stock based compensation expense (includes restricted stock)	11,095	8,236	4,175
Other expenses	526	608	515
Total operating expense	12,412	12,904	7,241
INCOME BEFORE INCOME TAX BENEFIT AND EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	245,907	90,355	196,374
FEDERAL INCOME TAX BENEFIT	4,331	4,468	2,495
INCOME BEFORE EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	250,238	94,823	198,869
EQUITY IN UNDISTRIBUTED EARNINGS OF SUBSIDIARIES	36,408	202,618	22,529
NET INCOME	$ 286,646	$ 297,441	$ 221,398

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PROSPERITY BANCSHARES, INC.

(Parent Company Only)

CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
Net income	$ 286,646	$ 297,441	$ 221,398
Other comprehensive loss, before tax:			
Securities available for sale:			
Change in unrealized gain during period	(2,599)	(1,776)	(6,312)
Total other comprehensive loss	(2,599)	(1,776)	(6,312)
Deferred tax benefit related to other comprehensive income	910	622	2,209
Other comprehensive loss, net of tax	(1,689)	(1,154)	(4,103)
Comprehensive income	$ 284,957	$ 296,287	$ 217,295

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PROSPERITY BANCSHARES, INC.

(Parent Company Only)

CONDENSED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2015	2014	2013
	(Dollars in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 286,646	$ 297,441	$ 221,398
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	(36,408)	(202,618)	(22,529)
Stock based compensation expense (includes restricted stock)	11,095	8,236	4,175
Decrease (increase) in other assets	3,298	4,838	(2,382)
(Decrease) increase in accrued interest payable and other liabilities	(309)	(968)	3,135
Net cash provided by operating activities	264,322	106,929	203,797
CASH FLOWS FROM INVESTING ACTIVITIES:			
Cash paid for acquisitions		(34,246)	(152,807)
Cash acquired from acquisitions		2,733	7,441
Net cash used in investing activities		(31,513)	(145,366)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Redemption of junior subordinated debentures	(167,531)		
Proceeds from stock option exercises	290	3,705	5,379
Payments of cash dividends	(78,258)	(68,384)	(54,039)
Net cash used in financing activities	(245,499)	(64,679)	(48,660)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	18,823	10,737	9,771
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	21,334	10,597	826
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 40,157	$ 21,334	$ 10,597

19. SUBSEQUENT EVENTS

Acquisition of Tradition Bancshares, Inc. On January 1, 2016, the Company completed the acquisition of Tradition Bancshares, Inc. (Tradition) and its wholly-owned subsidiary Tradition Bank headquartered in Houston, Texas. Tradition Bank operated 7 banking offices in the Houston, Texas area, including its main office in Bellaire, 3 banking centers in Katy and 1 banking center in The Woodlands.

Under the terms of the definitive agreement, Bancshares issued 679,528 shares of Bancshares common stock plus $39.0 million in cash for all outstanding shares of Tradition capital stock, for a total merger consideration of $71.5 million, based on Bancshares closing stock price of $47.86. On the effective date, the Company recognized preliminary goodwill of $27.5 million, which is calculated as the excess of both the consideration exchanged and liabilities assumed compared with the fair value of the assets acquired. The Company is currently in the process of obtaining fair values for certain acquired assets and assumed liabilities and, therefore, the estimates are preliminary.

On January 1, 2016, in connection with the acquisition of Tradition, the Company assumed $7.2 million in junior subordinated debentures. The Company has given irrevocable notice of its intent to redeem the outstanding debentures on April 7, 2016 and has advised the Federal Reserve Board of its redemption intent and timing. The Federal Reserve Board had no objections to the redemption. The Company will fund the redemption of the trust preferred securities through a dividend from the Bank.