
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2019

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: 0-09439

INTERNATIONAL BANCSHARES CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Texas
(State or other jurisdiction of
Incorporation or organization)

74-2157138
(I.R.S. Employer
Identification No.)

1200 San Bernardo Avenue
Laredo, Texas 78042 - 1359
(Address of principal executive office and Zip Code)

(956) 722-7611
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(g) of the Act:

<u>Title of each class:</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered:</u>
Common Stock, \$1.00 par value	IBOC	NASDAQ

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large Accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
Emerging Growth Company ☐

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2019 was \$2,475,805,000.00 based on the closing sales price per share of the Registrant's common stock on such date as reported by NASDAQ.

As of February 24, 2020, there were 65,207,831 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference into the designated parts of this Form 10-K: (a) Annual Report to security holders for the fiscal year ended December 31, 2019 (in Parts I and II) and (b) Proxy Statement relating to the Company's 2020 Annual Meeting of Shareholders (in Part III).

CONTENTS

	<u>Page</u>
Part I	
Item 1. Business	3
Item 1A. Risk Factors	21
Item 1B. Unresolved Staff Comments	27
Item 2. Properties	27
Item 3. Legal Proceedings	28
Item 4. Mine Safety Disclosures	28
Item 4A. Executive Officers of the Registrant	28
Part II	
Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	28
Item 6. Selected Financial Data	29
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	29
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	29
Item 8. Financial Statements and Supplementary Data	29
Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure	29
Item 9A. Controls and Procedures	29
Item 9B. Other Information	32
Part III	
Item 10. Directors, Executive Officers and Corporate Governance	32
Item 11. Executive Compensation	32
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	32
Item 13. Certain Relationships and Related Transactions, and Director Independence	32
Item 14. Principal Accounting Fees and Services	32
Part IV	
Item 15. Exhibits, Financial Statement Schedules	33
Item 16. Form 10-K Summary	34

Part I

As used in this report, the words “Company,” “we,” “us,” and “our” refer to International Bancshares Corporation, a Texas corporation, its five wholly-owned subsidiary banks, and other subsidiaries. The information that follows may contain forward-looking statements, which are qualified as indicated under “Cautionary Notice Regarding Forward-Looking Statements” in Item 7 (Management’s Discussion and Analysis of Financial Condition and Results of Operations) of this report. Our website address is www.ibc.com.

Item 1. Business

General

We are a registered multibank financial holding company providing a diversified range of commercial and retail banking services in our main banking and branch facilities located in north, south, central and southeast Texas and the State of Oklahoma. We were organized and we operate as a bank holding company within the meaning of the Bank Holding Company Act of 1956, (BHCA). As a bank holding company, we may own one or more banks and may engage in activities closely related to banking. In this regard, we are subject to supervision and regulation by the Board of Governors of the Federal Reserve System (FRB). In addition, all of our wholly-owned banking subsidiaries are members of and subject to regulation by the Federal Deposit Insurance Corporation (FDIC). Our principal corporate offices are located in Laredo, Texas.

Our principal assets at December 31, 2019, consisted of all the outstanding capital stock of four Texas state banking associations and one Oklahoma state banking corporation as follows:

- International Bank of Commerce, located in Laredo, Texas (IBC);
- Commerce Bank, located in Laredo, Texas (Commerce Bank);
- International Bank of Commerce, located in Brownsville, Texas (IBC Brownsville);
- International Bank of Commerce, located in Zapata, Texas (IBC Zapata); and
- International Bank of Commerce, located in Oklahoma City, Oklahoma (IBC-Oklahoma).

IBC-Oklahoma was formed as of January 1, 2017, as part of an internal corporate reorganization, whereby IBC assigned and transferred certain assets and liabilities located in Oklahoma and Dallas, Texas to IBC-Oklahoma. These five subsidiary banks are collectively referred to in this report as our “Subsidiary Banks.”

Our philosophy focuses on customer service as represented by the motto, “We Do More.” Our Subsidiary Banks maintain a strong commitment to their local communities by, among other things, appointing selected community members to local advisory boards (local boards). These local advisory boards help to direct the operations of the branches, under the supervision of the Subsidiary Bank’s board of directors. These local boards also assist in developing or modifying our products and services to meet local customer needs, as well as introducing prospective customers to our many products and services.

We also own four direct non-banking subsidiaries:

- IBC Trading Company, an export trading company which is currently inactive;
- IBC Charitable and Community Development Corporation, a Texas nonprofit corporation formed to conduct charitable and community development activities;
- IBC Capital Corporation, a company incorporated in the State of Delaware for the purpose of holding certain investments; and
- Premier Tierra Holdings, Inc., a liquidating subsidiary formed under the laws of the State of Texas.

We also own a fifty percent interest in Gulfstar Group I and II, Ltd. and related entities, which are involved in investment banking activities, a controlling interest in four merchant banking entities, and a majority ownership in a real-estate development partnership.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, as well as our Proxy Statements, are available free of charge on or through our website, www.ibc.com. We have also posted on the website a Code of Ethics that applies to our directors and executive officers, and charters for our Audit Committee, Risk Committee, Compensation Committee, and Nominating Committee.

Services and Employees

Our Subsidiary Banks have historically focused on providing commercial banking services to small and medium sized businesses located in their trade areas and select international banking services. In recent years, however, the Subsidiary Banks have emphasized consumer and retail banking, including mortgage lending, as well as locating branches in retail locations and shopping malls. Today, we have 188 facilities and 284 ATMs serving 88 communities in Texas and Oklahoma.

Through the Subsidiary Banks, we are engaged in the business of accepting checking and savings deposits and the making of commercial, real estate, personal, home improvement, automobile and other installment and term loans. Some Subsidiary Banks are very active in facilitating international trade along the United States border with Mexico and elsewhere. Our international banking business includes providing letters of credit, making commercial and industrial loans and providing foreign exchange services. Each Subsidiary Bank also offers other related services, such as credit cards, safety deposit boxes, collections, notary public, escrow services, drive up and walk up facilities and other customary banking services.

Each Subsidiary Bank makes available certain securities products through third party providers, as well as banking services during traditional and nontraditional banking hours through their ATM network and retail locations in shopping malls and other convenient places. Additionally, IBC also has introduced IBC Bank Online, an Internet banking product, in order to provide customers online access to banking information and services 24 hours a day, as well as, IBC Mobile Banking with access from mobile devices 24 hours a day. No material portion of our business may be deemed seasonal.

As of December 31, 2019, we and our Subsidiary Banks employed approximately 2,869 persons full time and 445 persons part time. We provide extensive training to our employees in an effort to ensure that our customers receive superior customer service. None of our employees are represented by any collective bargaining unit or are parties to a collective bargaining agreement. We believe that our relations with our employees are good.

Competition

We are one of the largest independent financial bank holding companies in the State of Texas. Our primary market area is bordered on the east by the Galveston area, the northwest by Dallas, the southwest by Del Rio and to the southeast by Brownsville. Our primary market area also includes the State of Oklahoma. We compete for deposits and loans with other commercial banks, savings and loan associations, and credit unions in our primary market area. We have increased our market share in our primary market area in the past through strategic acquisitions.

We also compete against non-bank entities, which serve as an alternative to traditional financial institutions. The percentage of bank related services being provided by non-bank entities has increased during the last several years.

We do a large amount of business for customers domiciled in Mexico, with an emphasis in Northern Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of the Subsidiary Banks. These deposits comprised approximately 29%, 29% and 27% of the Subsidiary Banks total deposits for the three years ended December 31, 2019, 2018 and 2017, respectively.

Under the Gramm Leach Bliley Financial Services Modernization Act of 1999 (GLBA), banks, securities firms and insurance companies may affiliate under an entity known as a financial holding company, which may then serve its customers' varied financial needs through a single corporate structure. The GLBA has significantly changed the competitive environment in which we and our Subsidiary Banks conduct business. The financial services industry is also likely to become even more competitive as further technological advances enable more companies to provide financial services. These technological advances may reduce the necessity of depository institutions and other financial intermediaries in the transfer of funds between parties.

Supervision and Regulation

Banking is a complex, highly regulated industry. In addition to the generally applicable state and federal laws governing businesses and employers, we and our Subsidiary Banks are further extensively regulated by special federal and state laws governing financial institutions. These laws comprehensively regulate the operations of the Subsidiary Banks and include, among other matters:

- requirements to maintain reserves against deposits;
- restrictions on the nature and amount of loans that may be made and the interest that may be charged thereon;
- restrictions on the amounts, terms and conditions of loans to directors, officers, large shareholders and their affiliates;
- restrictions related to investments in activities other than banking; and
- minimum capital requirements.

Furthermore, Congress, state legislatures and applicable federal and state regulatory agencies are continually reviewing such statutes, regulations and policies. Any change in such laws or policies applicable to us and our subsidiaries could have a material adverse effect on our business, financial condition or our results of operations. Recent political developments, including the change in the United States' administration, have increased uncertainty with respect to the implementation, scope and timing of regulatory reforms. With few exceptions, state and federal banking laws have as their principal objective either the maintenance of the safety and soundness of the federal deposit insurance system or the protection of consumers, rather than the specific protection of our shareholders or creditors.

Further, our earnings are affected by the fiscal and monetary policies of the FRB, which regulates the national money supply in order to mitigate recessionary and inflationary pressures. These monetary policies significantly influence the overall growth of bank loans, investments and deposits, as well as, the interest rates charged on loans or paid on time and savings deposits. The nature of future monetary policies and the effect of such policies on our future earnings and business cannot be predicted.

The Dodd-Frank Act

On July 21, 2010, sweeping financial regulatory reform legislation entitled the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (Dodd-Frank Act) was signed into law. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, addressing, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, interchange fees, derivatives, lending limits, mortgage lending practices, registration of investment advisors and changes among the bank regulatory agencies. These far-reaching changes across the financial regulatory landscape include provisions that, among other things, have or will:

- Centralize responsibility for consumer financial protection in a new agency named the Bureau of Consumer Financial Protection (CFPB);
- Restrict the preemption of state law by federal law;
- Apply the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies;

- Require financial holding companies, to be well capitalized and well managed in order to acquire banks located outside their home state;
- Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminate the ceiling on the size of the Deposit Insurance Fund (DIF) and increase the floor of the size of the DIF;
- Impose comprehensive regulation of over the counter derivatives market, which would include certain provisions that would effectively prohibit insured depository institutions from conducting certain derivatives businesses in the institution itself;
- Require publicly traded bank holding companies with at least \$10 billion in assets to create a risk committee to be chaired by an independent director, with at least one member with risk management expertise.
- Require annual stress testing of certain financial institutions with consolidated assets greater than \$10 billion, but, at this time, none of the Subsidiary Banks meets the \$10 billion asset threshold required to conduct the bank stress tests;
- Implement corporate governance revisions, including an advisory shareholder vote on executive compensation and proxy access by shareholders;
- Make permanent the \$250,000 limit for federal deposit insurance and increase the cash limit of Securities Investor Protection Corporation protection from \$100,000 to \$250,000;
- Repeal the federal prohibitions on the payment of interest on demand deposits;
- Amend the Electronic Fund Transfer Act to give the FRB authority to establish rules regarding interchange fees, which must be reasonable and proportional to the actual cost of a transaction to the issuer;
- Increase the authority of the FRB to examine us and our Subsidiary Banks;
- Permit interstate de novo branching without the need to acquire an existing bank;
- Require extensive new restrictions relating to residential mortgage transactions to increase compliance for financial institutions that originate mortgage loans;
- Establish a Whistleblower Incentives and Protection Program for public company employees;
- Require each agency to establish an Office of Minority and Women Inclusion and to develop diversity assessment standards for all the entities regulated by the agencies;
- Require the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in short term proprietary trading and investing in and sponsoring certain unregistered investment companies; and
- Authorize the FRB to adopt enhanced supervision and prudential standards for bank holding companies with total consolidated assets of \$250 billion (as modified by EGRRCPA) or more (often referred to as “systemically important financial institutions” or “SIFI”).

Many provisions of the Dodd-Frank Act became effective upon enactment, while others were subject to further study, SEC rulemaking and discretion afforded to federal regulators. Some provisions have only recently taken effect or will take effect in the future making it difficult to anticipate the overall financial impact on us, our customers or the financial industry in general. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees are likely to increase the costs associated with deposits, as well as place limitations on certain revenues those deposits may generate. Provisions that require revisions to our capital requirements could require us to seek other sources of capital in the future.

Emergency Economic Stabilization Act

On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008 (EESA), which, among other measures, authorized the Secretary of the Treasury to establish the Troubled Asset Relief Program (TARP). Under TARP, the Treasury created a capital purchase program (CPP), pursuant to which it provided access to capital that serves as Tier 1 capital to financial institutions through a standardized program to acquire preferred stock

(accompanied by warrants) from eligible financial institutions. Subsequently, we sold \$216 million of Series A Preferred Stock to the Treasury and a warrant (Warrant) to purchase 1,326,238 shares of our class of common stock at a price per share of \$24.43 per share that expired on December 23, 2018.

In November 2012, we repurchased all of the Series A Preferred Stock and exited the TARP program. In 2013, the Treasury sold the Warrant to a third party. On September 18, 2018, the Company entered into an agreement to repurchase the Warrant from the third party at an aggregate purchase price of \$29,005,000, which transaction was consummated in the third quarter of 2018. The repurchase of the outstanding Warrant eliminated any restrictions on certain shareholder distributions or payments of cash dividends in excess of \$0.33 per semi-annual period that would have impacted the exercise price of the Warrant while it remained outstanding.

FRB Approvals

As a registered bank holding company we are subject to supervision by, among others, the FRB. As such, we are required to file with the FRB annual reports and other information regarding our business operations and those of our Subsidiary Banks. We are also subject to periodic examination by the FRB. Under the BHCA, a bank holding company is prohibited from acquiring direct or indirect control of any company that is not a bank or bank holding company, and must engage only in the business of banking, managing, controlling banks and furnishing services to or performing services for its subsidiary banks, except where the FRB has determined the ownership to be so closely related to banking, managing or controlling banks as to be a proper incident thereto.

The BHCA and the Change in Bank Control Act of 1978 require that either FRB approval must be obtained or notice must be furnished to the FRB and not disapproved prior to any person or company acquiring “control” of a bank holding company, subject to exception for certain transactions. Control is conclusively presumed to exist if any person acquires 25% or more of the voting securities of a bank holding company; control is a rebuttable presumption between 10% and 25% ownership. Ownership by affiliated persons, or persons acting in concert, is typically aggregated for these purposes. The FRB recently revised its control rules under the BHCA by expanding the number of presumptions used to determine whether control exists or not. Effective April 1, 2020, the FRB’s new rule amends Regulation Y, the implementing regulation for the BHCA, to provide additional transparency regarding control determinations by implementing a tiered framework establishing factors and thresholds that are indicative of control. We do not anticipate that the rule will have a significant detrimental effect on us given that it is generally consistent with the FRB’s historical practices in making control determinations.

As a bank holding company, we are required to obtain approval prior to merging or consolidating with any other bank holding company, acquiring all or substantially all of the assets of any bank, or acquiring ownership or control of shares of a bank or bank holding company if, after the acquisition, we would directly or indirectly own or control 5% or more of the voting shares of such bank or bank holding company. In approving acquisitions or the addition of activities, one of the issues the FRB considers is 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.

The USA PATRIOT Act

Combating money laundering and terrorist financing is a major focus of financial institution regulatory policy. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (PATRIOT Act), substantially expanded the responsibilities of U.S. financial institutions with respect to countering money laundering and terrorist activities. The implementing 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. Also, the PATRIOT Act requires the bank regulatory agencies to consider the record of a bank or bank holding company in combating money laundering activities in their evaluation of bank and bank holding company merger or acquisition transactions. Anti-money laundering regulations are continually evolving, including new requirements effective May 11, 2018 requiring U.S. financial institutions to ascertain and document the beneficial owners of legal entity customers opening new accounts.

We have a program in place to monitor and enforce our policies on money laundering, corruption and bribery, as well as our policies on prohibiting the use of Company assets to finance or otherwise aid alleged terrorist groups. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Nonresident Alien Deposits

In 2013, the IRS published a rule requiring U.S. banks to report on the interest they pay to nonresident alien individuals, and the IRS will share the information with tax authorities in other countries with whom the United States has an agreement regarding the exchange of tax information.

Foreign Account Tax Compliance Act

On July 1, 2014, the Foreign Account Tax Compliance Act (FATCA) became effective. Originally enacted in 2010, FATCA is aimed at curbing offshore tax evasion by foreign financial institutions by requiring such institutions to identify any U.S. account holders. Moreover, FATCA requires U.S. withholding agents, including U.S. banks, to withhold a tax (30%) on U.S. sourced income payable to foreign financial institutions that do not agree to report certain information to the IRS regarding their U.S. accounts, as well as on payments to nonfinancial foreign entities that do not provide information on their U.S. account owners to withholding agents.

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. The Office of Foreign Assets Control of the U.S. Department of the Treasury (OFAC) publishes lists of specially designated countries and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States. The OFAC administered sanctions take many forms, including restrictions on trade or investment and the blocking of certain assets related to the designated foreign countries and nationals. Blocked assets, which may include bank deposits, cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with the OFAC sanctions could have serious legal and reputational consequences.

Gramm Leach Bliley

The GLBA eliminates the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers. The GLBA provides for a new type of financial holding company structure under which affiliations among these entities may occur. Under the GLBA, a financial holding company may engage in a broad list of financial activities and any non-financial activity that the FRB determines is complementary to a financial activity and poses no substantial risk to the safety and soundness of depository institutions or the financial system. In addition, the GLBA permitted certain non-banking financial and financially related activities to be conducted by financial subsidiaries of banks.

Under the GLBA, a bank holding company may become certified as a financial holding company by filing a declaration with the FRB, together with a certification that each of its subsidiary banks is well capitalized, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 (CRA). We elected and were approved by the FRB to become a financial holding company under the GLBA in 2000 and the election was made effective by the FRB as of March 13, 2000. During the second quarter of 2000, IBC established an insurance agency subsidiary and acquired two insurance agencies.

The investments that may be made under the GLBA are substantially broader in scope than the investment activities otherwise permissible for bank holding companies and are referred to as “merchant banking investments” in “portfolio companies.” The FRB and the Secretary of the Treasury have regulations governing the scope of permissible merchant banking investments. Before making a merchant banking investment, a financial holding company must either

be or have a registered securities firm or a qualified insurance affiliate. The merchant banking investments may be made by the financial holding company or any of its subsidiaries, other than a depository institution or a subsidiary of a depository institution. The regulations place restrictions on the ability of a financial holding company to become involved in the routine management or operation of any portfolio company. The regulation also generally limits the ownership period of merchant banking investments to no more than ten years.

The FRB, the Office of the Comptroller of the Currency (OCC), and the FDIC have rules governing the regulatory capital treatment of equity investments in non-financial companies held by banks, bank holding companies and financial holding companies. The rules apply a graduated capital charge on covered equity investments, which would increase as the proportion of such investments to Tier 1 capital increases.

On September 8, 2016, the FRB published a report to Congress in which it recommended the repeal of the merchant banking authority granted to financial holding companies under the GLBA. Specifically, the FRB recommended that Congress repeal the statutory merchant banking authority and the grandfathering exemption for certain companies that became financial holding companies after 1999. The FRB also noted in its report that it is considering regulatory measures that would limit what it termed “safety and soundness risks of merchant banking investments.” Following this report, on September 30, 2016, the FRB published a Notice of Proposed Rulemaking (NPR) proposing to, among other things, amend the risk-based capital requirements to increase the requirements associated with a subset of merchant banking investments; specifically, merchant banking investments in companies engaged in physical commodities activities. The changes proposed in the NPR were significantly narrower than the FRB’s recommendations regarding merchant banking investments in its report to Congress. To date, a final rule implementing the changes put forth in the NPR has not been issued and it is uncertain what action, if any, will be taken regarding the FRB’s report.

State Law Preemption

At the beginning of 2004, the OCC issued final rules clarifying when federal law overrides state law for national banks and their operating subsidiaries and confirming that only the OCC has the right to examine and take enforcement action against those institutions. The Dodd-Frank Act, however, limits the applicability of the preemption doctrine so that state laws affecting national banks are preempted only in certain circumstances. In this regard, the OCC has concluded that the Dodd-Frank Act did not create a new, standalone preemption standard, but rather, existing OCC regulations are “preserved,” including federal preemption over state consumer protection laws. The OCC also clarified that a state attorney general or chief law enforcement officer may enforce any applicable law against a national bank (as opposed to a non-preempted state law), and to seek relief if, and as, authorized by that law.

Financial Privacy

In accordance with the GLBA, the federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose nonpublic information about consumers to nonaffiliated third parties. Pursuant to these rules, financial institutions must provide disclosure of privacy policies to consumers and allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party in some instances.

Additional regulations were adopted to implement the provisions of the Fair Access to Credit Transactions Act (FACTA), which requires certain disclosures and consents to share certain information among bank affiliates. These privacy provisions affect how customer information is transmitted through diversified financial companies and conveyed to outside vendors. These privacy provisions also have the effect of increasing the length of the waiting period, after privacy disclosures are provided to new customers, before information can be shared among different affiliated companies for the purpose of cross-selling products and services between those affiliated companies. On December 4, 2015, the Fixing America’s Surface Transportation Act (FAST Act) was signed into law. Part of the FAST Act amended the GLBA by providing financial institutions with an exception to the general requirement that those institutions deliver annual privacy notices.

NASDAQ Listing Standards

Shares of our common stock are listed and trade on the NASDAQ Stock Market under the symbol “IBOC”. As such, we must comply with the quantitative and qualitative listing standards of the NASDAQ Stock Market. In addition to other matters, the listing standards address disclosure requirements and standards relating to board independence and other corporate governance matters.

Interstate Banking

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Interstate Banking Act), rewrote federal law governing the interstate expansion of banks in the United States. Under the Interstate Banking Act, adequately capitalized, well managed bank holding companies with FRB approval may acquire banks located in any state in the United States, provided that the target bank meets the minimum age established by the host state (maximum of five years in Texas). Under the Interstate Banking Act, an anti-concentration limit will bar interstate acquisitions that would give a bank holding company control of more than ten percent of all deposits nationwide or thirty percent of any one state’s deposits, or such higher or lower percentage established by the host state. The anti-concentration limit in each of Texas and Oklahoma has been set at twenty percent of all federally insured deposits in Texas and Oklahoma, respectively. The Dodd-Frank Act changes the requirements for interstate branching by permitting de novo interstate branching if, under the laws of the state where the new branch is to be established, a state bank chartered in that state would be permitted to establish a branch.

FRB Enforcement Powers

The FRB has certain divestiture and other powers over bank holding companies and non-banking subsidiaries where their actions would constitute a serious threat to the safety, soundness or stability of a subsidiary bank. These powers may be exercised through the issuance of cease and desist orders or other actions. In the event a Subsidiary Bank experiences either a significant loan loss or rapid growth of loans or deposits, we may be compelled by the FRB to invest additional capital in the Subsidiary Bank. Further, we would be required to guarantee performance of the capital restoration plan of any undercapitalized Subsidiary Bank.

The FRB is also empowered to assess civil money penalties against companies or individuals who violate the BHCA in amounts up to \$1,000,000 per day, order termination of non-banking activities of non-banking subsidiaries and order termination of ownership and control of a non-banking subsidiary. Under certain circumstances the Texas Banking Commissioner may bring enforcement proceedings against a bank holding company in Texas.

Company Dividends

Our holding company is regarded as a legal entity separate and distinct from our Subsidiary Banks and is subject to regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The ability of our holding company to pay dividends is largely dependent on the amount of cash derived from dividends declared by our Subsidiary Banks. The payment of dividends by any bank or bank holding company is affected by the requirement to maintain adequate capital. Under FRB policy, 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 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 FRB has historically discouraged dividend payment ratios that are at the maximum allowable levels unless both asset quality and capital are very strong.

The ability of the Subsidiary Banks to pay dividends is also restricted under Texas and Oklahoma law. A Texas bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. An Oklahoma bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Oklahoma Department of Banking. The FDIC has the right to prohibit the payment of dividends by a bank where the payment is deemed to be an unsafe and unsound banking practice.

At December 31, 2019, there was an aggregate of approximately \$891,500,000 available for the payment of dividends to our holding company by our Subsidiary Banks under the capital rules applicable as of December 31, 2019, assuming that each of such banks continues to be classified as “well-capitalized.” Further, we could expend the entire \$891,500,000 and continue to be classified as “well-capitalized” under the capital rules applicable as of December 31, 2019.

Source of Strength Doctrine

FRB policy has historically required bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. The Dodd-Frank Act codified this policy as a statutory requirement. Under this requirement, we are expected to commit resources to support our Subsidiary Banks, including at times when we 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. In the event of a bank holding company’s bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment. In addition to the foregoing requirements, the Dodd-Frank Act’s provisions authorize the FRB and other federal banking regulators to require a company that directly or indirectly controls a bank to submit reports that are designed both to assess the ability of such company to comply with its “source of strength” obligations and to enforce the company’s compliance with these obligations.

The Dodd-Frank Act requires the federal banking agencies to jointly issue rules implementing the “source of strength” doctrine, but as of December 31, 2019, the FRB and other federal banking regulators have not yet issued such rules.

Deposit Insurance

All of the Subsidiary Banks are examined by the FDIC, which currently insures the deposits of each member bank up to applicable limits. The FDIC may terminate deposit insurance upon a finding that an institution has engaged in unsafe and unsound practices, is in an unsafe or uninsured condition to continue operations, or has violated any applicable law, regulation, rule or order of condition imposed by the FDIC.

Deposits of each of the Subsidiary Banks are insured by the FDIC through the DIF to the extent provided by law. The FDIC uses a risk-based assessment system that imposes premiums based upon a matrix that takes into account a bank’s capital level and supervisory rating.

Our FDIC deposit insurance expense totaled \$1,416,000, \$3,742,000 and \$3,294,000 in 2019, 2018 and 2017, respectively.

The FDIC proposed new requirements, which became effective in 2017, for insured depository institutions with at least 2 million deposit accounts to impose new recordkeeping standards and deposit insurance calculation requirements for these institutions. The institutions also are required to ensure that their information technology (IT) systems are capable of calculating the amount of insured money for most depositors within 24 hours of a failure.

Capital Adequacy

Our holding company and our Subsidiary Banks are required to meet certain minimum regulatory capital guidelines. The FRB has historically utilized a system based upon risk-based capital guidelines under a two-tier capital framework to evaluate the capital adequacy of bank holding companies. Tier 1 capital generally consists of common stockholders’ equity, retained earnings, a limited amount of qualifying perpetual preferred stock, qualifying trust preferred securities and non-controlling interests in the equity accounts of consolidated subsidiaries, less goodwill and certain intangibles. Tier 2 capital generally consists of certain hybrid capital instruments and perpetual debt, mandatory convertible debt securities and a limited amount of subordinated debt, qualifying preferred stock, loan loss allowance, and unrealized holding gains on certain equity securities.

The federal authorities' risk based capital guidelines utilize total capital to risk weighted assets and Tier 1 capital elements. In this way, the guidelines make regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, consider off balance sheet exposure in assessing capital adequacy and encourage the holding of liquid, low risk assets. At least one half of the minimum total capital is required to be comprised of Core Capital or Tier 1 capital elements. Our Tier 1 capital is comprised of common shareholders' equity and permissible amounts related to the trust preferred securities. The deductible core deposit intangibles and goodwill booked in connection with all our financial institution acquisitions after February 1992 are deducted from the sum of core capital elements when determining our capital ratios.

In addition, the FRB has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of Tier 1 capital to adjusted average quarterly assets ("leverage ratio") equal to three percent for bank holding companies that meet certain specified criteria, including having the highest regulatory rating. All other bank holding companies will generally be required to maintain a leverage ratio of at least four to five percent. Our leverage ratio at December 31, 2019 was 16.65%.

The guidelines also provide that bank holding companies 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. Each of our Subsidiary Banks is subject to similar capital requirements adopted by the FDIC and had a leverage ratio in excess of five percent as of December 31, 2019.

The federal bank regulatory agencies have adopted regulations which mandate a five-tier scheme of capital requirements and corresponding supervisory actions to implement the prompt corrective action provisions of FDICIA. The regulations include requirements for the capital categories that will serve as benchmarks for mandatory supervisory actions. Under the regulations, the highest of the five categories would be a well-capitalized institution with a total risk-based capital ratio of 10%, a Tier 1 risk-based capital ratio of 6% and a Tier 1 leverage ratio of 5%. An institution would be prohibited from declaring any dividends, making any other capital distribution or paying a management fee if the capital ratios drop below the levels for an adequately capitalized institution, which are 8%, 4% and 4%, respectively. The corresponding provisions of the Federal Deposit Insurance Improvement Act (FDICIA) mandate corrective actions are taken if a bank is undercapitalized. Based on our capital ratios as of December 31, 2019, our holding company and each of the Subsidiary Banks were classified as "well-capitalized" under the applicable regulations.

The risk-based standards that apply to bank holding companies and banks incorporate market and interest rate risk components. Applicable banking institutions are required to adjust their risk-based capital ratio to reflect market risk. Under the market risk capital guidelines, capital is allocated to support the amount of market risk related to a financial institution's ongoing trading activities. Financial institutions are allowed to issue qualifying unsecured subordinated debt (Tier 3 capital) to meet a part of their market risks. We do not have any Tier 3 capital and did not need Tier 3 capital to offset market risks. In 2010, the federal bank regulators issued a final risk-based capital rule related to new accounting standards that make substantive changes in how banking organizations account for more items, including securitized assets that previously had been taken off banks' balance sheets. The Dodd-Frank Act directed the banking agencies to issue capital requirements for banking institutions that are countercyclical. These will require a higher level of capital to be maintained in times of economic expansion and a lower level of capital during times of economic contraction.

Basel III

In July 2013, the FRB and the FDIC published the Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implemented the Basel Committee on Banking Supervision's -- a college of central bankers and other financial regulators from the United States and other advanced economies -- December 2010 framework known as "Basel III" for strengthening international capital standards, as well as certain provisions of the Dodd-Frank Act. Basel III requires bank holding companies and their subsidiary banks to maintain substantially more capital, with a greater emphasis on common equity.

The Basel III final capital framework, among other things, (i) introduces as a new capital measure "Common Equity Tier 1" (CET1), (ii) specifies that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) defines CET1 narrowly by requiring that most adjustments to regulatory capital

measures be made to CET1 and not to the other components of capital and (iv) expands the scope of the adjustments as compared to existing regulations.

Basel III also provides for a “countercyclical capital buffer,” generally to be imposed when national regulators determine that excess aggregate credit growth becomes associated with a buildup of systemic risk. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk weighted assets above the minimum, but below the conservation buffer, will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall and the institution’s “eligible retained income” (meaning, four quarter trailing income, net of distributions and tax effects not reflected in net income).

The Basel III capital rules include the new components of “Accumulated Other Comprehensive Income (Loss)” (AOCI) that factors into the calculation of CET1 all net unrealized gains (losses) on available for sale securities. The definition also establishes the expectation that the majority of Common Equity Tier 1 should be voting shares. Basel III creates a category referred to as “High Volatility CRE,” which has a risk weight of 150% and generally includes nonresidential real estate acquisition development or construction financing. Basel III requires the phase-out from Tier 1 capital of trust preferred securities and cumulative preferred stock over a ten-year time period.

Further, the Basel III capital rules establish calculations for risk-weighted assets using alternatives to credit ratings that would be based on either the weighted average of the underlying collateral or a formula based on subordination position and delinquencies or the use of a 1,250% risk rating, which would be the default rating if requisite standards of a comprehensive understanding and levels of the due diligence are not met. Securitized structures, such as private label mortgage backed securities, may be risk weighted based on a gross up approach considering underlying assets, otherwise they default to the 1,250% risk weight.

On the quality of capital side, the final Basel III capital rule emphasized Common Equity Tier 1 capital, the most loss absorbing form of capital, and implements strict eligibility criteria for regulatory capital instruments. The final rule also improved the methodology for calculating risk-weighted assets to enhance risk sensitivity. The banking agencies made a number of changes in the final rule, in particular, to address concerns about regulatory burden on community banks. For example, the final rule is significantly different from the proposal in terms of risk weighting for residential mortgages and the regulatory capital treatment of certain unrealized gains and losses on trust preferred securities for common banking organizations.

Our phase-in period for mandatory compliance with the final Basel III rule was January 1, 2015. A key provision of the rules permitted us to make a one-time irrevocable election to determine how most items reported in AOCI will be handled for regulatory capital purposes. For institutions that opt out, most AOCI items will not be included in the calculation of Common Equity Tier 1 capital; institutions that do not opt out will have most AOCI items included in the calculation of Common Equity Tier 1 capital, which affects the institution’s legal lending limit calculation. If a top tier banking organization makes the AOCI opt out election, all consolidated banking subsidiary organizations under it must make the same election. We made the AOCI opt out election in 2015.

Since fully phased-in on January 1, 2019, the Basel III capital rules require the following minimum capital ratios:

- 4.5% CET1 to risk-weighted assets, plus a capital conservation buffer of at least 2.5% (resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7.0%);
- 6.0% Tier 1 capital to risk-weighted assets, plus a capital conservation buffer (resulting in a Tier 1 capital to risk-weighted assets ratio of at least 8.5%);
- 8.0% Total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets, plus the capital conservation buffer (resulting in a minimum total capital ratio of 10.5%); and
- 4.0% minimum leverage ratio, calculated as the ratio of Tier 1 capital to average assets.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and was phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The

implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased-in over a four-year period (increasing by that amount on each subsequent January 1), until it reached 2.5% on January 1, 2019.

The Basel III capital rules prescribe a standardized approach for risk weightings that expand the risk weighting categories from four 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, resulting in higher risk weights for a variety of asset categories. Specific changes to the rules impacting our determination of risk-weighted assets include, among other things:

- Applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans;
- Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due;
- Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%);
- Providing for a risk weight, generally not less than 20% with certain exceptions, for securities lending transactions based on the risk weight category of the underlying collateral securing the transaction;
- Providing for a 100% risk weight for claims on securities firms; and
- Eliminating the current 50% cap on the risk weight for OTC derivatives.

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.

On November 21, 2017, the OCC, the Federal Reserve and the FDIC finalized a proposed rule that extends the current treatment under the regulatory capital rules for certain regulatory capital deductions and risk weights and certain minority interest requirements, as they apply to banking organizations that are not subject to the advanced approaches capital rules. Effective January 1, 2018, the rule also pauses the full transition to the Basel III treatment of mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions and minority interests.

On December 7, 2017, the Basel Committee on Banking Supervision unveiled the latest round of its regulatory capital framework, commonly called “Basel IV.” The framework makes changes to the capital framework first introduced as “Basel III” in 2010. The committee targeted 2022-2027 as the timeframe for implementation by regulators in individual countries, including the U.S. federal bank regulatory agencies (after notice and comment).

Basel III Prompt Corrective Action

The Federal Deposit Insurance Act, as amended (FDIA), requires the federal banking agencies to take “prompt corrective action” in respect of depository institutions that do not meet minimum capital requirements. The FDIA includes the following five capital tiers: (i) “well-capitalized;” (ii) “adequately capitalized;” (iii) “undercapitalized;” (iv) “significantly undercapitalized;” and (v) “critically undercapitalized.” A depository institution’s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures which reflect changes under the Basel III capital rules that became effective on January 1, 2015, are the total capital ratio, the CET1 capital ratio, the Tier 1 capital ratio and the leverage ratio. A bank will be considered:

- “well-capitalized” if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by an such regulatory authority to meet and maintain a specific capital level for any capital measure;
- “adequately capitalized” if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital

ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 4.0% or greater and is not “well capitalized”;

- “undercapitalized” if the institution has a total risk-based capital ratio that is 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%;
- “significantly undercapitalized” if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 3.0%; and
- “critically undercapitalized” if the institution’s tangible equity is equal to or less than 2.0% of average quarterly tangible assets.

An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank’s capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank’s overall financial condition or prospects for other purposes.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be “undercapitalized.” “Undercapitalized” institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution’s capital. In addition, for a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution’s total assets at the time it became undercapitalized, and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is “significantly undercapitalized.”

The appropriate federal banking agency may, under certain circumstances, reclassify a well-capitalized insured depository institution as adequately capitalized. The FDIA provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

As of December 31, 2019, each of our Subsidiary Banks are “well-capitalized” based on the aforementioned ratios pursuant to the Basel III capital rules.

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 final 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, going forward will be required by regulation.

The Basel III liquidity coverage ratio was published in 2013 and uses international liquidity standards that serve to reconcile the differences of the liquidity standards of countries. The Basel Committee is expected to address the net stable funding ratio in the future. These new standards are subject to further rulemaking and their terms may well change before implementation. The federal bank regulatory agencies also issued a proposed rule that would implement qualitative liquidity requirements, including a liquidity coverage ratio (LCR), consistent with liquidity standards adopted by the Basel Committee, for certain banking organizations with more than \$250 billion in total assets or subsidiary depository institutions of internationally active banking organizations with \$10 billion or more in total consolidated assets. The FRB issued a separate proposed rule at the same time to apply a modified version of the LCR to certain depository institution

holding companies with assets greater than \$50 billion. The final version of the rule defines banks with between \$50 billion and \$250 billion in assets as “modified LCR companies,” which will be subjected to less rigorous requirements regarding the high-quality liquid assets calculations.

In July 2018, following the enactment of the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 (“EGRRCPA”), the Federal Reserve Board stated that it would no longer require bank holding companies with less than \$100 billion in total consolidated assets to comply with the modified version of the LCR. In October 2018, the federal banking regulators further proposed to revise their liquidity requirements so that banking organizations that are not globally systemic important banks and have less than \$250 billion in total consolidated assets and less than \$75 billion in each of off-balance sheet exposures, nonbank assets, cross-jurisdictional activity and short-term wholesale funding would not be subject to any LCR or net stable funding ratio requirements.

FASB CECL Accounting Standard

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-13 to ASC 326, “Financial Instruments – Credit Losses,” (CECL). The accounting standards update amends existing standards for credit losses on financial assets. The change in accounting standard requires that the expected credit losses on financial instruments held as of the end of the period be measured based on historical loss experience, current conditions and reasonable and supportable forecasts. The update also amends the accounting for credit losses on available-for-sale debt securities and financial assets purchased with credit deterioration. The accounting standard change will be effective for us for interim and annual periods beginning after December 15, 2019. The change in accounting method represents a significant difference to current accounting practice over the accounting for credit losses on financial assets. We estimate that the impact of the adoption of CECL will increase our allowance for probable loan losses between approximately 2 and 6%. In December 2018, the FRB and the other federal banking regulators issued a final rule that modified their regulatory capital rules and provided an option for banks to phase-in the increased reserves required pursuant to the adoption of CECL over a period of three-years to mitigate the effects on their regulatory capital requirements. We have decided we will not be electing this phase-in option and instead will immediately recognize the capital impact.

State Enforcement Powers

The Banking Commissioners of Texas and Oklahoma may determine to close a Texas or Oklahoma state bank, respectively, when such Commissioner finds that the interests of depositors and creditors of a state bank are jeopardized through its insolvency or imminent insolvency and that it is in the best interest of such depositors and creditors that the bank be closed. The Texas Department of Banking and Oklahoma State Banking Department also have broad enforcement powers over the Subsidiary Banks, as applicable, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

Depositor Preference

Because our holding company is a legal entity separate and distinct from our Subsidiary Banks, it’s our holding company’s 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 a Subsidiary Bank, the claims of depositors and other general or subordinated creditors of the bank 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 or any shareholder or creditor.

Community Reinvestment Act

Under the CRA, the FDIC is required to assess the record of each Subsidiary Bank to determine if the bank meets the credit needs of its entire community, including low and moderate-income neighborhoods served by the institution, and to take that record into account in its evaluation of any application made by the bank for, among other things, approval of the acquisition or establishment of a branch or other deposit facility, an office relocation, a merger, or the acquisition of shares of capital stock of another financial institution. The FDIC prepares a written evaluation of an institution’s record of meeting the credit needs of its entire community and assigns a rating. Federal banking agencies make public a rating of a

bank's performance under the CRA. The Subsidiary Banks conduct an award winning financial literacy program in their communities as part of their community outreach.

Two of our Subsidiary Banks received an "Outstanding" CRA rating, and the rest received a "Satisfactory" CRA rating in their most recently completed examinations. Financial institutions are evaluated under different CRA examinations procedures based upon their asset size classification, which asset thresholds are updated annually and were updated as of January 1, 2020. "Large institution" now means a bank with total assets of at least \$1.305 billion for December 31 of both of the prior two calendar years and "intermediate small institution" means an institution with assets of at least \$326 million and less than \$1.305 billion as of December 31 of both of the prior two calendar years. Three of our Subsidiary Banks are considered "intermediate small institutions" and IBC and IBC Oklahoma are considered "large institutions" under the new asset thresholds.

Consumer Laws

In addition to the laws and regulations discussed herein, the Subsidiary Banks are also subject to numerous consumer laws and regulations that are designed to protect consumers in transactions with banks. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Subsidiary Banks must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations. The Dodd-Frank Act established comprehensive new rules regulating mortgage activities and created the CFPB with direct supervisory authority over banks with assets of \$10 billion or more and certain nonbank entities.

The CFPB has broad authority, among other matters, to declare acts or practices to be "unfair, deceptive, or abusive," and to develop and require new consumer disclosures. While the CFPB does not currently have direct supervisory authority over any of our Subsidiary Banks because they each fall below the \$10 billion assets threshold, the CFPB's broad authority to issue, interpret, and enforce almost all federal consumer protection laws, and its issuance of applicable disclosure forms, will significantly impact each of the Subsidiary Banks' consumer compliance programs.

In light of the current political climate in Washington, DC and changes in CFPB leadership in recent years, we cannot predict what additional actions may be taken by the CFPB with respect to its previous regulations, rulings and decisions and any impact on our operations.

Military Lending Act

In 2015, the Department of Defense issued final amendments to the rule that implements the federal Military Lending Act. Under the amended rule, the Department of Defense expanded the definition of "consumer credit" to include a much broader range of credit products, including some credit products offered by depository institutions. The rule requires lenders to provide certain protections to borrowers who are covered under the rule. For instance, lenders must cap the Military Annual Percentage Rate for covered credit products provided to covered borrowers at 36%. Lenders must also provide certain disclosures and other protections to covered borrowers. Although a lender can use any method to determine a borrower's military status, the lender can obtain a safe harbor by verifying the borrower's military status either through the Department of Defense Manpower Data Center or by using a consumer credit report that contains military status.

Electronic Banking and Cyber Security

The Federal Financial Institutions Examination Council (FFIEC) issued guidance in 2005 entitled "Authentication in an Internet Banking Environment" (2005 Guidance), which provided a risk management framework for financial institutions offering Internet-based products and services to their customers. The 2005 Guidance required that institutions use effective methods to authenticate the identity of customers and that the techniques employed be commensurate with the risks associated with the products and services offered and the protection of sensitive customer information. The FDIC and other FFIEC agencies supplemented the 2005 Guidance by specifying the FDIC's supervisory expectations regarding customer authentication, layered security, and other controls in an increasingly hostile online environment. The FDIC indicated that layered security controls should include processes to detect and respond to suspicious or anomalous activity

and, for business accounts, administrative controls. In 2011, the Texas Banking Commissioner and the U.S. Secret Service formed the Bankers Electronic Crimes Task Force and issued guidance entitled “Best Practices: Reducing the Risks of Corporate Account Takeovers.” This guidance sets forth nineteen best practices to reduce the risk of corporate account takeover thefts. Our Subsidiary Banks are required to comply with these guidelines and best practices.

The National Institute of Standards and Technology (NIST) released a preliminary Framework for Improving Critical Infrastructure Cybersecurity in 2014. Our Subsidiary Banks are expected to incorporate the NIST Cybersecurity Framework into their security frameworks, which are also governed by FFIEC guidelines. In 2016, the federal banking agencies proposed enhanced cyber risk management standards for large interconnected entities and their service providers. The proposal establishes enhanced standards to increase the operational resilience of these entities and reduce the impact on the financial system in case of a cyber event experienced by one of these entities. The standards address cyber risk governance, cyber risk management, internal dependency management, external dependency management, incident response, cyber resilience and situational awareness. The enhanced standards would be implemented in a tiered manner, imposing more stringent standards on the systems of those entities that are critical to the functioning of the financial sector.

Increasingly, state regulators are implementing additional privacy and cybersecurity standards and regulations. Recently, several states adopted regulations requiring certain financial institutions to implement cybersecurity programs and providing detailed requirements for such programs, including data encryption requirements. Many states have also recently implemented or modified their data breach notification and data privacy requirements. Effective January 1, 2020, Texas amended its data breach notification law, limiting the time frame for notifying individuals whose data has been compromised and requiring notice to the Texas Attorney General in certain circumstances. We expect state-level activity to continue in this area and will monitor legislative developments in Texas and Oklahoma.

Affiliate Transactions

Our holding company and Subsidiary Banks are “affiliates” within the meaning of Section 23A of the Federal Reserve Act, which sets forth certain restrictions on (i) loans and extensions of credit between a bank subsidiary and affiliates, (ii) on investments in an affiliate’s stock or other securities, and (iii) on acceptance of such stock or other securities as collateral for loans. These restrictions prevent a bank holding company from borrowing from any of its bank subsidiaries, unless the loans are secured by specific obligations. Further, such secured loans and investments by a bank subsidiary are limited in amount, as to a bank holding company or any other affiliate, to 10% of such bank subsidiary’s capital and surplus and, as to the bank holding company and its affiliates, to an aggregate of 20% of such bank subsidiary’s capital and surplus. Certain restrictions do not apply to 80% or more owned sister banks of bank holding companies. Each Subsidiary Bank is wholly-owned by our holding company.

Section 23B of the Federal Reserve Act requires that the terms of affiliate transactions be comparable to terms of similar non-affiliate transactions. Among other things, the Dodd-Frank Act expands the limitations on affiliate transactions by expanding the definitions of “affiliate” and “covered transactions,” including debt obligations of an affiliate utilized as collateral. The Dodd-Frank Act also requires that the 10% of capital limit on covered transactions begin to apply to non-bank financial subsidiaries. “Covered transactions” are defined to include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the FRB) from the affiliate, the acceptance of securities issued by the affiliate as collateral for a loan, and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate. While the Dodd-Frank Act changes became effective in 2012, the FRB has not issued any guidance nor has it amended Regulation W. Regulation W predates the Dodd-Frank Act and is expected to remain under any deregulation under the current administration.

Insider Loans

The restrictions on loans to directors, executive officers, principal shareholders and their related interests contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. In general, any such extensions of credit must (i) not exceed certain dollar limitations, (ii) be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (iii) not involve more than the normal risk of repayment or present other unfavorable features. Additional restrictions are imposed on extensions of credit to executive officers. Certain extensions of credit

also require the approval of a bank's board of directors. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution's total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Mortgage Lending

In 2016, the CFPB amended certain mortgage rules issued in 2013. This final rule clarifies, revises, or amends provisions regarding force-placed insurance notices, policies and procedures, early intervention, and loss mitigation requirements under Regulation X's servicing provisions; and prompt crediting and periodic statement requirements under Regulation Z's servicing provisions. The final rule also addresses compliance when a consumer is in bankruptcy and makes technical corrections to several other provisions.

Also in October 2016, the CFPB also issued a final rule amending the mortgage servicing rules, most of which became effective on October 19, 2017, and the remainder of which became effective on April 19, 2018. The CFPB issued this interpretive rule under the Fair Debt Collection Practices Act (FDCPA) to clarify the interaction of the FDCPA and mortgage servicing rules. This interpretive rule constitutes an advisory opinion under FDCPA section 813(e) and provides a safe harbor from liability for actions done or omitted in good faith in conformity with the opinion. The CFPB's final rules also addresses insufficiency of hazard insurance which may lead to new requirements for lender-placed insurance, and early intervention with delinquent buyers will be governed by new contract obligations.

On November 30, 2016, the CFPB, FRB, and OCC finalized amendments to the official interpretations that implement special appraisal requirements for "higher-risk mortgages" or "higher-priced mortgages." Under the interpretations when there is no annual percentage increase in the Consumer Price Index, the OCC, FRB and CFPB will not adjust the exemption threshold from the prior year.

On July 7, 2017, the CFPB modified the TILA/RESPA Integrated Disclosure Rule implemented in Regulations X and Z. The amendments created tolerances for the total of payments and provided guidance on sharing the integrated disclosures with various parties involved in the mortgage origination process. The TILA-RESPA Rule was amended again in 2018 to make amendments regarding when a creditor may use a Closing Disclosure to reset tolerances.

On October 4, 2017, the CFPB issued an interim final rule and a proposed rule to provide mortgage servicers more flexibility and certainty around requirements to communicate with certain borrowers under the CFPB's 2016 mortgage servicing amendments. The interim final rule gives servicers more flexibility regarding when to communicate about foreclosure prevention options with borrowers who have requested a cease in communication under federal debt collection law. The interim final rule became effective on Oct. 19, 2017, the same date that the related 2016 rule provisions become effective. The proposed rule was finalized and became effective on April 19, 2018. It imposes mortgage servicing requirements which are complex. All servicers must ensure they have comprehensive practices for responding to potential successors in interest and for confirming and communicating with them. Additionally, servicers need to determine which of the CFPB's three options to adopt for communicating with confirmed successors in interest, in a manner that ensures clarity and does not indicate an obligation to repay a mortgage. The CFPB also removed the blanket exemption from the periodic statement requirement for borrowers in bankruptcy, making it necessary to provide modified periodic statements – which will require significant system configurations and testing to ensure the new requirements are met.

Powers

As a result of FDICIA, the authority of the FDIC over state-chartered banks was expanded. The FDICIA limits state chartered banks to only those principal activities permissible for national banks, except for other activities specifically approved by the FDIC. The Texas Banking Act includes a parity provision which establishes procedures for state banks to notify the Texas Banking Commissioner if the bank intends to conduct any activity permitted for a national bank that is otherwise denied to a state bank. The Texas Banking Commissioner has 30 days to prohibit the activity. Also, the Texas Finance Code includes a "super parity" provision with procedures for state banks to notify the Texas Banking Commissioner if the bank intends to conduct any activity permitted for any depository institution in the United States. Texas Banking Commissioner has 30 days after receiving such notice to prohibit the activity. Similarly, under the

Oklahoma Banking Code, Oklahoma state banks have the authority to exercise such incidental powers as may be necessary or desirable to carry on the banking business including, but not limited to, powers conferred upon national banks, unless otherwise prohibited or limited by the Oklahoma Banking Commissioner or the Oklahoma State Banking Board. Additionally, upon approval of the Oklahoma Banking Commissioner, and subject to all applicable federal and state laws, the operating subsidiaries or financial subsidiaries of an Oklahoma state bank may exercise any power and engage in any activity that is permitted for an operating subsidiary or financial subsidiary of a national bank, unless otherwise prohibited or limited by the Oklahoma Banking Commissioner or Oklahoma State Banking Board.

Incentive Compensation

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

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

The Dodd-Frank Act requires the federal banking agencies and the SEC to jointly prescribe regulations or guidelines that require financial institutions with \$1 billion or more in assets to disclose to the appropriate federal regulator, the structure of all incentive-based compensation arrangements sufficient to determine whether the compensation structure provides an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits, or could lead to material financial loss to the financial institutions. On February 7, 2011, the FDIC issued a notice of proposed rulemaking that would prohibit bank incentive-based compensation arrangements that encourage inappropriate risk taking, are deemed excessive, or may lead to material losses. The proposal would apply to financial institutions with more than \$1 billion in assets. The rule also includes heightened standards for financial institutions with \$50 billion or more in total consolidated assets that requires at least 50 percent of incentive based payments for designated executives to be deferred for a minimum of three years. The interagency rule must be approved by all of the five federal members of the FFIEC, the SEC and the Federal Housing Finance Agency before comments on the rule are sought. Comments on the proposed interagency rule were due to the agencies by May 31, 2011. A definitive final rule has not been issued.

Regulation Z was amended in 2011 to restrict incentive compensation programs with regard to residential mortgage programs. Such limitations affect mortgage brokers as well as loan officers in the subsidiary banks. Compensation may be tied to volume, but not to terms or conditions of the transaction other than the amount of credit extended. Further amendments to Regulation Z relating to mortgage loan originator compensation were adopted on January 20, 2013, by the CFPB in accordance with the Dodd-Frank Act.

The scope and content of the U.S. banking regulators' policies on executive compensation are continuing to develop and are likely to continue evolving. It cannot be determined at this time whether compliance with such policies will adversely affect our ability to hire, retain and motivate our key employees.

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 our operating environment in substantial and unpredictable ways. Such changes could have a material effect on our business, including increasing our cost of doing business, affecting our compensation structure, or limiting or expanding permissible activities. We cannot predict whether any such changes will be adopted and we cannot determine the ultimate effect that potential legislation, if enacted, or implementing regulations with respect thereto, would have upon our financial condition or results of our operations. The same uncertainty exists with respect to regulations authorized or required under the Dodd-Frank Act, but that have not yet been proposed or finalized. There is also the possibility that the Dodd-Frank Act or other federal laws may be revised by Congress in the future because certain bills have been introduced into Congress from time to time that would amend certain provisions of the Dodd-Frank Act, or other federal legislation relating to financial institutions. Similarly, it is possible that the legislatures of the State of Texas or the State of Oklahoma would amend applicable state laws relating to us or our Subsidiary Banks.

Item 1A. Risk Factors

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 its common stock. If any of the risks described below were to occur, our 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 all or part of an investment could be lost.

Risks Related to Our Business

Our allowance for probable loan losses may be insufficient.

The determination of an appropriate level of loan loss allowance is an inherently difficult process and is based on numerous assumptions. This allowance represents management's best estimate of probable losses that may exist within our existing loan portfolio. The determination of the appropriate level of the allowance for probable loan losses inherently involves a high degree of subjectivity and requires management to make significant estimates and assumptions regarding current credit risks and future trends, all of which may undergo material changes. In addition, if future charge-offs exceed the allowance for probable loan losses, we may need to increase the allowance for probable loan losses. Any increases in the allowance for probable loan losses will result in a decrease in net income and capital and may have a material adverse effect on our financial condition and results of operations.

The adoption of ASU 2016-13, as amended, on January 1, 2020 will impact our methodology for estimating the allowance for loan losses. The accounting standards update is changing accounting practice from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. ASU 2016-13 will also necessitate that we establish an allowance for expected credit losses for certain debt securities and other financial assets. We expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date. In December 2018, the federal banking regulators issued a final rule that would provide an optional three-year phase-in period for the day-one regulatory capital effects of the adoption of ASU 2016-13. The impact of the adoption of the new rule will increase our allowance for probable loan losses between approximately 2 and 6%.

If real estate values in our target markets decline, the loan portfolio would be impaired.

A significant portion of our loan portfolio consists of loans secured by real estate located in the markets we serve. An adverse change in the economy affecting real estate values generally or in our target markets could significantly impair the value of collateral underlying certain of our loans and our ability to sell the collateral at a profit or at all upon foreclosure.

We operate in a highly competitive industry and market area.

We face substantial competition from a variety of different competitors in our market areas, many of which are larger and may have more financial resources. These competitors include national, regional and community banks within the various markets we serve. We also face competition from many other types of financial institutions, including credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. Many of our competitors have fewer regulatory constraints and lower cost structures, which may allow them to offer better pricing on a broader range of products and services. Also, technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. The process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits and related income. Technology and other changes have lowered barriers to entry and made it possible for non-banks to offer products and traditionally offered by banks. In particular, the activity of financial technology companies (“fintechs”) has grown significantly over recent years and is expected to continue to grow. Fintechs have and may continue to offer bank or bank-like products and a number of fintechs have applied to bank or industrial loan charters. In addition, other fintechs have partnered with existing banks to allow them to offer deposit products to their customers. The loss of revenue streams and the reduction of lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

External funding which we rely on, in part, to provide liquidity may not be available to us on favorable terms or at all.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. We rely on deposits, repurchase agreements, advances from the Federal Home Loan Bank (FHLB) of Dallas, the FHLB of Topeka and other borrowings to meet our liquidity demands. If we were unable to access any of these funding sources when needed, we might be unable to meet customers’ needs, which could adversely impact our financial condition, results of operations, cash flows and liquidity, and level of regulatory-qualifying capital. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry.

Our earnings are subject to interest rate risk.

Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the FRB. Changes in monetary policy, interest rates, the yield curve, or market risk spreads, a prolonged inverted yield curve or instability in domestic or foreign financial markets could negatively influence the interest we receive on loans and securities, as well as the amount of interest we pay on deposits and borrowings. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. Any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations.

We may be adversely impacted by the transition from LIBOR as a reference rate

The United Kingdom’s Financial Conduct Authority announced that after 2021 it will no longer compel banks to submit the rates required to calculate the London Interbank Offered Rate (“LIBOR”). This means that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. Consequently, it is not currently possible to predict whether and to what extent banks will continue to provide submissions for the calculation of LIBOR. It is equally

impossible to predict whether LIBOR will continue to be an acceptable market benchmark, what alternative rate or rates may become acceptable, or what the effect of any such changes may be on the markets for LIBOR-indexed financial instruments.

Specifically, regulators, industry groups and certain committees, like the Alternative Reference Rates Committee, have published recommended fallback language for LIBOR-linked financial instruments, identified recommended alternatives for certain LIBOR rates, such as the Secured Overnight Financing Rate as the recommended alternative to U.S. Dollar LIBOR, and proposed implementations of such alternatives in floating rate instruments. Currently, it is not possible to predict whether these specific recommendations and proposals will be broadly accepted, whether they will continue to evolve, and what the effect of their implementation may be on the markets for floating-rate financial instruments.

We have a significant number of loans, derivative contracts, borrowings and other financial instruments with attributes that are either directly or indirectly dependent on LIBOR. The transition from LIBOR could create considerable costs and additional risk, even though our loan documents contain mitigating language around rates in the event LIBOR is phased out. Since proposed alternative rates are calculated differently, payments under contracts referencing new rates will differ from those referencing LIBOR. The transition will change our market risk profiles, requiring changes to risk and pricing models, valuation tools, product design and hedging strategies. Furthermore, failure to adequately manage this transition process with our customers could adversely impact our reputation. Although we are currently unable to assess what the ultimate impact of the transition from LIBOR will be, failure to adequately manage the transition could have a material adverse effect on our business, financial condition and results of operations.

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

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. These regulations affect our lending practices, capital structure, investment practices, dividend policy, data and privacy protection policies and growth, among other things. The statutory and regulatory framework under which we operate has changed substantially over the years, and will likely continue to do so. These changes and other changes to statutes and regulations, including changes in the interpretation or implementation of statutes, regulations or policies, could affect our operations in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations.

Our potential future acquisitions and branch expansion could be adversely affected by a number of factors.

Acquisitions of other financial institutions and branch expansion have been a key element of our growth in the past. There are a number of factors that may impact our ability to continue to grow through acquisition transactions, including strong competition from other financial institutions who are active or potential acquirers of financial institutions in our existing or future markets. Acquisitions of other financial institutions and new branches must be approved by bank regulators and such approvals are dependent on many factors, including the results of regulatory examinations and CRA ratings.

We rely heavily on our chief executive officer.

We have experienced substantial growth in assets and deposits, particularly since Dennis E. Nixon became our President in 1979. We do not have an employment agreement with Mr. Nixon and the loss of his services could have a material adverse effect on our business and prospects.

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

We rely heavily on communications and information systems to conduct our business. Our products and services involve the gathering, storage and transition of sensitive information regarding our customers and their accounts. While we conduct our own data processing, we are reliant on certain external vendors to provide products and services necessary to maintain our day to day operations. As a financial institution we are also subject to and examined for compliance with an array of data protection laws, regulations and guidance, as well as our own internal privacy and information security policies and programs. If our information systems or infrastructure experience a significant disruption or breach, it could lead to unauthorized access to personal or confidential information of our customers in our possession and unauthorized access to our proprietary information, methodologies and business secrets. Any failure, interruption, or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. In addition, if our partners, vendors, or other market participants experience a disruption or breach, it could lead to unauthorized transactions on our or our customer accounts, or unauthorized access to personal or confidential information maintained by those entities. The occurrence of any failures, interruptions or security breaches of these information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Additional capital or funding to increase liquidity levels may not be available when needed or at all.

Our ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside our control, and our financial performance. We have historically had access to a number of alternative sources of liquidity, but if there is an increase in volatility in the credit and liquidity markets similar to 2008, there is no assurance that we will be able to obtain such liquidity on terms that are favorable to us, or at all. If we were unable to access any of these funding sources when needed, we might be unable to meet customers' needs, which could adversely impact our financial condition, results of operations, cash flows and liquidity, and level of regulatory-qualifying capital.

Our holding company relies on dividends from our Subsidiary Banks for most of our revenue.

Our holding company receives substantially all of our revenue from dividends from our Subsidiary Banks. These dividends are the principal source of funds to pay dividends on our common stock to shareholders of our holding company, as well as interest and principal on our holding company's debt. Various federal and/or state laws and regulations limit the amount of dividends that our Subsidiary Banks may pay to our holding company. Our Subsidiary Banks' ability to pay dividends to us is subject to, among other thing, their earnings, financial condition and need for funds, as well as federal and state governmental policies and regulations applicable to our holding company and Subsidiary Banks which limit the amount that may be paid as dividends without prior regulatory approval, including a statutory requirement that our holding company serve as a source of financial strength for our Subsidiary Banks. Although our holding company has historically declared semi-annual cash dividends on our common stock, we are not required to do so and may reduce or cease to pay common stock dividends in the future. If we reduce or cease to pay common stock dividends, the market price of our common stock could be adversely affected.

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

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. These events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and cause us to incur additional expenses. Although we have established disaster recovery policies and procedures, a severe weather event, natural disaster or other external event in or near the markets we serve could have a material adverse effect on our business.

An impairment in the carrying value of our goodwill could negatively impact our earnings and capital.

Goodwill is initially recorded at fair value and is not amortized, but is reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying value may not be recoverable. If we experience disruption in our business, unexpected significant declines in our operating results, or sustained market capitalization declines, it could result in goodwill impairment charges in the future, which would be recorded as charges against earnings. We performed an annual goodwill impairment assessment as of October 1, 2019. Based on our analyses, we concluded that the fair value of our reporting units exceeded the carrying value of our assets and liabilities and, therefore, goodwill was not considered impaired. Depending on the response of the financial industry to the legal, regulatory and competitive changes related to interchange fees, overdraft services and interest on demand deposit accounts, financial institutions may need to change their policies, procedures and operating plans in the future to compete more effectively. Such changes may require certain financial institutions to take a goodwill impairment charge to account for anticipated reduction in revenue related to such changes, which could have a material adverse effect on our financial condition and results of operation.

We are subject to environmental liability risks as a result of certain lending activities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. There is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental remediation may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our controls and procedures may fail or be circumvented.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting and for evaluating and reporting on its system of internal controls. While management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures, any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

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

From time to time, we may implement new lines of business or offer new products and services within existing lines of business. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products may not be achieved and price and profitability targets may not prove feasible. 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. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.

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

The processes we use to estimate probable loan losses and to measure the fair value of financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depends upon the use of analytical tools and forecasting models. These tools and models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the tools or models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. Any such failure in our analytical or forecasting tools or models could have a material adverse effect on our business, financial condition and results of operations.

We may be adversely affected by declining crude oil prices.

Decreased market oil prices have compressed margins for many U.S., Texas and Oklahoma-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. Energy production and related industries represent a large part of the economies in some of our primary markets. Furthermore, a prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy dominant states such as Texas and Oklahoma. Accordingly, a prolonged period of low oil prices could have a material adverse effect on our business, financial condition and results of operation.

Risks Related to the Company's Industry

Our success depends significantly on economic conditions in the local markets in which we operate.

Our success depends, to a certain extent, on local, national and international economic and political conditions and local, as well as governmental monetary policies. We are particularly affected by conditions in our primary market areas of south, central and southeast Texas, including Austin, Dallas and Houston, the State of Oklahoma and Mexico. If economic conditions in these market areas weaken or worsen due to a decline in oil prices or other factors, or fail to improve or to continue to improve, we could experience an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for our products and services, any of which could have a material adverse impact on our financial condition and results of operations.

We depend on the accuracy and completeness of information about customers and counterparties as well as the soundness of other financial institutions.

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

If we do not adjust to rapid changes in the financial services industry, our financial performance may suffer.

Our ability to deliver strong financial performance and returns on investment to shareholders will depend in part on our ability to expand the scope of available financial services to meet the needs and demands of our customers and our ability to stay abreast of technological innovations and evaluate those technologies that will enable us to compete on a cost-effective basis. In addition to traditional banks, our competitors also include securities dealers, brokers, mortgage bankers, investment advisors, specialty finance and insurance companies who seek to offer one-stop financial services that may include services that banks have not been able or allowed to offer to their customers in the past. The continued competitive environment in our industry is primarily a result of changes in regulation, technology and product delivery systems, and the accelerating pace of consolidation among financial service providers. Changes in the financial industry may result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations. Further, the costs of new technology, including personnel, can be high in both absolute and relative terms. There can be no assurance, given the fast pace of change and innovation, that our technology will meet or continue to meet our operational needs and the needs of our customers.

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

Banking and other financial services companies, including us and our Subsidiary Banks, rely on technology companies to provide information technology products and services necessary to support our day-to-day operations. Technology companies frequently enter into litigation based on allegations of patent infringement or other violations of

intellectual property rights. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, we may have to engage in protracted litigation. Such litigation is often expensive, time-consuming, disruptive to our operations, and distracting to management. If legal matters related to intellectual property claims were resolved against us, we 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 Dodd-Frank Act, the powers of the CFPB, and the FDIC Overdraft Payment Supervisory Guidance may increase the likelihood of lawsuits against financial institutions.

The Dodd-Frank Act provides that courts must make preemption determinations on a case-by-case basis with the respect to particular state laws and can no longer rely on blanket preemption determinations. Also, the CFPB is authorized to protect consumers from “unfair,” “deceptive” and “abusive” acts and practices. Depending on the future actions of the CFPB, the likelihood of lawsuits against financial institutions related to allegedly “unfair,” “deceptive” and “abusive” acts and practices could increase. Moreover, the costs related to such lawsuits would be significantly increased if the CFPB restricts the use of arbitration and/or class action waivers in consumer banking contracts.

Risks Related to the Company’s Stock

The trading price of our common stock may be volatile.

The trading price of our common stock has fluctuated over time due in part to actual or anticipated variations in our earnings, changes in government regulations, policies and guidance, news reports of trends, concerns and other issues related to the financial services industry, operating and stock performance of our peer companies, new technology used or services offered by traditional and non-traditional competitors, continued low trading volume in our common stock, the impact of short selling activity in our common stock and reports of trends, concerns and other issues related to the financial services industry. Moreover, general market price declines or market volatility in the future could adversely affect the trading price of our common stock.

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

As of December 31, 2019, we had approximately \$134 million in junior subordinated debentures outstanding that were purchased by our statutory trusts using the proceeds from the sale of trust preferred securities to third party investors. The junior subordinated debentures are senior to our shares of common stock. Payments of the principal and interest on the trust preferred securities are conditionally guaranteed by us to the extent not paid or made by each trust. We must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock. While we have the right to defer interest payments on the junior subordinated debentures at any time no dividends may be paid to holders of our common stock during any such deferral, which could cause the trading price of our stock to decline.

Item 1B. Unresolved Staff Comments

N/A

Item 2. Properties

Our principal offices are located at 1200 San Bernardo Avenue, Laredo, Texas and 2418 Jacaman Road, Laredo, Texas in buildings we own and completely occupy and containing approximately 147,000 square feet. The Subsidiary Banks have main banking and branch facilities. All the facilities are customary to the banking industry. The Subsidiary Banks own most of their banking facilities and the remainder are leased. The facilities are located in the regions of Laredo, San Antonio, Austin, Dallas, Houston, Zapata, Eagle Pass, the Rio Grande Valley of Texas, the Coastal Bend area of Texas, and throughout the State of Oklahoma.

None of our Texas state chartered Subsidiary Banks, without the prior written consent of the Texas Banking Commissioner, may invest in an amount in excess of its Tier 1 capital in bank facilities, furniture, fixtures and equipment. Our Oklahoma state chartered Subsidiary Bank, without the prior written consent of the Oklahoma Banking Commissioner, may not invest in an amount in excess of its Tier 1 and Tier 2 capital in bank facilities, furniture, fixtures and equipment. None of the Subsidiary Banks exceeds such applicable limitation.

Item 3. Legal Proceedings

We and our subsidiaries are involved in various legal proceedings that are in various stages of litigation. We and our subsidiaries have determined, based on discussions with our counsel that any material loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to our consolidated financial position or results of operations. Many of these matters are in various stages of proceedings and further developments could cause management to revise our assessment of these matters. Further information regarding legal proceedings has been provided in Note 17 of the Notes to consolidated financial statements located on page 67 of the 2019 Annual Report to Shareholders which is incorporated herein by reference.

Item 4. Mine Safety Disclosures

None

Item 4A. Executive Officers of the Registrant

Certain information is set forth in the following table concerning the executive officers of the Company, each of whom has been elected to serve until the 2019 Annual Meeting of Shareholders and until his or her successor is duly elected and qualified.

Name	Age	Position of Office	Officer of the Company Since
Dennis E. Nixon	77	Chairman of the Board of the Company since 1992, President of the Company since 1979, Chief Executive Officer and Director of IBC	1979
Julie L. Tarvin	50	Vice President of the Company since 2017, President of IBC Service Center	2017
Judith I. Wawroski	45	Treasurer of the Company since 2017, Principal Financial Officer of the Company since 2017, Executive Vice President of IBC	2017

There are no family relationships among any of the named persons. Each executive officer has held the same position or another executive position with our holding company, or our lead Subsidiary Bank IBC Laredo during the past five years.

Part II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The information set forth under the caption "Preferred Stock, Common Stock and Dividends," "Stock Repurchase Program," and "Equity Compensation Plan Information" located on pages 24 through 26 of our 2019 Annual Report is incorporated herein by reference.

Item 6. *Selected Financial Data*

The information set forth under the caption “Selected Financial Data” located on page 1 of our 2019 Annual Report is incorporated herein by reference.

Item 7. *Management’s Discussion and Analysis of Financial Condition and Results of Operations*

The information set forth under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations” located on pages 2 through 27 of our 2019 Annual Report is incorporated herein by reference.

Item 7A. *Quantitative and Qualitative Disclosures about Market Risk*

The information set forth under the caption “Liquidity and Capital Resources” located on pages 17 through 22 of our 2019 Annual Report is incorporated herein by reference.

Item 8. *Financial Statements and Supplementary Data*

The consolidated financial statements located on pages 28 through 80 of our 2019 Annual Report are incorporated herein by reference.

The condensed quarterly income statements located on pages 81 and 82 of our 2019 Annual Report are incorporated herein by reference.

Item 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

Item 9A. *Controls and Procedures*

As of the end of the period covered by this Annual Report on Form 10-K, an evaluation was carried out by our management with the participation of our Chief Executive Officer and Chief Accounting Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Accounting Officer concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report. Additionally, there were no changes in our internal control over financial reporting (as defined in Rule 13a15(f) under the Securities Exchange Act of 1934) that occurred during the quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting, as defined under Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed under the supervision of our Chief Executive Officer and Chief Accounting Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with generally accepted accounting principles.

As of December 31, 2019, management assessed the effectiveness of the design and operation of our internal controls 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 in 2013. Based on the assessment, management determined that we maintained effective internal control over financial reporting as of December 31, 2019, based on those criteria.

RSM US LLP, the independent registered public accounting firm that audited our 2019 consolidated financial statements included in this Annual Report on Form 10-K, has audited the effectiveness of our internal controls over

financial reporting as of December 31, 2019. Their report, which expresses an unqualified opinion, on the effectiveness of our internal controls over financial reporting as of December 31, 2019 is included in this Item under the heading “Report of Independent Registered Public Accounting Firm.”

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
International Bancshares Corporation:

Opinion on the Internal Control Over Financial Reporting

We have audited International Bancshares Corporation and its subsidiaries' (the Company) internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated statements of condition as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2019, 2018 and 2017, and the related notes to the consolidated financial statements of the Company and our report dated February 27, 2020 expressed an unqualified opinion.

Basis for Opinion

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 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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. 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, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed 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 its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ RSM US LLP

Austin, Texas
February 27, 2020

Item 9B. Other Information

None.

Part III**Item 10. Directors, Executive Officers and Corporate Governance**

There is incorporated in this Item 10 by reference to our definitive proxy statement relating to our 2020 Annual Meeting of Shareholders (i) that portion entitled “ELECTION OF DIRECTORS,” (ii) that portion entitled “Audit Committee” in the portion entitled “MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS,” (iii) that portion entitled “Code of Ethics,” in the portion entitled “CORPORATE GOVERNANCE,” and (iv) that portion entitled “DELINQUENT SECTION 16(a) REPORTS.” There is also incorporated in this Item 10 by reference Item 4A of this report entitled “Executive Officers of the Registrant.”

Item 11. Executive Compensation

There is incorporated in this Item 11 by reference to our definitive proxy statement relating to our 2020 Annual Meeting of Shareholders (i) that portion entitled “EXECUTIVE COMPENSATION,” and (ii) that portion entitled “Compensation Committee and Stock Option Plan Committee Interlocks and Insider Participation” in the portion entitled “MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS.”

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

There are incorporated in this Item 12 by reference those portions of our definitive proxy statement relating to the Company’s 2020 Annual Meeting of Shareholders entitled “PRINCIPAL SHAREHOLDERS,” “SECURITY OWNERSHIP OF MANAGEMENT,” and “Equity Compensation Plan Information” in the portion entitled “EXECUTIVE COMPENSATION.”

Item 13. Certain Relationships and Related Transactions, and Director Independence

There is incorporated in this Item 13 by reference to our definitive proxy statement relating to our 2020 Annual Meeting of Shareholders (i) that portion entitled “INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS” and (ii) that portion entitled “Director Independence” in the portion entitled “CORPORATE GOVERNANCE.”

Item 14. Principal Accounting Fees and Services

There is incorporated in this Item 14 by reference that portion of our definitive proxy statement relating to our 2020 Annual Meeting of Shareholders entitled “PRINCIPAL ACCOUNTANT FEES AND SERVICES.”

Part IV

Item 15. Exhibits, Financial Statement Schedules

(a) Documents

1. Our consolidated financial statements are incorporated into Item 8 of this report by reference from the 2018 Annual Report to Shareholders filed as an exhibit hereto and they include:

Reports of Independent Registered Public Accounting Firm

Consolidated:

Statements of Condition as of December 31, 2019 and 2018

Statements of Income for the years ended December 31, 2019, 2018 and 2017

Statements of Comprehensive Income for the years ended December 31, 2019, 2018 and 2017

Statements of Shareholders' Equity for the years ended December 31, 2019, 2018 and 2017

Statements of Cash Flows for the years ended December 31, 2019, 2018 and 2017

Notes to Consolidated Financial Statements

2. All Financial Statement Schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.
3. The following exhibits have previously been filed or are included in this report following the Index to Exhibits:

(3a)* —Articles of Incorporation of International Bancshares Corporation.

(3b)* —Articles of Amendment to the Articles of Incorporation of International Bancshares Corporation dated May 22, 1998.

(3c)* —Articles of Amendment to the Articles of Incorporation of International Bancshares Corporation dated May 21, 2002.

(3d)* —Articles of Amendment to the Articles of Incorporation of International Bancshares Corporation filed with the Secretary of State of the State of Texas on May 17, 2005.

(3e)* —Articles of Amendment to the Articles of Incorporation of International Bancshares Corporation filed with the Secretary of State of the State of Texas on December 22, 2008.

(3f)* —Amended and Restated By-Laws of International Bancshares Corporation.

(3g)* —Certificate of Amendment to Articles of Incorporation of International Bancshares Corporation filed with the Secretary of State of Texas on May 21, 2013.

(4) —Description of the Registrant's Securities.

(10a)*+ —The 1996 International Bancshares Corporation Stock Option Plan.

(10b)*+ —2005 International Bancshares Corporation Stock Option Plan.

(10c)*+ —International Bancshares Corporation 2006 Executive Incentive Compensation Plan.

(10d)*+ —International Bancshares Corporation Long-Term Restricted Stock Unit Plan.

(10e)*+ —2012 International Bancshares Corporation Stock Option Plan.

(10f)*+ —International Bancshares Corporation 2013 Management Incentive Plan.

(13)** —International Bancshares Corporation 2019 Annual Report

(21) —List of Subsidiaries of International Bancshares Corporation as of February 27, 2020

(23) —Consent of Independent Registered Public Accounting Firm

(31a) —Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

(31b) —Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

- (32a) —Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- (32b) —Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101++ —Interactive Data File
- 104++ —Cover Page Interactive Data File

* Previously filed

+ Executive Compensation Plans and Arrangements

** Deemed filed only with respect to those portions thereof incorporated herein by reference

++ Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statement of Earnings for the years ended December 31, 2019, 2018 and 2017 (ii) the Condensed Consolidated Balance Sheet as of December 31, 2019 and 2018, (iii) the Condensed Consolidated Statement of Cash Flows for the years ended December 31, 2019, 2018 and 2017, and (iv) Cover Page interactive data.

Item 16. Form 10-K Summary

None

Exhibit Index

- Exhibit 4— Description of Registrant's Securities
- Exhibit 13— International Bancshares Corporation 2019 Annual Report, Exhibit 13, page 1
- Exhibit 21— List of Subsidiaries of International Bancshares Corporation as of February 25, 2020
- Exhibit 23— Consent of Independent Registered Public Accounting Firm
- Exhibit 31a— Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31b— Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32a— Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32b— Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 101— Interactive Inline Data File
- Exhibit 104— Cover Page Inline Interactive Data File

SIGNATURES

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

INTERNATIONAL BANCSHARES CORPORATION
(Registrant)

By: /s/ DENNIS E. NIXON
Dennis E. Nixon
President

Date: February 27, 2020

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

<u>Signatures</u>	<u>Title</u>	<u>Date</u>
<u>/s/ DENNIS E. NIXON</u> Dennis E. Nixon	President and Director (Principal Executive Officer)	February 27, 2020
<u>/s/ JUDITH I. WAWROSKI</u> Judith I. Wawroski	Treasurer (Principal Financial Officer)	February 27, 2020
<u>/s/ JAVIER DE ANDA</u> Javier de Anda	Director	February 27, 2020
<u>/s/ IRVING GREENBLUM</u> Irving Greenblum	Director	February 27, 2020
<u>/s/ DOUG HOWLAND</u> Doug Howland	Director	February 27, 2020
<u>/s/ RUDOLPH M. MILES</u> Rudolph M. Miles	Director	February 27, 2020
<u>/s/ LARRY NORTON</u> Larry Norton	Director	February 27, 2020
<u>/s/ ROBERTO RESENDEZ</u> Roberto Resendez	Director	February 27, 2020
<u>/s/ ANTONIO R. SANCHEZ, JR.</u> Antonio R. Sanchez, Jr.	Director	February 27, 2020

Exhibit 13

As used in this report, the words “Company,” “we,” “us,” and “our” refer to International Bancshares Corporation, a Texas corporation, its five wholly-owned subsidiary banks (“Subsidiary Banks”), and other subsidiaries. The information that follows may contain forward-looking statements, which are qualified as indicated under “Cautionary Notice Regarding Forward-Looking Statements” in Item 7 (Management’s Discussion and Analysis of Financial Condition and Results of Operations) of this report. Our website address is www.ibc.com.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**(Consolidated)**

The following consolidated selected financial data is derived from our audited financial statements as of and for the five years ended December 31, 2019. The following consolidated financial data should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes in this report.

SELECTED FINANCIAL DATA

	AS OF OR FOR THE YEARS ENDED DECEMBER 31,				
	2019	2018	2017	2016	2015
	(Dollars in Thousands, Except Per Share Data)				
STATEMENT OF CONDITION					
Assets	\$ 12,112,894	\$ 11,871,952	\$ 12,184,698	\$ 11,804,041	\$ 11,772,869
Investment securities available-for-sale	3,378,923	3,411,350	4,154,470	4,177,349	4,199,372
Net loans	6,834,668	6,499,905	6,280,485	5,900,027	5,883,926
Deposits	8,826,034	8,696,545	8,544,892	8,610,089	8,536,253
Other borrowed funds	626,511	705,665	1,195,225	733,375	505,750
Junior subordinated deferrable interest debentures	134,642	160,416	160,416	160,416	161,416
Shareholders' equity	2,118,053	1,939,582	1,838,980	1,724,667	1,665,503
INCOME STATEMENT					
Interest income	\$ 492,401	\$ 465,822	\$ 415,136	\$ 387,914	\$ 396,754
Interest expense	58,629	52,668	38,931	43,129	44,317
Net interest income	433,772	413,154	376,205	344,785	352,437
Provision for probable loan losses	18,843	6,112	11,221	19,859	24,405
Non-interest income	154,826	165,042	150,406	161,702	155,734
Non-interest expense	309,801	299,501	293,748	289,625	276,924
Income before income taxes	259,954	272,583	221,642	197,003	206,842
Income taxes	54,850	56,652	64,206	63,071	70,116
Net income	205,104	215,931	157,436	133,932	136,726
Net income available to common shareholders	\$ 205,104	\$ 215,931	\$ 157,436	\$ 133,932	\$ 136,726
Per common share:					
Basic	\$ 3.13	\$ 3.27	\$ 2.38	\$ 2.03	\$ 2.06
Diluted	\$ 3.12	\$ 3.24	\$ 2.36	\$ 2.02	\$ 2.05

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis represents an explanation of significant changes in our financial position and results of our operations on a consolidated basis for the three-year period ended December 31, 2019. The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2019, and the Selected Financial Data and Consolidated Financial Statements included elsewhere herein.

Special Cautionary Notice Regarding Forward Looking Information

Certain matters discussed in this report, excluding historical information, include forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by these sections. Although we believe such forward-looking statements are based on reasonable assumptions, no assurance can be given that every objective will be reached. The words "estimate," "expect," "intend," "believe" and "project," as well as other words or expressions of a similar meaning are intended to identify forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this report. Such statements are based on current expectations, are inherently uncertain, are subject to risks and should be viewed with caution. Actual results and experience may differ materially from the forward-looking statements as a result of many factors.

Risk factors that could cause actual results to differ materially from any results that we project, forecast, estimate or budget in forward-looking statements include, among others, the following possibilities:

- Local, regional, national and international economic business conditions and the impact they may have on us, our customers, and such customers' ability to transact profitable business with us, including the ability of our borrowers to repay their loans according to their terms or a change in the value of the related collateral.
- Volatility and disruption in national and international financial markets.
- Government intervention in the U.S. financial system.
- The unavailability of funding from the FHLB, the Fed or other sources in the future could adversely impact our growth strategy, prospects and performance.
- Changes in consumer spending, borrowing and saving habits.
- Changes in interest rates and market prices, including, changes in federal regulations on the payment of interest on demand deposits.
- Changes in the capital markets we utilize, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations, including, the impact of the Consumer Financial Protection Bureau ("CFPB") as a regulator of financial institutions, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance, employment, environmental and immigration laws and regulations and the risk of litigation that may follow.
- Changes in U.S.—Mexico trade, including, reductions in border crossings and commerce, integration and implementation of the recently enacted United State-Mexico-Canada Agreement or the possible imposition of tariffs on imported goods.
- The reduction of deposits from nonresident alien individuals due to the IRS rules requiring U.S. financial institutions to report deposit interest payments made to such individuals.
- The loss of senior management or operating personnel.
- The timing, impact and other uncertainties of the potential future acquisitions, as well as our ability to maintain our current branch network and enter new markets to capitalize on growth opportunities.
- Changes in estimates of future reserve requirements based upon periodic review thereof under relevant regulatory and accounting requirements.

- Additions to our loan loss allowance as a result of changes in local, national or international conditions which adversely affect our customers.
- Greater than expected costs or difficulties related to the development and integration of new products and lines of business.
- Increased labor costs and effects related to health care reform and other laws, regulations and legal developments impacting labor costs.
- Impairment of carrying value of goodwill could negatively impact our earnings and capital.
- Changes in the soundness of other financial institutions with which we interact.
- Political instability in the United States or Mexico.
- Technological changes or system failures or breaches of our network security, as well as other cyber security risks, could subject us to increased operating costs, litigation and other liabilities.
- Acts of war or terrorism.
- Natural disasters.
- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale portfolios.
- The effect of changes in accounting policies and practices by the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.
- The costs and effects of regulatory developments or regulatory or other governmental inquiries and the results of regulatory examinations or reviews and obtaining regulatory approvals.
- The effect of final rules amending Regulation E that prohibit financial institutions from charging consumer fees for paying overdrafts on ATM and one-time debit card transactions, as well as the effect of any other regulatory or legal developments that limit overdraft services.
- The reduction of income and possible increase in required capital levels related to the adoption of legislation, including and the implementing rules and regulations, including those that establish debit card interchange fee standards and prohibit network exclusivity arrangements and routing restrictions.
- The increase in required capital levels related to the implementation of capital and liquidity rules of the federal banking agencies that address or are impacted by the Basel III capital and liquidity standards.
- The enhanced due diligence burden imposed on banks related to the banks' inability to rely on credit ratings under Dodd-Frank.
- Our failure or circumvention of our internal controls and risk management, policies and procedures.

Forward-looking statements speak only as of the date on which such statements are made. It is not possible to foresee or identify all such factors. We make no commitment to update any forward-looking statement, or to disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement, unless required by law.

Overview

We are headquartered in Laredo, Texas, with 188 facilities and 284 ATMs, providing banking services for commercial, consumer and international customers of north, south, central and southeast Texas and the State of Oklahoma. We are one of the largest independent commercial bank holding companies headquartered in Texas. We, through our Subsidiary Banks, are in the business of gathering funds from various sources and investing those funds in order to earn a return. We, either directly or through a Subsidiary Bank, own one insurance agency, a liquidating subsidiary, a fifty percent interest in an investment banking unit that owns a broker/dealer, a controlling interest in four merchant banking entities, and a majority ownership in a real-estate development partnership. Our primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, we generate income from fees on products offered to commercial, consumer and international customers. The sales team of each of our Subsidiary Banks aims to match the right mix of products and services to each customer to best serve the customer's needs. That process entails spending time with customers to assess those needs and servicing the sales arising from those

discussions on a long-term basis. Our Subsidiary Banks have various compensation plans, including incentive-based compensation, for fairly compensating employees. Our Subsidiary Banks also have a robust process in place to review sales that support the incentive-based compensation plan to monitor the quality of the sales and identify any significant irregularities, a process that has been in place for many years.

One of our primary goals is to grow net interest income and non-interest income while adequately managing credit risk, interest rate risk and expenses. Effective management of capital is one of our critical objectives. A key measure of the performance of a banking institution is the return on average common equity ("ROE"). Our ROE for the year ended December 31, 2019 was 9.97% as compared to 11.22% for the year ended December 31, 2018.

We are very active in facilitating trade along the United States border with Mexico. We do a large amount of business with customers domiciled in Mexico and deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of our Subsidiary Banks. The loan policies of our Subsidiary Banks generally require that loans to borrowers domiciled in foreign countries be primarily secured by assets located in the United States or have credit enhancements in the form of guarantees, from significant United States corporations. We also serve the growing Hispanic population through our facilities located throughout north, south, central and southeast Texas and the State of Oklahoma.

Expense control is an essential element in our long-term profitability. As a result, we monitor the efficiency ratio, which is a measure of non-interest expense to net interest income plus non-interest income closely. As we adjust to regulatory changes related to the Dodd-Frank Act, including congressional efforts to revamp or reform it, our efficiency ratio may suffer because the additional regulatory compliance costs are expected to increase non-interest expense. We monitor this ratio over time to assess our efficiency relative to our peers. We use this measure as one factor in determining if we are accomplishing our long-term goals of providing superior returns to our shareholders.

Results of Operations

Summary

Consolidated Statements of Condition Information

	<u>December 31, 2019</u>	<u>December 31, 2018</u>	<u>Percent Increase (Decrease)</u>
	<u>(Dollars in Thousands)</u>		
Assets	\$ 12,112,894	\$ 11,871,952	2.0 %
Net loans	6,834,668	6,499,905	5.2
Deposits	8,826,034	8,696,545	1.5
Securities sold under repurchase agreements	236,536	229,989	2.8
Other borrowed funds	626,511	705,665	(11.2)
Junior subordinated deferrable interest debentures	134,642	160,416	(16.1)
Shareholders' equity	2,118,053	1,939,582	9.2

Consolidated Statements of Income Information

	Year Ended December 31, 2019	Year Ended December 31, 2018	Percent Increase (Decrease) 2019 vs. 2018	Year Ended December 31, 2017	Percent Increase (Decrease) 2018 vs. 2017
	(Dollars in Thousands, Except Per Share Data)				
Interest income	\$ 492,401	\$ 465,822	5.7 %	\$ 415,136	12.2 %
Interest expense	58,629	52,668	11.3	38,931	35.3
Net interest income	433,772	413,154	5.0	376,205	9.8
Provision for probable loan losses	18,843	6,112	208.3	11,221	(45.5)
Non-interest income	154,826	165,042	(6.2)	150,406	9.7
Non-interest expense	309,801	299,501	3.4	293,748	2.0
Net income	205,104	215,931	(5.0)	157,436	37.2
Per common share:					
Basic	\$ 3.13	\$ 3.27	(4.3)%	\$ 2.38	37.4 %
Diluted	3.12	3.24	(3.7)	2.36	37.3

Net Income

Net income for the year ended December 31, 2019 decreased by 5% compared to the same period of 2018. Net interest income continues to be positively affected by an increase in net interest income due to a higher volume of loans and an increase in the overall yield on the portfolio. Interest expense increased for the year ended December 31, 2019 and can be primarily attributed to an increase in the cost of borrowings, and an increase in the interest paid on savings and time deposit accounts, which have increased because of the Federal Reserve Board actions to increase interest rates in 2019. Net income for the year ended December 31, 2019 was negatively impacted by an increase in the provision for probable loan losses due to a charge-off of \$7.5 million, net of tax, on a relationship that was secured by real property on which car dealerships are operated. Net income for the year ended December 2018 increased by 37.2% compared to the same period of 2017. Net income for the years ended December 31, 2018 and December 31, 2017 was positively affected by a decrease in the provision for probable loan losses as a result of a decrease in the historical loss experience in the commercial category of the allowance for probable loan loss calculation. As discussed in prior periods, charge-offs had increased due to the deterioration of one relationship that was secured by multiple pieces of transportation equipment beginning in the fourth quarter of 2014. We use a three-year historical charge-off experience in the calculation, therefore, as those charge-offs began to be eliminated, the allowance for probable loan losses was impacted. As fluctuations occur in historical loss factors, management evaluates the need to adjust the qualitative factors used in the calculation to properly reflect probable loan losses. Net income for the year ended December 31, 2018 was also positively impacted by an increase in net interest income due to a higher volume of loans and an increase in the overall yield on the loan portfolio. Interest expense increased for the year ended December 31, 2018 compared to the same period of 2017 and can be attributed primarily to an increase in the cost of borrowings and an increase in the interest paid on savings and time deposit accounts, which have increased because of Federal Reserve Board actions to raise interest rates. Net income for 2018 was also positively impacted by a decrease in the effective tax rate arising from the Tax Cut and Jobs Act signed into law on December 22, 2017, resulting in a decrease in income tax expense of approximately \$38.6 million due to the decrease in the corporate tax rate from 35% to 21%.

Net Interest Income

Net interest income is the spread between income on interest-earning assets, such as loans and securities, and the interest expense on liabilities used to fund those assets, such as deposits, repurchase agreements and funds borrowed. Net interest income is our largest source of revenue. Net interest income is affected by both changes in the level of interest

rates and changes in the amount and composition of interest-earning assets and interest-bearing liabilities. Tax-exempt yields have not been adjusted to a tax-equivalent basis.

	For the years ended December 31,		
	2019 Average Rate/Cost	2018 Average Rate/Cost	2017 Average Rate/Cost
<i>Assets</i>			
Interest earning assets:			
Loan, net of unearned discounts:			
Domestic	6.07 %	5.80 %	5.27 %
Foreign	4.15	3.78	3.29
Investment securities:			
Taxable	2.23	2.24	2.08
Tax-exempt	3.85	4.05	4.10
Other	1.29	1.07	0.74
Total interest-earning assets	4.77 %	4.46 %	3.97 %
<i>Liabilities</i>			
Interest bearing liabilities:			
Savings and interest bearing demand deposits	0.50 %	0.39 %	0.19 %
Time deposits:			
Domestic	1.09	0.67	0.46
Foreign	1.02	0.64	0.44
Securities sold under repurchase agreements	0.91	0.77	1.64
Other borrowings	1.98	1.88	1.23
Junior subordinated deferrable interest debentures	4.43	4.36	3.36
Total interest bearing liabilities	0.93 %	0.79 %	0.57 %

The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net income and net interest margin. The yield on average interest-earning assets increased 7.0% from 4.46% in 2018 to 4.77% in 2019, and the rates paid on average interest-bearing liabilities increased 17.7% from 0.79% in 2018 to 0.93% in 2019. The yield on average interest-earning assets increased 12.3% from 3.97% in 2017 to 4.46% in 2018, and the rates paid on average interest-bearing liabilities increased 38.6% from .57% in 2017 to .79% in 2018. The majority of our taxable investment securities are invested in mortgage backed securities and, during rapid increases or reduction in interest rates, the yield on these securities do not re-price as quickly as the loans.

The following table analyzes the changes in net interest income during 2019, 2018 and 2017 and the relative effect of changes in interest rates and volumes for each major classification of interest-earning assets and interest-bearing liabilities. Non-accrual loans have been included in assets for the purpose of this analysis, which reduces the resulting yields:

	2019 compared to 2018			2018 compared to 2017		
	Net increase (decrease) due to			Net increase (decrease) due to		
	Volume ⁽¹⁾	Rate ⁽¹⁾	Total	Volume ⁽¹⁾	Rate ⁽¹⁾	Total
	(Dollars in Thousands)			(Dollars in Thousands)		
Interest earned on:						
Loans, net of unearned discounts:						
Domestic	\$ 20,056	\$ 18,349	\$ 38,405	\$ 14,837	\$ 37,604	\$ 52,441
Foreign	(441)	474	33	(483)	707	224
Investment securities:						
Taxable	(8,778)	(221)	(8,999)	(6,642)	5,779	(863)
Tax-exempt	(3,005)	(251)	(3,256)	(1,407)	(108)	(1,515)
Other	154	242	396	80	319	399
Total interest income	\$ 7,986	\$ 18,593	\$ 26,579	\$ 6,385	\$ 44,301	\$ 50,686
Interest incurred on:						
Savings and interest bearing demand deposits	\$ 59	\$ 3,556	\$ 3,615	\$ 82	\$ 6,474	\$ 6,556
Time deposits:						
Domestic	(185)	3,891	3,706	(590)	1,964	1,374
Foreign	87	4,081	4,168	(184)	2,170	1,986
Securities sold under repurchase agreements	(364)	381	17	(1,439)	(2,763)	(4,202)
Other borrowings	(5,590)	599	(4,991)	395	6,031	6,426
Junior subordinated deferrable interest debentures	(661)	107	(554)	—	1,597	1,597
Total interest expense	\$ (6,654)	\$ 12,615	\$ 5,961	\$ (1,736)	\$ 15,473	\$ 13,737
Net interest income	\$ 14,640	\$ 5,978	\$ 20,618	\$ 8,121	\$ 28,828	\$ 36,949

(1) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

As part of our strategy to manage interest rate risk, we strive to manage both assets and liabilities so that interest sensitivities match. One method of calculating interest rate sensitivity is through gap analysis. A gap is the difference between the amount of interest rate sensitive assets and interest rate sensitive liabilities that re-price or mature in a given time period. Positive gaps occur when interest rate sensitive assets exceed interest rate sensitive liabilities, and negative gaps occur when interest rate sensitive liabilities exceed interest rate sensitive assets. A positive gap position in a period of rising interest rates should have a positive effect on net interest income as assets will re-price faster than liabilities. Conversely, net interest income should contract somewhat in a period of falling interest rates. Management can quickly change our interest rate position at any given point in time as market conditions dictate. Additionally, interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Analytical techniques we employ to supplement gap analysis include simulation analysis to quantify interest rate risk exposure. The gap analysis prepared by management is reviewed by our Investment Committee twice a year. The Investment Committee is comprised of certain members of the board of directors and senior managers of the various Subsidiary Banks. Management currently believes that we are properly positioned for interest rate changes; however, if management determines at any time that we are not properly positioned, we will strive to adjust the interest rate sensitive assets and liabilities in order to manage the effect of interest rate changes.

We have established guidelines for acceptable volatility of projected net interest income on the income simulation analysis and the guidelines are reviewed at least annually. As of December 31, 2019, in rising rate scenarios of +100, +200, +300 and +400 basis points, the guidelines established by management require that the net interest income not vary by more than plus or minus 15%, 15%, 15%, and 20%, respectively and in a decreasing rate scenario of -100 or -150 basis points, that the net interest income not vary by more than plus or minus 15%. At December 31, 2019, the income

simulations show that a rate shift of -150, -100, +100, +200, +300 and +400 basis points in interest rates up will vary projected net interest income for the coming 12 month period by -4.46%, -3.07%, +4.87%, +8.89%, +12.78% and +16.48%, respectively. The basis point shift in interest rates is a hypothetical rate scenario used to calibrate risk and does not necessarily represent management's current view of future market developments. We believe that we are properly positioned for a potential interest rate increase or decrease.

Allowance for Probable Loan Loss

The following table presents information concerning the aggregate amount of non-accrual, past due and restructured domestic loans; certain loans may be classified in one or more categories:

	December 31,				
	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis	\$ 4,886	\$ 15,791	\$ 54,730	\$ 36,858	\$ 47,320
Accruing loans contractually past due ninety days or more as to interest or principal payments	59,694	39,935	6,590	5,215	11,174

Domestic loans accounted for on a non-accrual basis decreased at December 31, 2019 by 68% compared to the same period of 2018. The decrease can be attributed to one commercial loan relationship secured by equipment and accounts receivable that is no longer on non-accrual. Domestic loans contractually past due ninety days and still accruing increased at December 31, 2019 compared to the same period of 2018 and can be attributed to a relationship that is secured by real property on which education centers are operated.

The allowance for probable loan losses decreased 1.8% to \$60,278,000 at December 31, 2019 from \$61,384,000 at December 31, 2018. The allowance was .87% of total loans, net of unearned income at December 31, 2019 and .94% at December 31, 2018. The provision for probable loan losses charged to expense increased \$12,731,000 to \$18,843,000 for the year ended December 31, 2019 from \$6,112,000 for the same period in 2018. The increase can be primarily attributed to the charge-off of a relationship that is secured by multiple pieces of real property on which car dealerships are operated. The relationship began deteriorating in the fourth quarter of 2018, triggered by significant fraud by a high level insider of the car dealership resulting in the dealerships unexpectedly filing for bankruptcy and creating an exposure for potential loss since the operations of the dealership were the source of repayment from the borrower. The relationship further deteriorated in the first quarter of 2019 after the sponsor of the court approved debtor in possession plan discontinued its role in the process and thus did not fulfill its obligation to assume full responsibility of the accrued and unpaid interest. Although the relationship is secured by real property (the dealerships' real estate), the real property has specialized use, contributing to the potential exposure for probable loss. During the first quarter of 2019, in light of the circumstances and management's evaluation of the relationship, the decision was made to place the relationship on impaired, non-accrual status and place a specific reserve on the relationship in the amount of \$9.5 million. During the second quarter of 2019, management continued to evaluate the relationship and decided to foreclose on the underlying real estate collateral, resulting in a charge-off of approximately \$9.5 million. The decrease in the provision for probable loan losses charged to expense for the year ended December 31, 2018 can be attributed to a decrease in the historical charge-off experience in the commercial category of the allowance for probable loan loss calculation. As discussed in prior periods, charge-offs had increased due to the deterioration of one relationship that was secured by multiple pieces of transportation equipment beginning in the fourth quarter of 2014. We use a three-year historical charge-off experience in the calculation, therefore, as those charge-offs began to be eliminated from the calculation, the allowance for probable loan losses was impacted. As fluctuations occur in historical loss factors, management evaluates the need to adjust the qualitative factors used in the calculation to properly reflect probable loan losses.

The following table details loans accounted for as “troubled debt restructuring,” segregated by loan class. Loans accounted for as troubled debt restructuring are included in impaired loans. See Note 1 to the Consolidated Financial Statements.

	December 31, 2019	December 31, 2018
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 32	\$ 35
Residential: first lien	5,608	5,947
Residential: junior lien	692	730
Consumer	1,192	1,153
Foreign	264	293
Total troubled debt restructuring	<u>\$ 7,788</u>	<u>\$ 8,158</u>

The following table presents information concerning the aggregate amount of non-accrual and past due foreign loans extended to persons or entities in foreign countries. Certain loans may be classified in one or more category:

	2019	2018	December 31, 2017	2016	2015
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis	\$ —	\$ —	\$ —	\$ 387	\$ 365
Accruing loans contractually past due ninety days or more as to interest or principal payments	11	739	667	11	442

The gross income that would have been recorded during 2019, 2018 and 2017 on non-accrual loans in accordance with their original contract terms was approximately \$340,000, \$1,119,000 and \$977,000 on domestic loans and approximately \$0, \$0, and \$0 on foreign loans, respectively. The amount of interest income on such loans that was recognized in 2019, 2018 and 2017 was approximately \$4,000, \$4,000, and \$4,000 on domestic loans and \$0, \$0, and \$0 for foreign loans, respectively.

Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectability of the principal and/or interest to be in question, as well as when required by applicable regulatory guidelines. Interest income on non-accrual loans is recognized only to the extent payments are received or when, in management’s opinion, the creditor’s financial condition warrants reestablishment of interest accruals. Under special circumstances, a loan may be more than 90 days delinquent as to interest or principal and not be placed on non-accrual status. This situation generally results when a Subsidiary Bank has a borrower who is experiencing financial difficulties, but not to the extent that requires a restructuring of indebtedness. The majority of this category is composed of loans that are considered to be adequately secured and/or for which there has been a recent history of payments. When a loan is placed on non-accrual status, any interest accrued, not paid, is reversed and charged to operations against interest income.

Loan commitments, consisting of unused commitments to lend, letters of credit, credit card lines and other approved loans, that have not been funded, were approximately \$2,758,132,000 and \$3,076,184,000 at December 31, 2019 and 2018, respectively. See Note 19 to the Consolidated Financial Statements.

The following table summarizes loan balances at the end of each year and average loans outstanding during the year; changes in the allowance for probable loan losses arising from loans charged-off and recoveries on loans previously charged-off by loan category; and additions to the allowance which have been charged to expense:

	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Loans, net of unearned discounts, outstanding at December 31	\$ 6,894,946	\$ 6,561,289	\$ 6,348,172	\$ 5,964,688	\$ 5,950,914
Average loans outstanding during the year (Note 1)	\$ 6,852,121	\$ 6,517,978	\$ 6,183,864	\$ 5,949,048	\$ 5,844,842
Balance of allowance at January 1	\$ 61,384	\$ 67,687	\$ 64,661	\$ 66,988	\$ 64,828
Provision charged to expense	18,843	6,112	11,221	19,859	24,405
Loans charged-off:					
Domestic:					
Commercial, financial and agricultural	(21,765)	(14,290)	(12,134)	(35,029)	(25,294)
Real estate—mortgage	(636)	(469)	(441)	(401)	(432)
Real estate—construction	(39)	(1)	(213)	(16)	(695)
Consumer	(487)	(362)	(309)	(414)	(704)
Foreign	(1)	(3)	(1)	(41)	—
Total loans charged-off:	(22,928)	(15,125)	(13,098)	(35,901)	(27,125)
Recoveries credited to allowance:					
Domestic:					
Commercial, financial and agricultural	2,514	2,227	4,547	7,229	4,098
Real estate—mortgage	312	405	269	299	461
Real estate—construction	113	25	21	6,099	141
Consumer	40	43	45	69	170
Foreign	—	10	21	19	10
Total recoveries	2,979	2,710	4,903	13,715	4,880
Net loans charged-off	(19,949)	(12,415)	(8,195)	(22,186)	(22,245)
Balance of allowance at December 31	\$ 60,278	\$ 61,384	\$ 67,687	\$ 64,661	\$ 66,988
Ratio of net loans charged-off during the year to average loans outstanding during the year (Note 1)	0.29 %	0.19 %	0.13 %	0.37 %	0.38 %
Ratio of allowance to loans, net of unearned discounts, outstanding at December 31	0.87 %	0.94 %	1.07 %	1.08 %	1.13 %

(1) The average balances for purposes of the above table are calculated on the basis of daily balances.

The allowance for probable loan losses has been allocated based on the amount management has deemed to be reasonably necessary to provide for the probable losses incurred within the following categories of loans at the dates indicated and the percentage of loans to total loans in each category:

	At December 31,									
	2019		2018		2017		2016		2015	
	Allowance	Percent of total	Allowance	Percent of total	Allowance	Percent of total	Allowance	Percent of total	Allowance	Percent of total
	(Dollars in Thousands)									
Commercial, Financial and Agricultural	\$ 29,753	49.1 %	\$ 31,197	50.4 %	\$ 35,885	52.3 %	\$ 32,928	50.2 %	\$ 35,379	52.1 %
Real estate—Mortgage	10,039	16.5	11,073	17.9	12,242	17.9	11,355	17.3	10,979	16.2
Real estate—Construction	19,242	31.7	17,806	28.7	18,183	26.5	18,887	28.8	18,818	27.7
Consumer	421	0.7	437	0.7	535	0.8	607	0.9	659	1.0
Foreign	823	2.0	871	2.3	842	2.5	884	2.8	1,152	3.0
	<u>\$ 60,278</u>	<u>100.0 %</u>	<u>\$ 61,384</u>	<u>100.0 %</u>	<u>\$ 67,687</u>	<u>100.0 %</u>	<u>\$ 64,661</u>	<u>100.0 %</u>	<u>\$ 66,988</u>	<u>100.0 %</u>

The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the Subsidiary Banks. The allowances are established through charges to operations in the form of provisions for probable loan losses.

The Subsidiary Banks charge-off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a “loss” by bank examiners. Commercial, financial and agricultural or real estate loans are generally considered by management to represent a loss, in whole or part, (i) when an exposure beyond any collateral coverage is apparent, (ii) when no further collection of the portion of the loan so exposed is anticipated based on actual results, (iii) when the credit enhancements, if any, are not adequate, and (iv) when the borrower’s financial condition would so indicate. Generally, unsecured consumer loans are charged-off when 90 days past due. As discussed in prior periods, charge-offs had increased due to the deterioration of one relationship that was secured by multiple pieces of transportation equipment beginning in the fourth quarter of 2014 and increased charge-offs for the twelve months ended December 31, 2016 and December 31, 2015. In March 2016, litigation against the management of the borrower was filed in the State of Nevada, resulting in a going concern issue with the borrower’s operations and the future use of the transportation equipment pledged as collateral on the relationship. As a result, management, in accordance with its credit review procedures, re-evaluated the collateral values on the equipment in light of the new circumstances and reduced the collateral values accordingly, resulting in a further charge-down of the relationship of approximately \$19.4 million, which is included in the losses charged to the allowance in the commercial category in the table detailing the activity for the twelve months ended December 31, 2016. The same relationship had been previously charged-down in the years ended December 31, 2015 and 2014. Two recoveries on loans charged-off in prior years are included in the recoveries credited to the allowance in the table detailing activity for the year ended December 31, 2016. The recoveries occurred in the first and third quarters of 2016 in the amounts of \$4.4 million and \$6 million, respectively, and are included in the Commercial and Commercial Real Estate: Other Construction and Land Development categories. The increase in charge-offs for the year ended December 31, 2015 in the Commercial category can be attributed to a charge-down of a relationship that is primarily secured by multiple pieces of transportation equipment. The relationship was charged-down by \$13.5 million for the year ended December 31, 2015.

The allowance for probable loan losses is a reserve established through a provision for probable loan losses charged to expense, which represents management’s best estimate of probable loan losses within the existing portfolio of loans. Our allowance for probable loan loss methodology is based on guidance provided in Securities and Exchange Commission Staff Accounting Bulletin No. 102, “Selected Loan Loss Allowance Methodology and Documentation Issues” and includes allowance allocations calculated in accordance with ASC 310, “Receivables” and ASC 450, “Contingencies.” Please refer to Note 4—Allowance for Probable Loan Losses in the accompanying Notes to the consolidated Financial Statements.

While our management considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The

determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. Our management believes that the allowance for probable loan losses at December 31, 2019 was adequate to absorb probable losses from loans in the portfolio at that date. See Critical Accounting Policies on page 24. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, our estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses.

Non-Interest Income

	Year Ended December 31, 2019	Year Ended December 31, 2018	Percent Increase (Decrease) 2019 vs. 2018	Year Ended December 31, 2017	Percent Increase (Decrease) 2018 vs. 2017
	(Dollars in Thousands)				
Service charges on deposit accounts	\$ 72,502	\$ 72,433	0.1 %	\$ 72,868	(0.6)%
Other service charges, commissions and fees					
Banking	50,996	46,685	9.2	44,964	3.8
Non-banking	7,832	7,801	0.4	7,345	6.2
Investment securities transactions, net	(12)	(141)	(91.5)	(4,774)	(97.0)
Other investments, net	5,985	19,897	(69.9)	18,918	5.2
Other income	17,523	18,367	(4.6)	11,085	65.7
Total non-interest income	<u>\$ 154,826</u>	<u>\$ 165,042</u>	<u>(6.2)%</u>	<u>\$ 150,406</u>	<u>9.7 %</u>

Total non-interest income for the year ended December 31, 2019 decreased by 6.2% compared to the same period of 2018. The decrease can be primarily attributed to a decrease in non-interest income from other investments due to the impairment of an equity investment of \$3.7 million, net of tax as a result of a re-evaluation of the carrying value and losses on various equity investments in which we hold an ownership. Non-interest income for the ended December 31, 2018 increased by 9.7% compared to the same period of 2017. Other income for the year ended December 31, 2018 was positively impacted by our share of income from a real estate development partnership in which we hold a majority interest.

Non-Interest Expense

	Year Ended December 31, 2019	Year Ended December 31, 2018	Percent Increase (Decrease) 2019 vs. 2018	Year Ended December 31, 2017	Percent Increase (Decrease) 2018 vs. 2017
	(Dollars in Thousands)				
Employee compensation and benefits	\$ 145,929	\$ 138,532	5.3 %	\$ 132,750	4.4 %
Occupancy	28,635	29,097	(1.6)	28,439	2.3
Depreciation of bank premises and equipment	28,270	25,873	9.3	25,281	2.3
Professional fees	17,661	12,601	40.2	13,650	(7.7)
Deposit insurance assessments	1,416	3,742	(62.2)	3,294	13.6
Net expense, other real estate owned	6,377	4,413	44.5	965	357.3
Amortization of identified intangible assets	—	—	—	25	(100.0)
Advertising	7,748	7,695	0.7	7,854	(2.0)
Early termination fee—securities sold under repurchase agreements	—	—	—	5,765	(100.0)
Software and software maintenance	19,850	17,516	13.3	19,189	(8.7)
Other	53,915	60,032	(10.2)	56,536	6.2
Total non-interest expense	<u>\$ 309,801</u>	<u>\$ 299,501</u>	<u>3.4 %</u>	<u>\$ 293,748</u>	<u>2.0 %</u>

Non-interest expense for the year ended December 31, 2019 increased by 3.4% compared to the same period of 2018. Non-interest expense was impacted by an increase in costs of our compensation and benefit plans as a result of our continued review of those plans and necessary increases to remain competitive and compensate our staff based on their

performance, as well as an increase in depreciation expense as we continue to invest in our network infrastructure, equipment and facilities. Professional fees increased in 2019 compared to the same period of 2018 primarily due to ongoing costs related to strategic projects across our entities to enhance efficiencies and workflow. Non-interest expense for the year ended December 31, 2018 increased by 2.0% compared to the same period of 2017. Non-interest expense for the year ended December 31, 2018 was negatively impacted by an increase in the cost of operations on other real estate owned and due to an increase in the specific reserve on a property as part of the re-evaluation of the carrying value of said property.

Effects of Inflation

The principal component of earnings is net interest income, which is affected by changes in the level of interest rates. Changes in rates of inflation affect interest rates. It is difficult to precisely measure the impact of inflation on net interest income because it is not possible to accurately differentiate between increases in net interest income resulting from inflation and increases resulting from increased business activity. Inflation also raises costs of operations, primarily those of employment and services.

Financial Condition

Investment Securities

The following table sets forth the carrying value of investment securities as of December 31, 2019, 2018 and 2017:

	December 31,		
	2019	2018	2017
	(Dollars in Thousands)		
Residential mortgage-backed securities			
Available for sale	\$ 3,285,548	\$ 3,223,010	\$ 3,891,233
Obligations of states and political subdivisions			
Available for sale	93,375	188,340	232,951
Equity securities with readily determinable fair values	6,095	5,937	27,886
Other securities			
Held to maturity	2,400	1,200	2,400
Total	<u>\$ 3,387,418</u>	<u>\$ 3,418,487</u>	<u>\$ 4,154,470</u>

The following tables set forth the contractual maturities of investment securities, based on amortized cost, at December 31, 2019 and the average yields of such securities, except for the totals, which reflect the weighted average yields. Actual maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

	Available for Sale Maturing							
	Within one year		After one but within five years		After five but within ten years		After ten years	
	Adjusted		Adjusted		Adjusted		Adjusted	
	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield
	(Dollars in Thousands)							
Residential mortgage-backed securities	\$ 135	5.25 %	\$ 41,920	2.13 %	925,396	2.72 %	\$ 2,318,172	2.96 %
Obligations of states and political subdivisions	—	—	—	—	2,241	4.96 %	88,206	4.29 %
Equity securities with readily determinable fair values	6,095	2.29	—	—	—	—	—	— %
Total	<u>\$ 6,230</u>	<u>2.35 %</u>	<u>\$ 41,920</u>	<u>2.13 %</u>	<u>\$ 927,637</u>	<u>2.72 %</u>	<u>\$ 2,406,378</u>	<u>3.00 %</u>

	Held to Maturity Maturing							
	Within one year		After one but within five years		After five but within ten years		After ten years	
	Adjusted		Adjusted		Adjusted		Adjusted	
	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield
	(Dollars in Thousands)							
Other securities	\$ 1,075	2.58 %	\$ 1,325	3.10 %	\$ —	— %	\$ —	— %
Total	\$ 1,075	2.58 %	\$ 1,325	3.10 %	\$ —	— %	\$ —	— %

Mortgage-backed securities are securities primarily issued by the Federal Home Loan Mortgage Corporation (“Freddie Mac”), Federal National Mortgage Association (“Fannie Mae”), and the Government National Mortgage Association (“Ginnie Mae”). Investments in mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U.S. government. Investments in mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. government; however, we believe that the quality of the bonds is similar to other AAA rated bonds with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in 2008 and because securities issued by others that are collateralized by residential mortgage-backed securities issued by Fannie Mae or Freddie Mac are rated consistently as AAA rated securities.

Loans

The amounts of loans outstanding, by classification, at December 31, 2019, 2018, 2017, 2016 and 2015 are shown in the following table:

	December 31,				
	2019	2018	2017	2016	2015
	(Dollars in Thousands)				
Commercial, financial and agricultural	\$ 3,379,837	\$ 3,305,124	\$ 3,322,668	\$ 2,993,203	\$ 3,101,748
Real estate—mortgage	1,140,377	1,173,101	1,133,525	1,032,222	962,582
Real estate—construction	2,185,883	1,886,231	1,683,550	1,716,875	1,649,827
Consumer	47,800	46,316	49,543	55,168	57,744
Foreign	141,049	150,517	158,886	167,220	179,013
Loans, net of unearned discount	\$ 6,894,946	\$ 6,561,289	\$ 6,348,172	\$ 5,964,688	\$ 5,950,914

The following table shows the amounts of loans (excluding real estate mortgages and consumer loans) outstanding as of December 31, 2019, which based on remaining scheduled repayments of principal are due in the years indicated. Also, the amounts due after one year are classified according to the sensitivity to changes in interest rates:

	Maturing			
	Within one year	After one but within five years	After five years	Total
	(Dollars in Thousands)			
Commercial, financial and agricultural	\$ 942,450	\$ 2,018,641	\$ 418,746	\$ 3,379,837
Real estate—construction	740,287	1,296,449	149,147	2,185,883
Foreign	89,486	31,973	19,590	141,049
Total	\$ 1,772,223	\$ 3,347,063	\$ 587,483	\$ 5,706,769

	Interest sensitivity	
	Fixed Rate	Variable Rate
	(Dollars in Thousands)	
Due after one but within five years	\$ 65,595	\$ 3,281,468
Due after five years	201,226	386,257
Total	<u>\$ 266,821</u>	<u>\$ 3,667,725</u>

International Operations

On December 31, 2019, we had \$141,049,000 (1.2% of total assets) in loans outstanding to borrowers domiciled in foreign countries, which included primarily borrowers domiciled in Mexico. The loan policies of our Subsidiary Banks generally require that loans to borrowers domiciled in foreign countries be primarily secured by assets located in the United States or have credit enhancements in the form of guarantees, from significant United States corporations. The composition of such loans and the related amounts of allocated allowance for probable loan losses as of December 31, 2019 and 2018 is presented below.

For the year ended December 31,				
	2019		2018	
	Amount of Loans	Related Allowance for Probable Losses	Amount of Loans	Related Allowance for Probable Losses
	(Dollars in Thousands)			
Secured by certificates of deposit in United States banks	\$ 89,734	\$ 386	\$ 94,138	\$ 424
Secured by United States real estate	33,008	291	30,961	257
Secured by other United States collateral (securities, gold, silver, etc.)	10,483	92	14,848	112
Unsecured	155	2	528	6
Other (principally Mexico real estate)	7,669	52	10,042	72
	<u>\$ 141,049</u>	<u>\$ 823</u>	<u>\$ 150,517</u>	<u>\$ 871</u>

The transactions for the years ended December 31, 2019, 2018 and 2017, in that portion of the allowance for probable loan losses related to foreign debt were as follows:

	2019	2018	2017
	(Dollars in Thousands)		
Balance at January 1,	\$ 871	\$ 842	\$ 884
Charge-offs	(1)	(3)	(1)
Recoveries	—	10	21
Net charge-offs	(1)	7	20
Charge (credit) to expense	(47)	22	(62)
Balance at December 31	<u>\$ 823</u>	<u>\$ 871</u>	<u>\$ 842</u>

Deposits

	2019 Average Balance	2018 Average Balance
	(Dollars in Thousands)	
Deposits:		
Demand—non-interest bearing		
Domestic	\$ 2,800,219	\$ 2,695,811
Foreign	717,236	670,229
Total demand non-interest bearing	3,517,455	3,366,040
Savings and interest bearing demand		
Domestic	2,511,166	2,595,963
Foreign	777,210	677,392
Total savings and interest bearing demand	3,288,376	3,273,355
Time certificates of deposit		
\$100,000 or more:		
Domestic	605,867	608,171
Foreign	820,301	802,030
Less than \$100,000:		
Domestic	312,678	338,060
Foreign	248,352	253,060
Total time, certificates of deposit	1,987,198	2,001,321
Total deposits	\$ 8,793,029	\$ 8,640,716

	2019	2018	2017
	(Dollars in Thousands)		
Interest expense:			
Savings and interest bearing demand			
Domestic	\$ 13,462	\$ 11,029	\$ 5,453
Foreign	2,917	1,735	755
Total savings and interest bearing demand	16,379	12,764	6,208
Time, certificates of deposit			
\$100,000 or more			
Domestic	7,804	4,741	3,644
Foreign	9,407	5,798	4,105
Less than \$100,000			
Domestic	2,232	1,589	1,312
Foreign	1,527	968	675
Total time, certificates of deposit	20,970	13,096	9,736
Total interest expense on deposits	\$ 37,349	\$ 25,860	\$ 15,944

Scheduled maturities of time deposits in amounts of \$100,000 or more at December 31, 2018, were as follows:

Due within 3 months or less	\$ 536,400
Due after 3 months and within 6 months	351,059
Due after 6 months and within 12 months	465,735
Due after 12 months	109,842
	<u>\$ 1,463,036</u>

We offer a variety of deposit accounts having a wide range of interest rates and terms. We rely primarily on our high-quality customer service, sales programs, customer referrals and advertising to attract and retain these deposits. Deposits provide the primary source of funding for our lending and investment activities, and the interest paid for deposits must be managed carefully to control the level of interest expense. Deposits at December 31, 2019 were \$8,826,034,000,

an increase of 1.5% from \$8,696,545,000 at December 31, 2018. Although deposits at December 31, 2019 increased from December 31, 2018 and we have experienced growth in deposits over the last few years, we are still experiencing a substantial amount of competition for deposits at higher than market rates. As a result, we have placed a focus on maintaining certain deposit relationships, given the result of aggressive pricing by competitors.

Other Borrowed Funds

Other borrowed funds include FHLB borrowings which are short-term and long-term borrowings issued by the FHLB of Dallas and the FHLB of Topeka at the market price offered at the time of funding. These borrowings are secured by residential mortgage-backed investment securities and a portion of our loan portfolio. At December 31, 2019, other borrowed funds totaled \$626,511,000, a decrease of 11.2% from \$705,655,000 at December 31, 2018. The decrease in borrowings can be attributed to an increase in cash arising from principal pay downs on available-for-sale debt securities and deposits.

Return on Equity and Assets

Certain key ratios for the years ended December 31, 2019, 2018 and 2017 follow ⁽¹⁾:

	Years ended December 31,		
	2019	2018	2017
Percentage of net income to:			
Average shareholders' equity	9.97 %	11.22 %	8.62 %
Average total assets	1.71	1.79	1.31
Percentage of average shareholders' equity to average total assets	17.17	15.96	15.19
Percentage of cash dividends per share to net income per share	33.38	22.79	27.70

⁽¹⁾ The average balances for purposes of the above table are calculated on the basis of daily balances.

Liquidity and Capital Resources

Liquidity

The maintenance of adequate liquidity provides our Subsidiary Banks with the ability to meet potential depositor withdrawals, provide for customer credit needs, maintain adequate statutory reserve levels and take full advantage of high-yield investment opportunities as they arise. Liquidity is afforded by access to financial markets and by holding appropriate amounts of liquid assets. Our Subsidiary Banks derive their liquidity largely from deposits of individuals and business entities. Other important funding sources for our Subsidiary Banks during 2019 and 2018 were borrowings from the FHLB, securities sold under repurchase agreements and large certificates of deposit, requiring management to closely monitor its asset/liability mix in terms of both rate sensitivity and maturity distribution. Our Subsidiary Banks have had a long-standing relationship with the FHLB and keep open, unused, lines of credit in order to fund liquidity needs. In the event that the FHLB indebtedness is not renewed, the repayment of the outstanding indebtedness would more than likely be repaid through proceeds generated from the sales of unpledged available-for-sale securities. We maintain a sizable, high quality investment portfolio to provide significant liquidity. These securities can be sold or sold under agreements to repurchase, to provide immediate liquidity. As in the past, we will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities and respond accordingly to anticipated fluctuations in interest rates over reasonable periods of time.

Asset/Liability Management

Our funds management policy has as its primary focus the measurement and management of the Subsidiary Banks' earnings at risk in the face of rising or falling interest rate forecasts. The earliest and most simplistic concept of earnings at risk measurement is the gap report, which is used to generate a rough estimate of the vulnerability of net interest

income to changes in market rates as implied by the relative re-pricings of assets and liabilities. The gap report calculates the difference between the amounts of assets and liabilities re-pricing across a series of intervals in time, with emphasis typically placed on the one-year period. This difference, or gap, is usually expressed as a percentage of total assets.

If an excess of liabilities over assets matures or re-prices within the one-year period, the statement of condition is said to be negatively gapped. This condition is sometimes interpreted to suggest that an institution is liability-sensitive, indicating that earnings would suffer from rising rates and benefit from falling rates. If a surplus of assets over liabilities occurs in the one-year time frame, the statement of condition is said to be positively gapped, suggesting a condition of asset sensitivity in which earnings would benefit from rising rates and suffer from falling rates.

The gap report thus consists of an inventory of dollar amounts of assets and liabilities that have the potential to mature or re-price within a particular period. The flaw in drawing conclusions about interest rate risk from the gap report is that it takes no account of the probability that potential maturities or re-pricings of interest-rate-sensitive accounts will occur, or at what relative magnitudes. Because simplicity, rather than utility, is the only virtue of gap analysis, financial institutions increasingly have either abandoned gap analysis or accorded it a distinctly secondary role in managing their interest-rate risk exposure.

The net interest rate sensitivity at December 31, 2019, is illustrated in the following table. This information reflects the balances of assets and liabilities whose rates are subject to change. As indicated in the table below, we are asset sensitive through the majority of the time periods illustrated. The table shows the sensitivity of the statement of condition at one point in time and is not necessarily indicative of the position at future dates.

INTEREST RATE SENSITIVITY

(Dollars in Thousands)

December 31, 2019	Rate/Maturity				
	3 Months or Less	Over 3 Months to 1 Year	Over 1 Year to 5 Years	Over 5 Years	Total
	(Dollars in Thousands)				
Rate sensitive assets					
Investment securities	\$ 312,398	\$ 695,977	\$ 2,285,668	\$ 93,375	\$ 3,387,418
Loans, net of non-accruals	5,453,809	180,790	124,259	1,131,202	6,890,060
Total earning assets	\$ 5,766,207	\$ 876,767	\$ 2,409,927	\$ 1,224,577	\$ 10,277,478
Cumulative earning assets	\$ 5,766,207	\$ 6,642,974	\$ 9,052,901	\$ 10,277,478	
Rate sensitive liabilities					
Time deposits	\$ 803,061	\$ 1,044,965	\$ 164,246	\$ 28	\$ 2,012,300
Other interest bearing deposits	3,267,829	—	—	—	3,267,829
Securities sold under repurchase agreements	225,243	11,293	—	—	236,536
Other borrowed funds	190,000	—	—	436,511	626,511
Junior subordinated deferrable interest debentures	134,642	—	—	—	134,642
Total interest bearing liabilities	\$ 4,620,775	\$ 1,056,258	\$ 164,246	\$ 436,539	\$ 6,277,818
Cumulative sensitive liabilities	\$ 4,620,775	\$ 5,677,033	\$ 5,841,279	\$ 6,277,818	
Repricing gap	\$ 1,145,432	\$ (179,491)	\$ 2,245,681	\$ 788,038	\$ 3,999,660
Cumulative repricing gap	1,145,432	965,941	3,211,622	3,999,660	
Ratio of interest-sensitive assets to liabilities	1.25	0.83	14.67	2.81	1.64
Ratio of cumulative, interest-sensitive assets to liabilities	1.25	1.17	1.55	1.64	

The detailed inventory of statement of condition items contained in gap reports is the starting point of income simulation analysis. Income simulation analysis also focuses on the variability of net interest income and net income, but without the limitations of gap analysis. In particular, the fundamental, but often unstated, assumption of the gap approach that every statement of condition item that can re-price will do so to the full extent of any movement in market interest rates is taken into consideration in income simulation analysis.

Accordingly, income simulation analysis captures not only the potential of assets and liabilities to mature or re-price, but also the probability that they will do so. Moreover, income simulation analysis focuses on the relative sensitivities of these balance sheet items and projects their behavior over an extended period of time in a motion picture rather than snapshot fashion. Finally, income simulation analysis permits management to assess the probable effects on balance sheet items not only of changes in market interest rates, but also of proposed strategies for responding to such changes. We and many other institutions rely primarily upon income simulation analysis in measuring and managing exposure to interest rate risk.

We have established guidelines for acceptable volatility of projected net interest income on the income simulation analysis and the guidelines are reviewed at least annually. As of December 31, 2019, in rising rate scenarios of +100, +200, +300 and +400 basis points, the guidelines established by management require that the net interest income not vary by more than plus or minus 15%, 15%, 15%, and 20%, respectively and in a decreasing rate scenario of -100 or -150 basis

points, that the net interest income not vary by more than plus or minus 15%. At December 31, 2019, the income simulations show that a rate shift of -150, -100, +100, +200, +300 and +400 basis points in interest rates up will vary projected net interest income for the coming 12 month period by -4.46%, -3.07%, +4.87%, +8.89%, +12.78% and +16.48%, respectively. The basis point shift in interest rates is a hypothetical rate scenario used to calibrate risk and does not necessarily represent management's current view of future market developments. We believe that we are properly positioned for a potential interest rate increase or decrease.

All the measurements of risk described above are made based upon our business mix and interest rate exposures at the particular point in time. The exposure changes continuously as a result of our ongoing business and our risk management initiatives. While management believes these measures provide a meaningful representation of our interest rate sensitivity, they do not necessarily take into account all business developments that have an effect on net income, such as changes in credit quality or the size and composition of the statement of condition.

Our principal sources of liquidity and funding dividends from subsidiaries and borrowed funds, with such funds being used to finance our cash flow requirements. We closely monitor the dividend restrictions and availability from our Subsidiary Banks as disclosed in Note 20 to the Consolidated Financial Statements. At December 31, 2019, the aggregate amount legally available to be distributed to us from our Subsidiary Banks as dividends was approximately \$891,500,000, assuming that each Subsidiary Bank continues to be classified as "well-capitalized" under the applicable regulations in effect at December 31, 2019. The restricted capital (capital and surplus) of our Subsidiary Banks was approximately \$1,217,735,000 as of December 31, 2019. The undivided profits of our Subsidiary Banks were approximately \$1,312,852,000 as of December 31, 2019.

At December 31, 2019, we had outstanding \$626,511,000 in other borrowed funds and \$134,642,000 in junior subordinated deferrable interest debentures. In addition to borrowed funds and dividends, we have a number of other available alternatives to finance the growth of our Subsidiary Banks as well as future growth and expansion.

Capital

We maintain an adequate level of capital as a margin of safety for our depositors and shareholders. At December 31, 2019, shareholders' equity was \$2,118,053,000 compared to \$1,939,582,000 at December 31, 2018, an increase of \$178,471,000, or 9.2%. Shareholders' equity increased primarily due to the retention of earnings, offset by the payment of cash dividends to shareholders and repurchases of our common stock in the form of treasury stock. The accumulated other comprehensive income (loss) is not included in the calculation of regulatory capital ratios.

During 1990, the Federal Reserve Board ("FRB") adopted a minimum leverage ratio of 3% for the most highly rated bank holding companies and at least 4% to 5% for all other bank holding companies. Our leverage ratio (defined as shareholders' equity plus eligible trust preferred securities issued and outstanding less goodwill and certain other intangibles divided by average quarterly assets) was 16.65% at December 31, 2019 and 15.87% at December 31, 2018. The core deposit intangibles and goodwill of \$282,532,000 as of December 31, 2019, are deducted from the sum of core capital elements when determining our capital ratios.

The FRB has adopted risk-based capital guidelines which assign risk weightings to assets and off-balance sheet items. The guidelines also define and set minimum capital requirements (risk-based capital ratios). Under the final 1992 rules, all banks are required to have Tier 1 capital of at least 4.0% of risk-weighted assets and total capital of 8.0% of risk-weighted assets. Tier 1 capital consists principally of shareholders' equity plus trust preferred securities issued and outstanding less goodwill and certain other intangibles, while total capital consists of Tier 1 capital, certain debt instruments and a portion of the reserve for loan losses. In order to be deemed well-capitalized pursuant to the regulations, an institution must have a total risk-weighted capital ratio of 10%, a Tier 1 risk-weighted ratio of 8% and a Tier 1 leverage ratio of 5%. We had risk-weighted Tier 1 capital ratios of 19.80% and 19.06% and risk weighted total capital ratios of 20.46% and 19.74% as of December 31, 2019 and 2018, respectively, which are well above the minimum regulatory requirements and exceed the well-capitalized ratios (see Note 20 to Notes to Consolidated Financial Statements).

In July 2013, the Federal Deposit Insurance Corporation ("FDIC") and other regulatory bodies established a new, comprehensive capital framework for U.S. banking organizations, consisting of minimum requirements that increase both

the quantity and quality of capital held by banking organizations. The final rules are a result of the implementation of the BASEL III capital reforms and various Dodd-Frank Act related capital provisions. Consistent with the Basel international framework, the rules include a new minimum ratio of Common Equity Tier 1 (“CET1”) to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets. The capital conservation buffer began phasing-in on January 1, 2016 at .625% and increased each year until January 1, 2019, when we were required to have a 2.5% capital conservation buffer, effectively resulting in a minimum ratio of CET1 capital to risk-weighted assets of at least 7% upon full implementation. The rules also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. Regarding the quality of capital, the rules emphasize CET1 capital and implements strict eligibility criteria for regulatory capital instruments. The rules also improve the methodology for calculating risk-weighted assets to enhance risk sensitivity. Management believes, as of December 31, 2019, that we and each of our Subsidiary Banks met all capital adequacy requirements of the fully phased-in the capital conservation buffer.

On November 21, 2017, the Office of the Comptroller of the Currency (“OCC”), the FRB and the FDIC finalized a proposed rule that extends the current treatment under the regulatory capital rules for certain regulatory capital deductions and risk weights and certain minority interest requirements, as they apply to banking organizations that are not subject to the advanced approaches capital rules. Effective January 1, 2018, the rule also pauses the full transition to the Basel III treatment of mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions and minority interests. On December 7, 2017, the Basel Committee on Banking Supervision unveiled the latest round of its regulatory capital framework, commonly called “Basel IV.” The framework makes changes to the capital framework first introduced as “Basel III” in 2010. The committee targeted 2022-2027 as the timeframe for implementation by regulators in individual countries, including the U.S. federal bank regulatory agencies (after notice and comment).

Junior Subordinated Deferrable Interest Debentures

We have formed five statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. These statutory business trusts (the “Trusts”) have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the “Debentures”) that we issued. As of December 31, 2019 and December 31, 2018, the principal amount of debentures outstanding totaled \$134,642,000 and \$160,416,000, respectively.

The Debentures are subordinated and junior in right of payment to all of our present and future senior indebtedness (as defined in the respective indentures), and are *pari passu* with one another. The interest rate payable on, and the payment terms of the Debentures are the same as the distribution rate and payment terms of the respective issues of Capital and Common Securities issued by the Trusts. We have fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. We have the right, unless an Event of Default (as defined in the Indentures) has occurred and is continuing, to defer payment of interest on the Debentures for up to twenty consecutive quarterly periods on Trusts VIII, IX, X, XI and XII. If interest payments on any of the Debentures are deferred, distributions on both the Capital and Common Securities related to that Debenture would also be deferred. The redemption prior to maturity of any of the Debentures may require the prior approval of the Federal Reserve and/or other regulatory bodies.

For financial reporting purposes, the Trusts are treated as investments and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders’ equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. At December 31, 2019 and December 31, 2018, the total \$134,642,000 and \$160,416,000 of the Capital Securities outstanding qualified as Tier 1 capital, respectively.

The following table illustrates key information about each of the Debentures and their interest rates at December 31, 2019:

	Junior Subordinated Deferrable Interest Debentures (in thousands)	Repricing Frequency	Interest Rate	Interest Rate Index	Maturity Date	Optional Redemption Date(1)
Trust VIII	25,774	Quarterly	5.04 %	LIBOR + 3.05	October 2033	October 2008
Trust IX	41,238	Quarterly	3.72 %	LIBOR + 1.62	October 2036	October 2011
Trust X	21,021	Quarterly	3.56 %	LIBOR + 1.65	February 2037	February 2012
Trust XI	25,990	Quarterly	3.72 %	LIBOR + 1.62	July 2037	July 2012
Trust XII	20,619	Quarterly	3.36 %	LIBOR + 1.45	September 2037	September 2012
	<u>\$ 134,642</u>					

(1) The Capital Securities may be redeemed in whole or in part on any interest payment date after the Optional Redemption Date.

Contractual Obligations and Commercial Commitments

The following table presents contractual cash obligations (other than deposit liabilities) as of December 31, 2019:

Contractual Cash Obligations	Payments due by Period (Dollars in Thousands)				
	Total	Less than One Year	One to Three Years	Three to Five Years	After Five Years
Securities sold under repurchase agreements	\$ 236,536	\$ 236,536	\$ —	\$ —	\$ —
Federal Home Loan Bank borrowings	626,511	190,000	—	—	436,511
Junior subordinated deferrable interest debentures	134,642	—	—	—	134,642
Operating leases	7,227	3,658	3,255	196	118
Total Contractual Cash Obligations	<u>\$ 1,004,916</u>	<u>\$ 430,194</u>	<u>\$ 3,255</u>	<u>\$ 196</u>	<u>\$ 571,271</u>

The following table presents contractual commercial commitments (other than deposit liabilities) as of December 31, 2019:

Commercial Commitments	Amount of Commitment Expiration Per Period (Dollars in Thousands)				
	Total	Less than One Year	One to Three Years	Three to Five Years	After Five Years
Financial and Performance Standby Letters of Credit	\$ 124,054	\$ 94,819	\$ 29,210	\$ 25	\$ —
Commercial Letters of Credit	489	489	—	—	—
Credit Card Lines	11,098	11,098	—	—	—
Other Commercial Commitments	2,622,491	1,222,267	689,123	445,532	265,569
Total Commercial Commitments	<u>\$ 2,758,132</u>	<u>\$ 1,328,673</u>	<u>\$ 718,333</u>	<u>\$ 445,557</u>	<u>\$ 265,569</u>

Due to the nature of our commercial commitments, including unfunded loan commitments and lines of credit, the amounts presented above do not necessarily reflect the amounts we anticipate funding in the periods presented above.

Critical Accounting Policies

We have established various accounting policies which govern the application of accounting principles in the preparation of our consolidated financial statements. The significant accounting policies are described in the Notes to the Consolidated Financial Statements. Certain accounting policies involve significant subjective judgments and assumptions

by management which have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies.

We consider our allowance for probable loan losses as a policy critical to the sound operations of our Subsidiary Banks. The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of our Subsidiary Banks. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each Subsidiary Bank is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance is derived from the following elements: (i) allowances established on specific impaired loans, which are based on a review of the individual characteristics of each loan, including the customer's ability to repay the loan, the underlying collateral values, and the industry in which the customer operates, (ii) allowances based on actual historical loss experience for similar types of loans in our loan portfolio, and (iii) allowances based on general economic conditions, changes in the mix of loans, company resources, border risk and credit quality indicators, among other things. See also discussion regarding the allowance for probable loan losses and provision for probable loan losses included in the results of operations and "Provision and Allowance for Probable Loan Losses" included in Notes 1 and 4 of the Notes to Consolidated Financial Statements.

The loan loss provision is determined using the following methods. On a weekly basis, loan past due reports are reviewed by the credit quality committee to determine if a loan has any potential problems and if a loan should be placed on our internal classified report. Additionally, our credit department reviews the majority of our loans for proper internal classification purposes regardless of whether they are past due and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, we will determine if a loan should be placed on an internal classified report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

Our internal classified report is segregated into the following categories: (i) "Special Review Credits," (ii) "Watch List—Pass Credits," or (iii) "Watch List—Substandard Credits." The loans placed in the "Special Review Credits" category reflect our opinion that the loans reflect potential weakness which require monitoring on a more frequent basis. The "Special Review Credits" are reviewed and discussed on a regular basis with the credit department and the lending staff to determine if a change in category is warranted. The loans placed in the "Watch List—Pass Credits" category reflect our opinion that the credit contains weaknesses which represent a greater degree of risk, which warrant "extra attention." The "Watch List—Pass Credits" are reviewed and discussed on a regular basis with the credit department and the lending staff to determine if a change in category is warranted. The loans placed in the "Watch List—Substandard Credits" classification are considered to be potentially inadequately protected by the current sound worth and debt service capacity of the borrower or of any pledged collateral. These credit obligations, even if apparently protected by collateral value, have shown defined weaknesses related to adverse financial, managerial, economic, market or political conditions which may jeopardize repayment of principal and interest. Furthermore, there is the possibility that we may sustain some future loss if such weaknesses are not corrected. For loans that are classified as impaired, management evaluates these credits ASC 310-10, "Receivables," and, if deemed necessary, a specific reserve is allocated to the credit. The specific reserve allocated under ASC 310-10, is based on (i) the present value of expected future cash flows discounted at the loan's effective interest rate; (ii) the loan's observable market price; or (iii) the fair value of the collateral if the loan is collateral dependent. Substantially all of our loans evaluated as impaired under ASC 310-10 are measured using the fair value of collateral method. In limited cases, we may use other methods to determine the specific reserve of a loan under ASC 310-10 if such loan is not collateral dependent.

The allowance based on historical loss experience on our remaining loan portfolio, which includes the "Special Review Credits," "Watch List—Pass Credits," and "Watch List—Substandard Credits" is determined by segregating the remaining loan portfolio into certain categories such as commercial loans, installment loans, international loans, loan concentrations and overdrafts. A historical loss percentage, adjusted for (i) management's evaluation of changes in lending policies and procedures, (ii) current economic conditions in the market area we serve, (iii) other risk factors, (iv) the effectiveness of the internal loan review function, (v) changes in loan portfolios, and (vi) the composition and

concentration of credit volume is applied to each category. Each category is then added together to determine the allowance allocated under ASC 450-20.

Our management continually reviews the allowance for loan losses of our Subsidiary Banks using the amounts determined from the allowances established on specific loans, the allowance established on quantitative historical loss percentages, and the allowance based on qualitative data, to establish an appropriate amount to maintain our allowance for probable loan loss. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, our estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses.

Recent Accounting Standards Issued

See Note 1—Summary of Significant Accounting Policies in the accompanying Notes to the Consolidated Financial Statements for details of recently issued and recently adopted accounting standards and their impact on our consolidated financial statements.

Preferred Stock, Common Stock and Dividends

We have issued and outstanding 65,207,831 shares of \$1.00 par value common stock held by approximately 1,886 holders of record at February 24, 2020. The book value of the common stock at December 31, 2019 was \$33.37 per share compared with \$31.33 per share at December 31, 2018. In connection with our participation in the Troubled Asset Relief Program Capital Purchase Program in 2008, the US Treasury received a warrant (the “Warrant”) to purchase 1,326,238 shares of our common stock (the “Warrant Shares”) at \$24.43 per share. The term of the Warrant was ten years and was immediately exercisable. The Warrant was included as a component of Tier 1 capital. On June 12, 2013, the U. S. Treasury sold the Warrant to a third party. On September 19, 2018, we entered into an agreement to repurchase the Warrant from the third party at an aggregate purchase price of \$29,005,000, which transaction was consummated in the third quarter of 2018. The repurchase of the outstanding Warrant eliminated any restrictions on certain shareholder distributions or payment of cash dividends in excess of \$0.33 per semi-annual period that would have impacted the exercise price of the Warrant while it remained outstanding.

Our common stock is traded on the NASDAQ National Market under the symbol “IBOC.” The following table sets forth the approximate high and low bid prices in our common stock during 2019 and 2018, as quoted on the NASDAQ National Market for each of the quarters in the two-year period ended December 31, 2019. Some of the quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. The closing sales price of our common stock was \$38.85 per share at February 24, 2020.

		High		Low	
2019:	First quarter	\$	41.41	\$	33.66
	Second quarter		42.16		35.76
	Third quarter		40.51		32.04
	Fourth quarter		44.00		36.57
		High		Low	
2018:	First quarter	\$	42.45	\$	37.80
	Second quarter		45.00		36.65
	Third quarter		47.95		42.45
	Fourth quarter		45.86		32.56

We paid cash dividends of \$.50 and \$0.55 per share on April 15 and October 15, 2019 to record holders of our common stock on April 1 and September 30, 2019, respectively. We paid cash dividends of \$0.33 and \$0.42 per share on April 16 and October 16, 2018 to record holders of our common stock on April 2 and October 9, 2018, respectively.

Our principal source of funds to pay cash dividends on our common stock is cash dividends from our Subsidiary Banks. For a discussion of the limitations, please see Note 20 of Notes to Consolidated Financial Statements.

Stock Repurchase Program

In April 2009, the Board of Directors re-established a formal stock repurchase program that authorized the repurchase of up to \$40 million of common stock within the following 12 months. Annually since then, including on March 11, 2019, the Board of Directors extended the repurchase program but in March 2019 authorized an increase to the repurchase program of up to \$50 million of common stock during the 12 month period commencing on April 9, 2019. Stock repurchases may be made from time to time, on the open market or through private transactions. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. During the fourth quarter of 2019, our Board of Directors adopted a Rule 10b5-1 plan and intends to adopt additional Rule 10b5-1 trading plans that will allow us to purchase shares of our common stock during certain trading blackout periods when we ordinarily would not be in the market due to trading restrictions in our internal trading policy. During the term of a 10b5-1 Plan, purchases of common stock are automatic to the extent the conditions of the 10b5-1 Plan's trading instructions are met. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of February 24, 2020, a total of 10,321,174 shares had been repurchased under all programs at a cost of \$308,177,000. We are not obligated to repurchase shares under our stock repurchase program or to enter into additional Rule 10b5-1 plans. The timing, actual number and value of shares purchased will depend on many factors, including our cash flow and the liquidity and price performance of our shares of common stock.

Except for repurchases in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices, common stock repurchases are only conducted under publicly announced repurchase programs approved by the Board of Directors. The following table includes information about common stock share repurchases for the quarter ended December 31, 2019.

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly- Announced Program	Approximate Dollar Value of Shares Available for Repurchase⁽¹⁾
October 1 – October 31, 2019	344	\$ 37.44	—	\$ 32,224,000
November 1 – November 30, 2019	—	—	—	32,224,000
December 1 – December 31, 2019	343	43.60	—	32,224,000
Total	687	\$ 40.52	—	

(1) The repurchase program was extended on March 11, 2019 and allows for the repurchase of up to an additional \$50,000,000 of treasury stock through April 9, 2020.

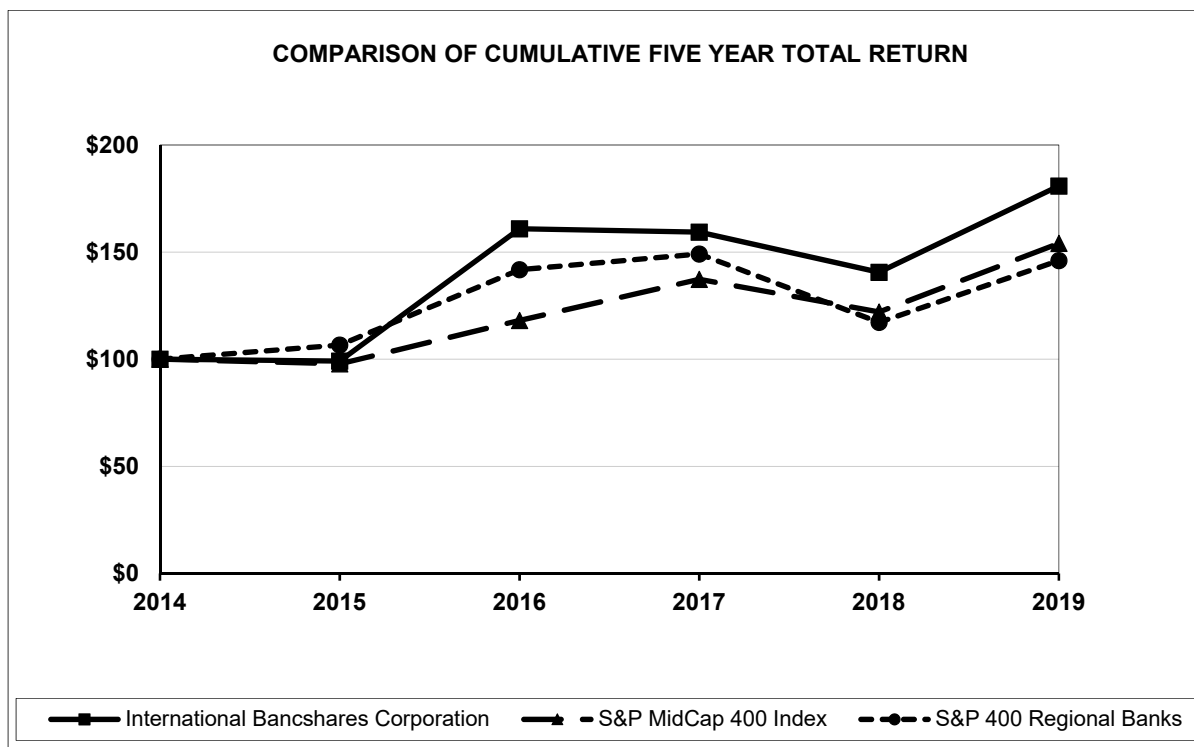
Equity Compensation Plan Information

The following table sets forth information as of December 31, 2019, with respect to our equity compensation plans:

Plan Category	(A) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(B) Weighted average exercise price of outstanding options, warrants and rights	(C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column A)
Equity Compensation plans approved by security holders	658,588	\$ 27.55	28,651
Total	658,588	\$ 27.55	28,651

Stock Performance

COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN



Total Return To Shareholders (Includes reinvestment of dividends)

Company / Index	Base Period	INDEXED RETURNS				
		December 31,				
	2014	2015	2016	2017	2018	2019
International Bancshares Corporation	100	101.82	165.25	163.63	144.54	180.85
S&P 400 Index	100	107.38	129.65	150.71	134.01	154.07
S&P 400 Banks	100	107.84	143.44	150.90	118.61	146.06

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and the Board of Directors
of International Bancshares Corporation:

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of condition of International Bancshares Corporation and its subsidiaries (the Company) as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2019, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, 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) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 27, 2020 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for Probable Loan Losses

As described in Note 4 of the consolidated financial statements, the company established an allowance for probable loan losses totaling \$60,278,000 as of December 31, 2019, derived from the following elements: (1) allowances established on specific impaired loans, which are based on a review of the individual characteristics of each loan,

including the customer's ability to repay the loan, the underlying collateral values, and the industry in which the customer operates; (2) allowances based on actual historical loss experience for similar types of loans in the loan portfolio; and (3) allowances based on qualitative factors such as general economic conditions, changes in the mix of loans, company resources, border risk and credit quality indicators, among other things (collectively, "the qualitative factors"). The qualitative factors considered in the allowance for probable loan losses require a significant amount of judgment by management and involves a high degree of estimation.

We identified the allowances derived from qualitative factors as a critical audit matter. Auditing management's estimate of the allowances derived from qualitative factors required a high degree of auditor judgement due to the nature of the qualitative factors and the subjectivity in judgments applied by management in forming them.

Our audit procedures related to auditing the Company's allowances derived from qualitative factors included the following, among others:

- We obtained an understanding of the relevant controls related to the allowance for probable loan losses, including allowances derived from qualitative factors, and tested such controls for design and operating effectiveness, including controls relating to management's review of the qualitative factors and approval of the allowance calculation.
- We evaluated the reasonableness of management's methods and assumptions used to determine allowances derived from qualitative factors by (1) evaluating management's identification and measurement of qualitative factors; (2) testing the completeness and accuracy of data and information used in estimating the components of the qualitative factors; (3) evaluating the reasonableness of the change to the general reserve as a result of the qualitative factors; and (4) reviewing subsequent events and considering their impact on judgments as of the consolidated balance sheet date.

/s/ RSM US LLP

We have served as the Company's auditor since 2007.

Austin, Texas
February 27, 2020

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition

December 31, 2019 and 2018

(Dollars in Thousands, Except Per Share Amounts)

	December 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents	\$ 256,820	\$ 316,797
Investment securities:		
Held to maturity debt securities (Market value of \$2,400 on December 31, 2019 and 1,200 on December 31, 2018)	2,400	1,200
Available for sale debt securities (Amortized cost of \$3,376,070 on December 31, 2019 and \$3,481,165 on December 31, 2018)	3,378,923	3,411,350
Equity securities with readily determinable fair values	6,095	5,937
Total investment securities	3,387,418	3,418,487
Loans	6,894,946	6,561,289
Less allowance for probable loan losses	(60,278)	(61,384)
Net loans	6,834,668	6,499,905
Bank premises and equipment, net	506,595	506,899
Accrued interest receivable	36,620	36,803
Other investments	318,427	337,507
Cash surrender value of life insurance policies	289,693	282,646
Goodwill	282,532	282,532
Other assets	200,121	190,376
Total assets	<u>\$ 12,112,894</u>	<u>\$ 11,871,952</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition Continued

December 31, 2019 and 2018

(Dollars in Thousands, Except Per Share Amounts)

	December 31, 2019	December 31, 2018
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand—non-interest bearing	\$ 3,545,905	\$ 3,454,840
Savings and interest-bearing demand	3,267,829	3,268,237
Time	2,012,300	1,973,468
Total deposits	8,826,034	8,696,545
Securities sold under repurchase agreements	236,536	229,989
Other borrowed funds	626,511	705,665
Junior subordinated deferrable interest debentures	134,642	160,416
Other liabilities	171,118	139,755
Total liabilities	9,994,841	9,932,370
Shareholders' equity:		
Common shares of \$1.00 par value. Authorized 275,000,000 shares; issued 96,214,967 shares on December 31, 2019 and 96,104,029 shares on December 31, 2018	96,215	96,104
Surplus	148,075	145,283
Retained earnings	2,200,568	2,064,134
Accumulated other comprehensive income (loss)	2,345	(54,634)
	2,447,203	2,250,887
Less cost of shares in treasury, 31,015,061 shares on December 31, 2019 and 30,494,143 on December 31, 2018	(329,150)	(311,305)
Total shareholders' equity	2,118,053	1,939,582
Total liabilities and shareholders' equity	\$ 12,112,894	\$ 11,871,952

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2019, 2018 and 2017

(Dollars in Thousands, Except Per Share Amounts)

	2019	2018	2017
Interest income:			
Loans, including fees	\$ 413,611	\$ 375,173	\$ 322,508
Investment securities:			
Taxable	72,485	81,484	82,347
Tax-exempt	4,885	8,141	9,656
Other interest income	1,420	1,024	625
Total interest income	492,401	465,822	415,136
Interest expense:			
Savings deposits	16,379	12,764	6,208
Time deposits	20,970	13,096	9,736
Securities sold under repurchase agreements	2,432	2,415	6,617
Other borrowings	12,413	17,404	10,978
Junior subordinated deferrable interest debentures	6,435	6,989	5,392
Total interest expense	58,629	52,668	38,931
Net interest income	433,772	413,154	376,205
Provision for probable loan losses	18,843	6,112	11,221
Net interest income after provision for probable loan losses	414,929	407,042	364,984
Non-interest income:			
Service charges on deposit accounts	72,502	72,433	72,868
Other service charges, commissions and fees			
Banking	50,996	46,685	44,964
Non-banking	7,832	7,801	7,345
Investment securities transactions, net	(12)	(141)	(4,774)
Other investments, net	5,985	19,897	18,918
Other income	17,523	18,367	11,085
Total non-interest income	154,826	165,042	150,406

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued

Years ended December 31, 2019, 2018 and 2017

(Dollars in Thousands, Except Per Share Amounts)

	2019	2018	2017
Non-interest expense:			
Employee compensation and benefits	\$ 145,929	\$ 138,532	\$ 132,750
Occupancy	28,635	29,097	28,439
Depreciation of bank premises and equipment	28,270	25,873	25,281
Professional fees	17,661	12,601	13,650
Deposit insurance assessments	1,416	3,742	3,294
Net expense, other real estate owned	6,377	4,413	965
Amortization of identified intangible assets	—	—	25
Advertising	7,748	7,695	7,854
Early termination fee - securities sold under repurchase agreements	—	—	5,765
Software and software maintenance	19,850	17,516	19,189
Other	53,915	60,032	56,536
	<u>309,801</u>	<u>299,501</u>	<u>293,748</u>
Income before income taxes	259,954	272,583	221,642
Provision for income taxes	54,850	56,652	64,206
Net income	<u>\$ 205,104</u>	<u>\$ 215,931</u>	<u>\$ 157,436</u>
Basic earnings per common share:			
Weighted average number of shares outstanding	65,476,606	66,106,580	66,046,155
Net income	<u>\$ 3.13</u>	<u>\$ 3.27</u>	<u>\$ 2.38</u>
Fully diluted earnings per common share:			
Weighted average number of shares outstanding	65,685,684	66,633,820	66,778,436
Net income	<u>\$ 3.12</u>	<u>\$ 3.24</u>	<u>\$ 2.36</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Years ended December 31, 2019, 2018, and 2017

(Dollars in Thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net income	\$ 205,104	\$ 215,931	\$ 157,436
Other comprehensive income, net of tax:			
Net unrealized holding gains (losses) on securities available for sale arising during period (net of tax effects of \$15,144, \$(7,004), and \$(2,586))	56,970	(26,348)	(4,803)
Reclassification adjustment for losses on securities available for sale included in net income (net of tax effects of \$3, \$30 and \$1,671)	9	111	3,103
	<u>56,979</u>	<u>(26,237)</u>	<u>(1,700)</u>
Comprehensive income	<u>\$ 262,083</u>	<u>\$ 189,694</u>	<u>\$ 155,736</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Years ended December 31, 2019, 2018 and 2017

	Preferred Stock	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2016	—	95,910	\$ 95,910	\$ 169,567	4 1,777,963	\$ (26,697)	\$ (292,076)	\$ 1,724,667
Net Income	—	—	—	—	157,436	—	—	157,436
Dividends:								
Cash (\$.66 per share)	—	—	—	—	(43,594)	—	—	(43,594)
Purchase of treasury (4,870 shares)	—	—	—	—	—	—	(187)	(187)
Exercise of stock options	—	109	109	1,346	—	—	—	1,455
Stock compensation expense recognized in earnings	—	—	—	903	—	—	—	903
Other comprehensive (loss), net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustment	—	—	—	—	—	(1,700)	—	(1,700)
Balance at December 31, 2017	—	96,019	\$ 96,019	\$ 171,816	\$ 1,891,805	\$ (28,397)	\$ (292,263)	\$ 1,838,980
Net Income	—	—	—	—	215,931	—	—	215,931
Dividends:								
Cash (\$.75 per share)	—	—	—	—	(49,599)	—	—	(49,599)
Purchase of treasury (520,918 shares)	—	—	—	—	—	—	(19,042)	(19,042)
Exercise of stock options	—	85	85	1,437	—	—	—	1,522
Stock compensation expense recognized in earnings	—	—	—	1,035	—	—	—	1,035
Repurchase of outstanding warrant	—	—	—	(29,005)	—	—	—	(29,005)
Cumulative adjustment for adoption of new accounting standards	—	—	—	—	5,997	(5,997)	—	—
Other comprehensive (loss), net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	—	(20,240)	—	(20,240)
Balance at December 31, 2018	—	96,104	\$ 96,104	\$ 145,283	\$ 2,064,134	\$ (54,634)	\$ (311,305)	\$ 1,939,582
Net Income	—	—	—	—	205,104	—	—	205,104
Dividends:								
Cash (\$1.05 per share)	—	—	—	—	(68,670)	—	—	(68,670)
Purchase of treasury (468,918 shares)	—	—	—	—	—	—	(17,845)	(17,845)
Exercise of stock options	—	111	111	1,812	—	—	—	1,923
Stock compensation expense recognized in earnings	—	—	—	980	—	—	—	980
Other comprehensive income, net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	—	56,979	—	56,979
Balance at December 31, 2019	—	96,215	\$ 96,215	\$ 148,075	\$ 2,200,568	\$ 2,345	\$ (329,150)	\$ 2,118,053

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2019, 2018 and 2017

(Dollars in Thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Operating activities:			
Net income	\$ 205,104	\$ 215,931	\$ 157,436
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for probable loan losses	18,843	6,112	11,221
Specific reserve, other real estate owned	322	3,071	710
Depreciation of bank premises and equipment	28,270	25,873	25,281
Gain on sale of bank premises and equipment	(237)	(1,456)	(38)
Gain on sale of other real estate owned	(1,470)	(1,465)	(703)
Accretion of investment securities discounts	(428)	(271)	(393)
Amortization of investment securities premiums	20,549	20,087	24,040
Investment securities transactions, net	12	141	4,774
Unrealized (gain) loss on equity securities with readily determinable fair values	(158)	388	—
Amortization of identified intangible assets	—	—	25
Stock based compensation expense	980	1,035	903
Earnings from affiliates and other investments	(3,914)	(15,484)	(13,198)
Deferred tax expense	3,309	5,143	4,570
Decrease (increase) in accrued interest receivable	183	(2,347)	(2,284)
Decrease (increase) in other assets	8,043	(51,827)	(16,117)
Net increase in other liabilities	<u>32,157</u>	<u>24,916</u>	<u>592</u>
Net cash provided by operating activities	<u>311,565</u>	<u>229,847</u>	<u>196,819</u>
Investing activities:			
Proceeds from maturities of securities	—	2,275	—
Proceeds from sales and calls of available for sale securities	94,585	38,175	396,066
Proceeds from sales of equity securities with readily determinable fair values	—	21,607	—
Purchases of available for sale securities	(893,301)	(47,346)	(1,182,006)
Principal collected on mortgage backed securities	882,479	675,304	780,097
Net increase in loans	(375,621)	(258,142)	(394,267)
Purchases of other investments	(52,795)	(43,418)	(26,193)
Distributions from other investments	44,919	3,668	20,344
Purchases of bank premises and equipment	(29,590)	(21,395)	(14,315)
Proceeds from sales of bank premises and equipment	1,861	4,533	2,201
Proceeds from sales of other real estate owned	<u>9,405</u>	<u>4,179</u>	<u>14,266</u>
Net cash (used in) provided by investing activities	<u>(318,058)</u>	<u>379,440</u>	<u>(403,807)</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Continued)

Years ended December 31, 2018, 2017 and 2016

(Dollars in Thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Financing activities:			
Net increase in non-interest-bearing demand deposits	\$ 91,065	\$ 211,585	\$ 85,204
Net (decrease) increase in savings and interest-bearing demand deposits	(408)	23,106	41,403
Net increase (decrease) in time deposits	38,832	(83,038)	(191,804)
Net increase (decrease) in securities sold under repurchase agreements	6,547	(123,816)	(151,180)
Net (decrease) increase in other borrowed funds	(79,154)	(489,560)	461,850
Redemption of long-term debt	(25,774)	—	—
Repurchase of outstanding common stock warrant	—	(29,005)	—
Purchase of treasury stock	(17,845)	(19,042)	(187)
Proceeds from stock transactions	1,923	1,522	1,455
Payments of cash dividends - common	(68,670)	(49,599)	(43,594)
Net cash (used in) provided by financing activities	<u>(53,484)</u>	<u>(557,847)</u>	<u>203,147</u>
(Decrease) increase in cash and cash equivalents	(59,977)	51,440	(3,841)
Cash and cash equivalents at beginning of period	<u>316,797</u>	<u>265,357</u>	<u>269,198</u>
Cash and cash equivalents at end of period	<u>\$ 256,820</u>	<u>\$ 316,797</u>	<u>\$ 265,357</u>
Supplemental cash flow information:			
Interest paid	\$ 56,728	\$ 50,623	\$ 38,995
Income taxes paid	44,089	40,565	66,983
Non-cash investing and financing activities:			
Net transfers from loans to other real estate owned	22,015	32,610	2,588
Establishment of lease liability and right-of-use asset	6,171	—	—

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

Our accounting and reporting policies conform to U.S. generally accepted accounting principles (“GAAP”) and to general practices within the banking industry. The following is a description of the more significant of those policies.

Consolidation and Basis of Presentation

Our consolidated financial statements include the accounts of the International Bancshares Corporation, its wholly-owned Subsidiary Banks and its wholly-owned non-bank subsidiaries, IBC Trading Company, Premier Tierra Holdings, Inc., IBC Charitable and Community Development Corporation, and IBC Capital Corporation. All significant inter-company balances and transactions have been eliminated in consolidation.

We, through our Subsidiary Banks, are primarily engaged in the business of banking, including the acceptance of checking and savings deposits and the making of commercial, real estate, personal, home improvement, automobile and other installment and term loans. Our primary markets are north, south, central, and southeast Texas and the state of Oklahoma. Each of our Subsidiary Banks is very active in facilitating international trade along the United States border with Mexico and elsewhere. Although our loan portfolio is diversified, the ability of our debtors to honor their contracts is primarily dependent upon the economic conditions in our trade area. In addition, the investment portfolio is directly impacted by fluctuations in market interest rates. We are subject to the regulations of certain federal agencies as well as the Texas Department of Banking and the Oklahoma Department of Banking and undergo periodic examinations by those regulatory authorities. Such agencies may require certain standards or impose certain limitations based on their judgments or changes in law and regulations.

We own one insurance-related subsidiary, IBC Insurance Agency, Inc., a wholly owned subsidiary of our Subsidiary Bank, International Bank of Commerce, Laredo. The insurance-related subsidiary does not conduct underwriting activities.

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the statement of condition and income and expenses for the periods. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant changes in the near-term relate to the determination of the allowance for probable loan losses.

Subsequent Events

We have evaluated all events or transactions that occurred through the date we issued these financial statements. During this period, we did not have any material recognizable or non-recognizable subsequent events.

Investment Securities

We classify debt securities into one of these categories: held-to-maturity, available-for-sale, or trading. Such classifications are reassessed for appropriate classification at each reporting date. Securities that are intended and expected to be held until maturity are classified as “held-to-maturity” and are carried at amortized cost for financial statement reporting. Securities that are not positively expected to be held until maturity, but are intended to be held for an indefinite period of time are classified as “available-for-sale” or “trading” and are carried at their fair value. Unrealized holding gains and losses are included in net income for those securities classified as “trading”, while unrealized holding gains and losses related to those securities classified as “available-for-sale” are excluded from net income and reported net of tax as other comprehensive income and in shareholders’ equity as accumulated other comprehensive income (loss) until realized. We did not maintain any trading securities during the three-year period ended December 31, 2019.

Mortgage-backed securities held at December 31, 2019 and 2018 represent participating interests in pools of long-term first mortgage loans originated and serviced by the issuers of the securities. Mortgage-backed securities are either issued or guaranteed by the U.S. government or its agencies including the Federal Home Loan Mortgage Corporation

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

("Freddie Mac"), the Federal National Mortgage Association ("Fannie Mae"), the Government National Mortgage Association ("Ginnie Mae") or other non-government entities. Investments in residential mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U. S. government. Investments in residential mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. government; however, we believe that the quality of the bonds is similar to other AAA rated bonds with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in 2008 and because securities issued by others that are collateralized by residential mortgage-backed securities issued by Fannie Mae or Freddie Mac are rated consistently as AAA rated securities. Market interest rate fluctuations can affect the prepayment speed of principal and the yield on the security.

Premiums and discounts are amortized using the level yield or "interest method" over the terms of the securities. Declines in the fair value of held-to-maturity and available-for sale-securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) our intent to hold and our determination of whether we will more likely than not be required to sell the security prior to a recovery in fair value. If we determine that (i) we intend to sell the security or (ii) it is more likely than not that we will be required to sell the security before it's anticipated recovery, the other-than-temporary impairment that is recognized in earnings is equal to the difference between the fair value of the security and our amortized cost of the security. If we determine that we (i) do not intend to sell the security and (ii) we will not be more likely than not required to sell the security before it's anticipated recovery, the other-than-temporary impairment is segregated into its two components (i) the amount of impairment related to credit loss and (ii) the amount of impairment related to other factors. The difference between the present value of the cash flows expected to be collected and the amortized cost is the credit loss recognized through earnings and an adjustment to the cost basis of the security. The amount of impairment related to other factors is included in other comprehensive income (loss). Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Equity Securities

Prior to January 1, 2018, equity securities with readily determinable fair values were included in available-for-sale securities, with the unrealized gain or loss recorded as a component of other comprehensive income (loss). Pursuant to the adoption of ASU 2016-02, equity securities with readily determinable fair values are a separate component of our balance sheet, with unrealized gains and losses recognized in net income. Equity securities with readily determinable fair values at December 31, 2019 and December 31, 2018 consist primarily of Community Reinvestment Act funds.

Provision and Allowance for Probable Loan Losses

The allowance for probable loan losses is maintained at a level considered adequate by management to provide for probable loan losses. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The provision for probable loan losses is the amount, which, in the judgment of management, is necessary to establish the allowance for probable loan losses at a level that is adequate to absorb known and inherent risks in the loan portfolio.

Management believes that the allowance for probable loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review our Subsidiary Banks' allowances for probable loan losses. Such agencies may require our Subsidiary Banks to make additions or reductions to their GAAP allowances based on their judgments of information available to them at the time of their examination.

The Subsidiary Banks charge-off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a "loss" by bank examiners. Commercial, financial and agricultural or real estate loans are generally considered by management to represent a loss, in whole or part, (i) when an exposure beyond any collateral coverage is apparent, (ii) when no further collection of the portion of the loan so exposed is

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

anticipated based on actual results, (iii) when the credit enhancements, if any, are not adequate, and (iv) when the borrower's financial condition would indicate so. Generally, unsecured consumer loans are charged-off when 90 days past due.

Loans

Loans are reported at the principal balance outstanding, net of unearned discounts. Interest income on loans is reported on an accrual basis. Loan fees and costs associated with originating the loans are accreted or amortized over the life of the loan using the interest method. We originate mortgage loans that may subsequently be sold to an unaffiliated third party. The loans are not securitized and if sold, are sold without recourse. Loans held for sale are carried at cost and the principal amount outstanding is not significant to the consolidated financial statements.

Impaired Loans

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. Impaired loans are measured based on (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price; or (3) the fair value of the collateral if the loan is collateral dependent. Substantially all our impaired loans are measured at the fair value of the collateral. In limited cases, we may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

Troubled Debt Restructured Loans

Troubled debt restructured loans ("TDR") are those loans where, for reasons related to a borrower's difficulty to repay a loan, we grant a concession to the borrower that we would not normally consider in the normal course of business. The original terms of the loan are modified or restructured. The terms that may be modified include a reduction in the original stated interest rate, an extension of the original maturity of the loan, a renewal of the loan at an interest rate below current market rates, a reduction in the principal amount of debt outstanding, a reduction in accrued interest or deferral of interest payments. A loan classified as a TDR is classified as an impaired loan and included in the impaired loan totals. A TDR loan may be returned to accrual status when the loan is brought current, has performed in accordance with the restructured terms for a reasonable period of time, is at the current market rate, and the ultimate collectability of the outstanding principal and interest is no longer questionable, however, although those loans may be placed back on accrual status, they will continue to be classified as impaired. Consistent with regulatory guidance, a TDR loan that is subsequently modified, but has shown sustained performance and classification as a TDR, will be removed from TDR status provided that the modified terms were market-based at the time of modification.

Non-Accrual Loans

The non-accrual loan policy of our Subsidiary Banks is to discontinue the accrual of interest on loans when management determines that it is probable that future interest accruals will be un-collectible. As it relates to consumer loans, management charges-off those loans when the loan is contractually 90 days past due. Under special circumstances, a consumer or non-consumer loan may be more than 90 days delinquent as to interest or principal and not be placed on non-accrual status. This situation generally results when a Subsidiary Bank has a borrower who is experiencing financial difficulties, but not to the extent that requires a restructuring of indebtedness. The majority of this category is composed of loans that are considered to be adequately secured and/or for which there are expected future payments. When a loan is placed on non-accrual status, any interest accrued, not paid is reversed and charged to operations against interest income. As it relates to non-consumer loans that are not 90 days past due, management will evaluate each of these loans to determine if placing the loan on non-accrual status is warranted. Interest income on non-accrual loans is recognized only to the extent payments are received or when, in management's opinion, the debtor's financial condition warrants reestablishment of interest accruals.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Other Real Estate Owned and Repossessed Assets

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal). Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. Any subsequent write-downs are charged against other non-interest expense through a valuation allowance. Other real estate owned totaled approximately \$71,103,000 and \$57,344,000 at December 31, 2019 and 2018, respectively. Other real estate owned is included in other assets. Repossessed assets consist primarily of non-real estate assets acquired by foreclosure. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the asset to be repossessed by a charge to the allowance for probable loan losses, if necessary. Repossessed assets are included in other assets on the consolidated financial statements and totaled approximately \$7,137,000 and \$6,454,000 at December 31, 2019 and 2018, respectively.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on straight-line and accelerated methods over the estimated useful lives of the assets. Repairs and maintenance are charged to operations as incurred and expenditures for renewals and betterments are capitalized. We primarily own all the property we occupy, with the exception of certain branches operating in grocery store or retail shopping centers and certain ATM locations, which are all under operating leases as classified under guidance prior to the issuance of ASU 2016-02, "Leases." We adopted the guidance in ASU 2016-02 on January 1, 2019 and recorded a right of use asset and a lease liability of approximately \$6.4 million. The right of use asset and lease liability are included in other assets and other liabilities, respectively, in our consolidated financial statements.

Other Investments

Other investments include equity investments in non-financial companies, as well as equity securities with no readily determinable fair market value. Equity investments are accounted for using the equity method of accounting. Equity securities with no readily determinable fair value are accounted for using the cost method.

Cash Surrender Value of Bank Owned Life Insurance

Cash surrender value of bank owned life insurance includes investments in cash value insurance policies to assist with financing employee compensation and benefit programs. The cash value of the underlying policies accumulates on a tax-free basis and is received through death proceeds, which are also tax-free. The earnings on the policies are derived from the investment portfolio returns of the individual insurance carriers for general account policies and on the returns on investments segregated in our name for separate account policies.

Revenue Recognition

On January 1, 2018, we adopted the provisions of ASU 2014-09 to ASC 606, "Revenue from Contracts with Customers." Since our revenue is primarily comprised of net interest income on financial assets and liabilities, which were excluded from the scope of the update, the remaining non-interest revenue streams were identified and then analyzed under the provisions of the update, to: (i) identify the contract, (ii) identify the performance obligation, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations, and (v) recognize revenue when the performance obligation was satisfied. Our non-interest revenue contracts with customers are primarily short term and our performance obligation is satisfied at a single point in time, typically within a single period. No changes to our existing methods for recognizing revenue were made as a result of the update.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Income Taxes

Deferred income tax assets and liabilities are determined using the asset and liability method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. We file a consolidated federal income tax return with our subsidiaries.

Recognition of deferred tax assets is based on management's assessment that the benefit related to certain temporary differences, tax operating loss carry forwards, and tax credits are more likely than not to be realized. A valuation allowance is recorded for the amount of the deferred tax items for which it is more likely than not that the tax benefits will not be realized.

We evaluate uncertain tax positions at the end of each reporting period. We may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefit recognized in the financial statements from any such a position is measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. As of December 31, 2019 and 2018, respectively, after evaluating all uncertain tax positions, we have recorded no liability for unrecognized tax benefits at the end of the reporting period. We would recognize any interest accrued on unrecognized tax benefits as other interest expense and penalties as other non-interest expense. During the years ended December 31, 2019, 2018 and 2017, we recognized no interest expense or penalties related to uncertain tax positions.

We file consolidated tax returns in the U.S. Federal jurisdiction and various state jurisdictions. We are no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2016.

Stock Options

Compensation expense for stock awards is based on the market price of the stock on the measurement date, which is generally the date of grant, and is recognized ratably over the service period of the award. The fair value of stock options granted was estimated using the Black-Scholes-Merton option-pricing model. This model was developed for use in estimating the fair value of publicly traded options that have no vesting restrictions and are fully transferable. Additionally, the model requires the input of highly subjective assumptions. Because our employee stock options have characteristics significantly different from those of publicly traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the Black-Scholes-Merton option-pricing model does not necessarily provide a reliable single measure of the fair value of our stock options.

Net Income Per Share

Basic Earnings Per Share ("EPS") is calculated by dividing net income by the weighted average number of common shares outstanding. The computation of diluted EPS assumes the issuance of common shares for all dilutive potential common shares outstanding during the reporting period. The dilutive effect of stock options is considered in earnings per share calculations, if dilutive, using the treasury stock method.

Goodwill and Identified Intangible Assets

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill is tested for impairment at least annually or on an interim basis if an event triggering impairment may have occurred. As of October 1, 2019, after completing goodwill testing, we have determined that no goodwill impairment exists.

Identified intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. Our identified intangible assets relate to core deposits and contract rights. As of December 31, 2019, we have determined that no impairment of identified intangibles exists. Identified

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. See Note 6—Goodwill and Other Intangible Assets.

Impairment of Long-Lived Assets

Long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying value of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying value of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statement of condition and reported at the lower of the carrying value or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the statement of condition.

Consolidated Statements of Cash Flows

For purposes of the consolidated statements of cash flows, we consider all short-term investments with a maturity at date of purchase of three months or less to be cash equivalents. Also, we report transactions related to deposits and loans to customers on a net basis.

Accounting for Transfers and Servicing of Financial Assets

We account for transfers and servicing of financial assets and extinguishments of liabilities based on the application of a financial-components approach that focuses on control. After a transfer of financial assets, we recognize the financial and servicing assets we control and liabilities we have incurred, derecognize financial assets when control has been surrendered and derecognize liabilities when extinguished. We have retained mortgage servicing rights in connection with the sale of mortgage loans. Because we may not initially identify loans as originated for resale, all loans are initially treated as held for investment. The value of the mortgage servicing rights are reviewed periodically for impairment and are amortized in proportion to, and over the period of estimated net servicing income or net servicing losses. The value of the mortgage servicing rights is not significant to the consolidated statements of condition.

Segments of an Enterprise and Related Information

We operate as one segment. The operating information used by our chief executive officer for purposes of assessing performance and making operating decisions is the consolidated financial statements presented in this report. We have five active operating subsidiaries, namely, the Subsidiary Banks. We apply the provisions of ASC Topic 280, “Segment Reporting,” in determining our reportable segments and related disclosures.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale.

Advertising

Advertising costs are expensed as incurred.

Reclassifications

Certain amounts in the prior year’s presentations have been reclassified to conform to the current presentation. These reclassifications had no effect on previously reported net income or shareholders’ equity.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

New Accounting Standards

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 to ASC 606, “Revenue from Contracts with Customers.” The update sets a common standard that defines revenue and the principles for recognizing revenue. The update outlines when an entity should recognize revenue, among other matters. At its core, the update states 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 to in exchange for those goods or services. The update also outlines the steps that entities should take to determine and record the current revenue number including: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract(s), (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract(s), and (v) recognize revenue when (or as) the entity satisfies the identified performance obligations in the contract(s). The update was originally effective for annual periods beginning after December 31, 2016 and the interim periods within that reporting period. In August 2015, the FASB issued Accounting Standards Update No. 2015-14 which deferred the effective date of ASU 2014-09 by one year to annual and interim periods beginning after December 15, 2017. On January 1, 2018, we adopted the provisions of ASU 2014-09 to ASC 606. Our revenue is primarily comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASC 606. We have evaluated the impact of the accounting standards update on certain other non-interest revenue streams that the provisions of the update apply to and has determined that the adoption of the new provisions to ASC 606 did not have a significant impact to our consolidated financial statements or operations.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01 to ASC 825-10, “Financial Instruments – Overall.” The update amends existing standards regarding certain aspects of recognition and measurement of financial assets and financial liabilities. The amendments in the update establish the following guidance: (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 securities without readily determinable fair values by requiring a qualitative assessment, (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 methods and significant assumptions used to estimate 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 fair value 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, (vii) requires separate presentation of financial assets and liabilities by measurement category and form of financial assets on the balance sheet or in the accompanying notes to the financial statements, and (viii) clarifies that an entity should evaluate the need to 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 update is effective for interim and annual periods beginning after December 15, 2017. On January 1, 2018, we adopted the provisions of ASU 2016-01. The main effect resulting from the adoption of the new standards is that beginning on January 1, 2018, equity securities with readily determinable fair values are now reported in a single line item on the face of our consolidated statement of condition under the caption, “Equity securities with readily determinable fair values.” Additionally, the changes in fair value of the equity securities is now recognized in net income and is included in other non-interest expense on the face of our consolidated income statement. Prior to January 1, 2018, the equity securities were classified as available-for-sale and stated at fair value with unrealized gains and losses included in accumulated comprehensive income, net of tax and had a net unrealized loss of \$189,000. Other equity securities without readily determinable fair values are recorded at cost less any impairment, if any, and included in other investments in our consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02 to ASC 820, “Leases.” The update amends existing standards for accounting for leases by lessees, with accounting for leases by lessors remaining mainly unchanged from current guidance. The update requires that lessees recognize a lease liability and a right of use asset for all leases (with the exception of short-term leases) at the commencement date of the lease and disclose key information about leasing arrangements. The update is to be applied on a modified retrospective basis for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements. The update is effective for interim and annual periods beginning after December 15, 2018. In January 2018, the FASB issued a proposal that provides an additional transition method that would allow entities to not apply the guidance in the

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

update in the comparative periods presented in the consolidated financial statements, but instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. On January 1, 2019, we adopted the provisions of ASU 2016-02, "Leases." As part of our business model, we primarily own all property we occupy, with the exception of certain branches operating in grocery stores or shopping centers and certain ATM locations that were classified as operating leases under previous guidance. The adoption of the standard did not have a significant impact on our consolidated financial statements. As of the date of adoption, we recorded a right of use asset and a lease liability of approximately \$6.4 million. The right of use asset and lease liability are included in other assets and other liabilities, respectively, on our consolidated statement of condition. Amortization of the right of use asset for the twelve months ended December 31, 2019 was approximately \$1,019,000 and is included as a part of occupancy expense in our consolidated income statement.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 to ASC 326, "Financial Instruments – Credit Losses." The update amends existing standards for accounting for credit losses for financial assets. The update requires that the expected credit losses on the financial instruments held as of the end of the period being reported be measured based on historical experience, current conditions, and reasonable and supportable forecasts. The update also expands the required disclosures related to significant estimates and judgements used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's financial assets. The update also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The impact of the adoption of the standard is to be recorded as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The accounting standard was effective for us on January 1, 2020. The task force formed last year, which includes key members of the teams that work with the current calculation of the allowance for probable loan losses with members representing the corporate accounting and risk management areas has continued to work with the implementation of the update. Implementation activities and decisions have been reached around key data needed for the new calculation including portfolio segmentation. Validation of our primary model/tool is substantially completed and ongoing activities around forecasting models and documentation of the process are substantially complete. We have completed a parallel run of the calculation against our current methodology. Based on the current portfolio, including its current composition, characteristics and credit quality, as well as the current economic conditions and forecasts, we believe that the adoption of the update will increase our allowance for probable loan losses between approximately 2 and 6%.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04 to ASC 350, "Intangibles – Goodwill and Other." The update amends existing guidance in evaluating goodwill for impairment. The update requires that an entity perform its annual or interim goodwill test by comparing the fair value of a reporting unit with its carrying amount, with any impairment charges being recognized as the difference between the fair value and carrying value. The update is intended to standardize the impairment test for all business entities and also reduce the complexity and cost of evaluating goodwill for impairment. The update is effective for any annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of the update is not expected to have a significant impact to our consolidated financial statements.

In March 2017, the FASB issued Accounting Standards Update No. 2017-08 to ASC 310, "Receivables – Nonrefundable Fees and Other Costs." The update amends existing guidance on the amortization period for certain callable debt securities held at a premium. The update shortens the amortization period of the premium to the earliest call date. The update is effective for fiscal years beginning after December 15, 2018. The update is to be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The adoption of the update did not have a significant impact to our consolidated financial statements.

In February 2018, the FASB issued Accounting Standards Update No. 2018-02 to ASC 220, "Income Statement – Reporting Comprehensive Income." The update amends current guidance surrounding the reclassification of certain tax effects from accumulated other comprehensive income. The update is being issued as a result of the 2017 Tax Cuts and Jobs Act and the related impact to comprehensive income as a result of the application of current guidance with respect to changes in tax rates. Under current guidance, entities must re-evaluate the carrying value of deferred tax assets and liabilities and adjust them for the tax effect of the rate change and record that change through earnings. The result is that the tax effects for items that normally would only be recognized in comprehensive income will be recognized through earnings and results in stranded tax effects in accumulated other comprehensive income (loss) for the impact of the rate

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

change. The update will allow a reclassification from accumulated other comprehensive income (loss) to retained earnings for the stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act. The update is effective for all entities for fiscal years beginning after December 31, 2018. We adopted the provisions of ASU 2018-02 to ASC 220 in the second quarter of 2018. We recorded a one-time reclassification of \$5,997,000 between accumulated comprehensive income (loss) and retained earnings as a result of the adoption of the accounting standards update.

In August 2018, the FASB issued Accounting Standards Update No. 2018-13 to ASC 820, "Fair Value Measurement." The update amends the existing guidance surrounding the disclosure of certain fair value measurements. The update removes certain disclosures that are no longer considered cost beneficial, modifies and, in some instances clarifies, the specific requirements of certain disclosures and adds disclosure requirements that are identified relevant. The update is effective for fiscal years beginning after December 15, 2019. The adoption of the update is not expected to have a significant impact on our consolidated financial statements.

In December 2019, the FASB issued Accounting Standards Update No. 2019-12 to ASC 740, "Income Taxes." The update amends existing guidance with the intention of simplifying the accounting for income taxes. Specifically, the update removes some exceptions in existing guidance around intraperiod tax allocations, recognition of deferred tax liabilities for certain changes in investments in foreign subsidiaries and to the general methodology for calculating taxes on interim periods when year to date losses exceed the anticipated loss for the year. Additionally, the update clarifies and provides more guidance with respect to the classification of franchise or similar taxes, requirements to evaluate when a step up in the tax basis of goodwill should be considered, eliminates the requirement that a consolidated entity allocate a portion of current and deferred tax expense to a legal entity that is not subject to tax, requires that an entity reflect the effect of changes in tax laws and tax rates in the effective tax rate computed in the interim period that includes the enactment date and makes minor changes for taxes related to employee stock ownership plans and investments in qualified affordable housing projects accounted for using the equity method. The update is effective for fiscal years beginning after December 15, 2020. The adoption of the update is not expected to have a significant impact on our consolidated financial statements.

(2) Investment Securities

The amortized cost and estimated fair value by type of investment security at December 31, 2019 are as follows:

	Held to Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	\$ 2,400	\$ —	\$ —	\$ 2,400	\$ 2,400
Total investment securities	\$ 2,400	\$ —	\$ —	\$ 2,400	\$ 2,400

	Available for Sale Debt Securities				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value ⁽¹⁾
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 3,285,623	\$ 16,534	\$ (16,609)	\$ 3,285,548	\$ 3,285,548
Obligations of states and political subdivisions	90,447	2,933	(5)	93,375	93,375
Total investment securities	\$ 3,376,070	\$ 19,467	\$ (16,614)	\$ 3,378,923	\$ 3,378,923

(1) Included in the carrying value of residential mortgage-backed securities are \$571,247 of mortgage-backed securities issued by Ginnie Mae and \$2,714,301 of mortgage-backed securities issued by Fannie Mae and Freddie Mac

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The amortized cost and estimated fair value of investment securities at December 31, 2019, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated fair value	Amortized Cost	Estimated fair value
	(Dollars in Thousands)			
Due in one year or less	\$ 1,075	\$ 1,075	\$ —	\$ —
Due after one year through five years	1,325	1,325	—	—
Due after five years through ten years	—	—	2,241	2,249
Due after ten years	—	—	88,206	91,126
Residential mortgage-backed securities	—	—	3,285,623	3,285,548
Total investment securities	<u>\$ 2,400</u>	<u>\$ 2,400</u>	<u>\$ 3,376,070</u>	<u>\$ 3,378,923</u>

The amortized cost and estimated fair value by type of investment security at December 31, 2018 are as follows:

	Held to Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	\$ 1,200	\$ —	\$ —	\$ 1,200	\$ 1,200
Total investment securities	<u>\$ 1,200</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,200</u>	<u>\$ 1,200</u>

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value ⁽¹⁾
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 3,295,366	\$ 6,813	\$ (79,169)	\$ 3,223,010	\$ 3,223,010
Obligations of states and political subdivisions	185,799	2,646	(105)	188,340	188,340
Total investment securities	<u>\$ 3,481,165</u>	<u>\$ 9,459</u>	<u>\$ (79,274)</u>	<u>\$ 3,411,350</u>	<u>\$ 3,411,350</u>

(1) Included in the carrying value of residential mortgage-backed securities are \$501,293 of mortgage-backed securities issued by Ginnie Mae, \$2,721,717 of mortgage-backed securities issued by Fannie Mae and Freddie Mac

Residential mortgage-backed securities are securities issued by Freddie Mac, Fannie Mae, Ginnie Mae or non-government entities. Investments in residential mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U.S. government. Investments in mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. government; however, we believe that the quality of the bonds is similar to other AAA rated bonds with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008 and because securities issued by others that are collateralized by residential mortgage-backed securities issued by Fannie Mae and Freddie Mac are rated consistently as AAA rated securities.

The amortized cost and fair value of available for sale investment securities pledged to qualify for fiduciary powers, to secure public monies as required by law, repurchase agreements and short-term fixed borrowings was \$856,135,000 and \$855,141,000, respectively, at December 31, 2019.

Proceeds from the sale and call of securities available-for-sale were \$94,585,000, \$59,782,000 and \$396,066,000 during 2019, 2018 and 2017, respectively, which amounts included \$0, \$0 and \$377,756,000 of mortgage-backed securities. Gross gains of \$3,000, \$3,000 and \$1,186,000, and gross losses of \$15,000, \$144,000 and \$5,960,000 were realized on the sales in 2019, 2018 and 2017, respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2019 were as follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in Thousands)					
Available for sale:						
Residential mortgage-backed securities	\$ 523,031	\$ (2,269)	\$ 1,448,109	\$ (14,340)	\$ 1,971,140	\$ (16,609)
Obligations of states and political subdivisions	766	(5)	—	—	766	(5)
	<u>\$ 523,797</u>	<u>\$ (2,274)</u>	<u>\$ 1,448,109</u>	<u>\$ (14,340)</u>	<u>\$ 1,971,906</u>	<u>\$ (16,614)</u>

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position, at December 31, 2018 were as follows:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in Thousands)					
Available for sale:						
Residential mortgage-backed securities	\$ 208,384	\$ (2,124)	\$ 2,537,181	\$ (77,045)	\$ 2,745,565	\$ (79,169)
Obligations of states and political subdivisions	12,756	(99)	512	(6)	13,268	(105)
	<u>\$ 221,140</u>	<u>\$ (2,223)</u>	<u>\$ 2,537,693</u>	<u>\$ (77,051)</u>	<u>\$ 2,758,833</u>	<u>\$ (79,274)</u>

The unrealized losses on investments in residential mortgage-backed securities are primarily caused by changes in market interest rates. Residential mortgage-backed securities are primarily securities issued by Freddie Mac, Fannie Mae and Ginnie Mae. The contractual cash obligations of the securities issued by Ginnie Mae are fully guaranteed by the U.S. government. The contractual cash obligations of the securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. government; however, we believe that the quality of the bonds is similar to other AAA rated bonds with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008 and because securities issued by others that are collateralized by residential mortgage-backed securities issued by Fannie Mae and Freddie Mac are rated consistently as AAA rated securities. The decrease in fair value on residential mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae is due to market interest rates. We have no intent to sell and more likely than not be required to sell before a market price recovery or maturity of the securities; therefore, it is our conclusion that the investments in residential mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae are not considered other-than-temporarily impaired. The unrealized losses on investments in other securities are caused by fluctuations in market interest rates. The underlying cash obligations of the securities are guaranteed by the entity underwriting the debt instrument. We believe that the entity issuing the debt will honor its interest payment schedule, as well as the full debt at maturity. We purchased the securities for their economic value. The decrease in fair value is primarily due to market interest rates and not other factors, and because we have no intent to sell and will more likely than not be required to sell before a market price recovery or maturity of the securities, it is our conclusion that the investments are not considered other-than-temporarily impaired.

Equity securities with readily determinable fair values consist primarily of Community Reinvestment Act funds. At December 31, 2019 and December 31, 2018, the balance in equity securities with readily determinable fair values recorded at fair value were \$6,095,000 and \$5,937,000, respectively. Prior to January 1, 2018, the equity securities were included in available-for-sale securities, with the related unrealized gain or loss recorded as a component of other

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

comprehensive income (loss). The following is a summary of unrealized and realized gains and losses recognized in net income on equity securities during the twelve months ended December 31, 2019 and December 31, 2018:

	Year Ended December 31, 2019 (Dollars in Thousands)
Net gains recognized during the period on equity securities	\$ 158
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	—
Unrealized gains recognized during the reporting period on equity securities still held at the reporting date	\$ 158

	Year Ended December 31, 2018 (Dollars in Thousands)
Net losses recognized during the period on equity securities	\$ (388)
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	—
Unrealized losses recognized during the reporting period on equity securities still held at the reporting date	\$ (388)

(3) Loans

A summary of loans, by loan type at December 31, 2019 and 2018 is as follows:

	December 31, 2019 (Dollars in Thousands)	December 31, 2018
Commercial, financial and agricultural	\$ 3,379,837	\$ 3,305,124
Real estate - mortgage	1,140,377	1,173,101
Real estate - construction	2,185,883	1,886,231
Consumer	47,800	46,316
Foreign	141,049	150,517
Total loans	<u>\$ 6,894,946</u>	<u>\$ 6,561,289</u>

(4) Allowance for Probable Loan Losses

The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the Subsidiary Banks. The allowances are established through charges to operations in the form of provisions for probable loan losses. Loan losses or recoveries are charged or credited directly to the allowances. The allowance for probable loan losses of each Subsidiary Bank is maintained at a level considered appropriate by management, based on estimated probable losses in the loan portfolio. The allowance for probable loan losses is derived from the following elements: (i) allowances established on specific impaired loans, which are based on a review of the individual characteristics of each loan, including the customer's ability to repay the loan, the underlying collateral values, and the industry in which the customer operates, (ii) allowances based on actual historical loss experience for similar types of loans in our loan portfolio, and (iii) allowances based on general economic conditions, changes in the mix of loans, company resources, border risk and credit quality indicators, among other things.

Our management continually reviews the allowance for loan losses of the Subsidiary Banks using the amounts determined from the allowances established on specific impaired loans, the allowance established on quantitative historical

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

loss percentages, and the allowance based on qualitative data to establish an appropriate amount to maintain in our allowance for probable loan losses. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, our estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses. While the calculation of the allowance for probable loan losses utilizes management's best judgment and all information available, the adequacy of the allowance is dependent on a variety of factors beyond our control, including, among other things, the performance of the entire loan portfolio, the economy, changes in interest rates and the view of regulatory authorities towards loan classifications.

The loan loss provision is determined using the following methods. On a weekly basis, loan past due reports are reviewed by the credit quality committee to determine if a loan has any potential problems and if a loan should be placed on our internal classified report. Additionally, our credit department reviews the majority of our loans for proper internal classification purposes regardless of whether they are past due and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, we will determine if a loan should be placed on an internal classified report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

World and U.S. economic conditions have continued to improve; however, there remains some uncertainty created by continued issues with negative demographic trends, weak labor participation rates, enormous government debt, excessive regulations, and unfunded entitlement programs that could create a financial crisis. The impact to the world and U.S. economy from these issues is being magnified by a lack of appropriate government action to find solutions to the problems. Economic risk factors are minimized by the underwriting standards of the Subsidiary Banks. The general underwriting standards encompass the following principles: (i) the financial strength of the borrower including strong earnings, a high net worth, significant liquidity and an acceptable debt to worth ratio, (ii) managerial and business competence, (iii) the ability to repay, (iv) for a new business, projected cash flows, (v) loan to value, (vi) in the case of a secondary guarantor, a guarantor financial statement, and (vii) financial and/or other character references. Although the underwriting standards reduce the risk of loss, unique risk factors exist in each type of loan in which the Subsidiary Banks invest.

Commercial and industrial loans are mostly secured by the collateral pledged by the borrower that is directly related to the business activities of the company such as accounts receivable and inventory. The ability of the borrower to collect accounts receivable, and to turn inventory into sales are risk factors in the repayment of the loan.

Construction and land development loans can carry risk of repayment when projects incur cost overruns, have an increase in the price of building materials, encounter zoning and environmental issues, or encounter other factors that may affect the completion of a project on time and on budget. Additionally, repayment risk may be negatively impacted when the market experiences a deterioration in the value of real estate. Risks specifically related to 1-4 family development loans also include the practice by the mortgage industry of more restrictive underwriting standards, which inhibits the buyer from obtaining long term financing and excessive housing and lot inventory in the market.

Commercial real estate loans demonstrate a risk of repayment when market values deteriorate, the business experiences turnover in key management, the business has an inability to attract or keep occupancy levels stable, or when the market experiences an exit of a specific business industry that is significant to the local economy, such as a manufacturing plant.

First and second lien residential 1-4 family mortgage and consumer loan repayments may be affected by unemployment or underemployment and deteriorating market values of real estate.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

A summary of the changes in the allowance for probable loan losses by loan class is as follows:

	December 31, 2019								
	Domestic						Foreign		
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31,	\$ 12,596	\$ 15,123	\$ 19,353	\$ 1,808	\$ 3,467	\$ 7,719	\$ 447	\$ 871	\$ 61,384
Losses charge to allowance	(14,412)	(39)	(7,353)	—	(201)	(435)	(487)	(1)	(22,928)
Recoveries credited to allowance	2,196	113	318	—	26	286	40	—	2,979
Net losses charged to allowance	(12,216)	74	(7,035)	—	(175)	(149)	(447)	(1)	(19,949)
Provision (credit) charged to operations	10,765	2,955	4,215	(22)	470	(35)	542	(47)	18,843
Balance at December 31,	\$ 11,145	\$ 18,152	\$ 16,533	\$ 1,786	\$ 3,762	\$ 7,535	\$ 542	\$ 823	\$ 60,278
	December 31, 2018								
	Domestic						Foreign		
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31,	\$ 27,905	\$ 11,675	\$ 16,663	\$ 1,109	\$ 2,950	\$ 6,103	\$ 440	\$ 842	\$ 67,687
Losses charge to allowance	(14,220)	(1)	(70)	—	(122)	(347)	(362)	(3)	(15,125)
Recoveries credited to allowance	1,981	25	246	—	36	369	43	10	2,710
Net losses charged to allowance	(12,239)	24	176	—	(86)	22	(319)	7	(12,415)
Provision (credit) charged to operations	(3,070)	3,424	2,514	699	603	1,594	326	22	6,112
Balance at December 31,	\$ 12,596	\$ 15,123	\$ 19,353	\$ 1,808	\$ 3,467	\$ 7,719	\$ 447	\$ 871	\$ 61,384
	December 31, 2017								
	Domestic						Foreign		
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31,	\$ 25,649	\$ 13,889	\$ 16,731	\$ 806	\$ 2,455	\$ 3,716	\$ 531	\$ 884	\$ 64,661
Losses charge to allowance	(12,094)	(213)	(40)	—	(101)	(340)	(309)	(1)	(13,098)
Recoveries credited to allowance	4,020	21	527	—	11	258	45	21	4,903
Net losses charged to allowance	(8,074)	(192)	487	—	(90)	(82)	(264)	20	(8,195)
Provision (credit) charged to operations	10,330	(2,022)	(555)	303	585	2,469	173	(62)	11,221
Balance at December 31,	\$ 27,905	\$ 11,675	\$ 16,663	\$ 1,109	\$ 2,950	\$ 6,103	\$ 440	\$ 842	\$ 67,687

The allowance for probable loan losses is a reserve established through a provision for probable loan losses charged to expense, which represents management's best estimate of probable loan losses when evaluating loans (i) individually or (ii) collectively. The increase in provision for probable loan losses charged to expense and charge-offs charged to the allowance for probable loan losses for the year ended December 31, 2019 can be primarily attributed to a relationship that is secured by multiple pieces of real property on which car dealerships are operated. The relationship began deteriorating in the fourth quarter of 2018, triggered by significant fraud by a high level insider of the car dealership resulting in the dealerships unexpectedly filing for bankruptcy and creating an exposure for potential loss since the operations of the dealerships were the source of repayment from the borrower. The relationship further deteriorated in the first quarter of 2019 after the sponsor of the court approved debtor in possession plan discontinued its role in the process and thus did not fulfill its obligation to assume full responsibility of the accrued and unpaid interest. Although the

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

relationship is secured by real property (the dealerships' real estate), the real property has specialized use, contributing to the potential exposure for probable loss. During the first quarter of 2019, in light of the circumstances and management's evaluation of the relationship, the decision was made to place the relationship on impaired, non-accrual status and place a specific reserve on the relationship in the amount of \$9.5 million. During the second quarter of 2019, management continued to evaluate the relationship and decided to foreclose on the underlying real estate collateral, resulting in a charge-off of approximately \$9.5 million, reflected in the tables above as part of the Commercial and Commercial Real Estate: Farmland and Commercial categories. The decrease in the provision for probable loan losses charged to expense for the years ended December 31, 2018 and December 31, 2017 can be attributed to a decrease in the historical loss experience in the commercial category of the calculation. As discussed in prior periods, charge-offs increased from historical levels due to the deterioration of one relationship that was secured by multiple pieces of transportation equipment beginning in the fourth quarter of 2014. We use a three-year historical charge-off experience in the calculation, therefore, as those charge-offs were eliminated from the calculation, the allowance for probable loan losses was impacted. As fluctuations occur in historical loss factors, management evaluates the need to adjust the qualitative factors used in the calculation to properly reflect probable loan losses.

The table below provides additional information on the balance of loans individually or collectively evaluated for impairment and their related allowance, by loan class:

	December 31, 2019			
	Loans Individually Evaluated For Impairment		Loans Collectively Evaluated For Impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$ 1,935	\$ 249	\$ 1,290,725	\$ 10,895
Commercial real estate: other construction & land development	938	116	2,184,945	18,037
Commercial real estate: farmland & commercial	1,208	—	1,895,539	16,533
Commercial real estate: multifamily	165	—	190,265	1,786
Residential: first lien	6,278	—	427,623	3,762
Residential: junior lien	692	—	705,784	7,535
Consumer	1,195	—	46,605	542
Foreign	264	—	140,785	823
Total	\$ 12,675	\$ 365	\$ 6,882,271	\$ 59,913

	December 31, 2018			
	Loans Individually Evaluated For Impairment		Loans Collectively Evaluated For Impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$ 9,179	\$ 656	\$ 1,119,790	\$ 11,940
Commercial real estate: other construction & land development	2,092	116	1,884,139	15,007
Commercial real estate: farmland & commercial	3,509	—	1,946,389	19,353
Commercial real estate: multifamily	507	—	225,750	1,808
Residential: first lien	6,244	—	439,556	3,467
Residential: junior lien	901	—	726,400	7,719
Consumer	1,175	—	45,141	447
Foreign	293	—	150,224	871
Total	\$ 23,900	\$ 772	\$ 6,537,389	\$ 60,612

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Loans accounted for on a non-accrual basis at December 31, 2019, 2018 and 2017 amounted to \$4,886,000, \$15,791,000 and \$54,730,000, respectively. The decrease in non-accrual commercial loans at December 31, 2019 compared to the same period of 2018 can be attributed to a relationship secured by equipment and accounts receivable that has been upgraded to Watch-List Substandard. The effect of such non-accrual loans reduced interest income by approximately \$340,000, \$1,119,000 and \$977,000 for the years ended December 31, 2019, 2018 and 2017, respectively. Amounts received on non-accruals are applied, for financial accounting purposes, first to principal and then to interest after all principal has been collected. Accruing loans contractually past due 90 days or more as to principal or interest payments at December 31, 2019, 2018 and 2017 amounted to approximately \$59,705,000, \$40,674,000 and \$7,257,000, respectively and can be attributed to a relationship that is secured by multiple pieces of real property on which car dealerships are operated.

The table below provides additional information on loans accounted for on a non-accrual basis by loan class:

	December 31, 2019	December 31, 2018
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 1,901	\$ 9,143
Commercial real estate: other construction & land development	938	2,092
Commercial real estate: farmland & commercial	1,208	3,509
Commercial real estate: multifamily	165	507
Residential: first lien	670	347
Residential: junior lien	—	171
Consumer	4	22
Total non-accrual loans	\$ 4,886	\$ 15,791

Impaired loans are those loans where it is probable that all amounts due according to contractual terms of the loan agreement will not be collected. We have identified these loans through our normal loan review procedures. Impaired loans are measured based on (i) the present value of expected future cash flows discounted at the loan's effective interest rate; (ii) the loan's observable market price; or (iii) the fair value of the collateral if the loan is collateral dependent. Substantially all of our impaired loans are measured at the fair value of the collateral. In limited cases, we may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

The following tables detail key information regarding our impaired loans by loan class for the year ended December 31, 2019:

	December 31, 2019				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)				
Loans with Related Allowance					
Domestic					
Commercial	\$ 510	\$ 516	\$ 249	\$ 514	\$ —
Commercial real estate: other construction & land development	126	169	116	131	—
Total impaired loans with related allowance	\$ 636	\$ 685	\$ 365	\$ 645	\$ —

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

	December 31, 2019			
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Average Recorded Investment</u>	<u>Interest Recognized</u>
	(Dollars in Thousands)			
Loans with No Related Allowance				
Domestic				
Commercial	\$ 1,425	\$ 1,516	\$ 18,794	\$ 2
Commercial real estate: other construction & land development	812	1,133	1,737	—
Commercial real estate: farmland & commercial	1,208	1,841	22,357	—
Commercial real estate: multifamily	165	168	651	—
Residential: first lien	6,278	6,445	6,988	309
Residential: junior lien	692	692	1,023	42
Consumer	1,195	1,196	1,117	—
Foreign	264	264	278	12
Total impaired loans with no related allowance	\$ 12,039	\$ 13,255	\$ 52,945	\$ 365

The following tables detail key information regarding our impaired loans by loan class for the year ended December 31, 2018:

	December 31, 2018				
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Recognized</u>
	(Dollars in Thousands)				
Loans with Related Allowance					
Domestic					
Commercial	\$ 1,563	\$ 2,161	\$ 656	\$ 1,741	\$ —
Commercial real estate: other construction & land development	135	169	116	141	—
Total impaired loans with related allowance	\$ 1,698	\$ 2,330	\$ 772	\$ 1,882	\$ —

	December 31, 2018			
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Average Recorded Investment</u>	<u>Interest Recognized</u>
	(Dollars in Thousands)			
Loans with No Related Allowance				
Domestic				
Commercial	\$ 7,616	\$ 7,730	\$ 16,194	\$ 3
Commercial real estate: other construction & land development	1,957	2,205	2,151	—
Commercial real estate: farmland & commercial	3,509	4,031	36,632	—
Commercial real estate: multifamily	507	538	565	—
Residential: first lien	6,244	6,386	7,136	305
Residential: junior lien	901	911	976	44
Consumer	1,175	1,190	1,211	2
Foreign	293	293	327	14
Total impaired loans with no related allowance	\$ 22,202	\$ 23,284	\$ 65,192	\$ 368

A portion of the impaired loans have adequate collateral and credit enhancements not requiring a related allowance for loan loss. Management is confident our loss exposure regarding these credits will be significantly reduced due to our long-standing practices that emphasize secured lending with strong collateral positions and guarantor support. Management is likewise confident the reserve for probable loan losses is adequate.

Management recognizes the risks associated with these impaired loans. However, management's decision to place loans in this category does not necessarily mean that losses will occur. In the current environment, troubled loan management can be protracted because of the legal and process problems that delay the collection of an otherwise collectible loan. Additionally, management believes that the collateral related to these impaired loans and/or the secondary support from guarantors mitigates the potential for losses from impaired loans.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The following table details loans accounted for as “troubled debt restructuring,” segregated by loan class. Loans accounted for as troubled debt restructuring are included in impaired loans.

	December 31, 2019	December 31, 2018
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 32	\$ 35
Residential: first lien	5,608	5,947
Residential: junior lien	692	730
Consumer	1,192	1,153
Foreign	264	293
Total troubled debt restructuring	\$ 7,788	\$ 8,158

The Subsidiary Banks charge-off that portion of any loan which management considers to represent a loss, as well as that portion of any other loan which is classified as a “loss” by bank examiners. Commercial and industrial or real estate loans are generally considered by management to represent a loss, in whole or part, when an exposure beyond any collateral coverage is apparent and when no further collection of the loss portion is anticipated based on the borrower’s financial condition and general economic conditions in the borrower’s industry. Generally, unsecured consumer loans are charged-off when 90 days past due.

While management considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. It is the judgment of our management that the allowance for probable loan losses at December 31, 2019 and December 31, 2018, was adequate to absorb probable losses from loans in the portfolio at that date.

The following table presents information regarding the aging of past due loans by loan class:

	December 31, 2019						
	30 - 59 Days	60 - 89 Days	90 Days or Greater	90 Days or greater & still accruing	Total Past Due	Current	Total Portfolio
	(Dollars in Thousands)						
Domestic							
Commercial	\$ 3,134	\$ 626	\$ 1,292	\$ 421	\$ 5,052	\$ 1,287,608	\$ 1,292,660
Commercial real estate: other construction & land development	509	55	—	—	564	2,185,319	2,185,883
Commercial real estate: farmland & commercial	8,058	2,031	54,928	54,878	65,017	1,831,730	1,896,747
Commercial real estate: multifamily	313	—	165	—	478	189,952	190,430
Residential: first lien	3,229	1,670	3,660	3,107	8,559	425,342	433,901
Residential: junior lien	1,112	477	1,200	1,200	2,789	703,687	706,476
Consumer	467	75	88	88	630	47,170	47,800
Foreign	1,347	3	11	11	1,361	139,688	141,049
Total past due loans	\$ 18,169	\$ 4,937	\$ 61,344	\$ 59,705	\$ 84,450	\$ 6,810,496	\$ 6,894,946

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

	December 31, 2018						
	30 - 59 Days	60 - 89 Days	90 Days or Greater	90 Days or greater & still accruing (Dollars in Thousands)	Total Past Due	Current	Total Portfolio
Domestic							
Commercial	\$ 4,651	\$ 1,089	\$ 19,851	\$ 10,890	\$ 25,591	\$ 1,103,378	\$ 1,128,969
Commercial real estate: other construction & land development	727	1,707	922	16	3,356	1,882,875	1,886,231
Commercial real estate: farmland & commercial	2,928	784	27,239	24,910	30,951	1,918,947	1,949,898
Commercial real estate: multifamily	927	—	578	71	1,505	224,752	226,257
Residential: first lien	3,998	1,677	3,362	3,079	9,037	436,763	445,800
Residential: junior lien	1,155	618	1,108	937	2,881	724,420	727,301
Consumer	486	19	45	32	550	45,766	46,316
Foreign	1,106	117	739	739	1,962	148,555	150,517
Total past due loans	<u>\$ 15,978</u>	<u>\$ 6,011</u>	<u>\$ 53,844</u>	<u>\$ 40,674</u>	<u>\$ 75,833</u>	<u>\$ 6,485,456</u>	<u>\$ 6,561,289</u>

The decrease in commercial loans past due 90 days or greater at December 31, 2019 compared to December 31, 2018 can be primarily attributed to a relationship secured by equipment and accounts receivable that was brought current and the charge-off of the previously discussed relationship secured by real property on which car dealerships are operated and the foreclosure of the underlying real estate assets securing the relationship. The increase in commercial real estate: farmland and commercial loans past due 90 days or greater at December 31, 2019 compared to December 31, 2018 can be primarily attributed to a loan relationship secured by real property on which a private education centers are operated. Our internal classified report is segregated into the following categories: (i) “Special Review Credits,” (ii) “Watch List—Pass Credits,” or (iii) “Watch List—Substandard Credits.” The loans placed in the “Special Review Credits” category reflect our opinion that the loans reflect potential weakness which require monitoring on a more frequent basis. The “Special Review Credits” are reviewed and discussed on a regular basis with the credit department and the lending staff to determine if a change in category is warranted. The loans placed in the “Watch List—Pass Credits” category reflect our opinion that the credit contains weaknesses which represent a greater degree of risk, which warrant “extra attention.” The “Watch List—Pass Credits” are reviewed and discussed on a regular basis with the credit department and the lending staff to determine if a change in category is warranted. The loans placed in the “Watch List—Substandard Credits” classification are considered to be potentially inadequately protected by the current sound worth and debt service capacity of the borrower or of any pledged collateral. These credit obligations, even if apparently protected by collateral value, have shown defined weaknesses related to adverse financial, managerial, economic, market or political conditions which may jeopardize repayment of principal and interest. Furthermore, there is the possibility that we could sustain some future loss if such weaknesses are not corrected. For loans that are classified as impaired, management evaluates these credits in accordance with the provision of ASC 310-10, “Receivables,” and, if deemed necessary, a specific reserve is allocated to the credit. The specific reserve allocated under ASC 310-10, is based on (i) the present value of expected future cash flows discounted at the loan’s effective interest rate; (ii) the loan’s observable market price; or (iii) the fair value of the collateral if the loan is collateral dependent. Substantially all of our loans evaluated as impaired under ASC 310-10 are measured using the fair value of collateral method. In limited cases, we may use other methods to determine the specific reserve of a loan under ASC 310-10 if such loan is not collateral dependent.

The allowance based on historical loss experience on our remaining loan portfolio, which includes the “Special Review Credits,” “Watch List—Pass Credits,” and “Watch List—Substandard Credits” is determined by segregating the remaining loan portfolio into certain categories such as commercial loans, installment loans, international loans, loan concentrations and overdrafts. Installment loans are then further segregated by number of days past due. A historical loss percentage, adjusted for (i) management’s evaluation of changes in lending policies and procedures, (ii) current economic conditions in the market area served, (iii) other risk factors, (iv) the effectiveness of the internal loan review function, (v) changes in loan portfolios, and (vi) the composition and concentration of credit volume is applied to each category. Each category is then added together to determine the allowance allocated under ASC 450-20.

A summary of the loan portfolio by credit quality indicator by loan class is as follows:

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

		December 31, 2019			
	Pass	Special Review	Watch List—Pass	Watch List—Substandard	Watch List—Impaired
(Dollars in Thousands)					
Domestic					
Commercial	\$ 1,228,110	\$ 569	\$ 39	\$ 62,007	\$ 1,935
Commercial real estate: other construction & land development	2,090,370	18,721	41,949	33,905	938
Commercial real estate: farmland & commercial	1,710,446	13,184	20,183	151,726	1,208
Commercial real estate: multifamily	190,265	—	—	—	165
Residential: first lien	426,546	253	144	680	6,278
Residential: junior lien	704,958	826	—	—	692
Consumer	46,605	—	—	—	1,195
Foreign	140,785	—	—	—	264
Total	\$ 6,538,085	\$ 33,553	\$ 62,315	\$ 248,318	\$ 12,675

		December 31, 2018			
	Pass	Special Review	Watch List—Pass	Watch List—Substandard	Watch List—Impaired
(Dollars in Thousands)					
Domestic					
Commercial	\$ 998,625	\$ 441	\$ 44,544	\$ 76,180	\$ 9,179
Commercial real estate: other construction & land development	1,817,098	1,648	9,055	56,338	2,092
Commercial real estate: farmland & commercial	1,726,711	62,046	38,373	119,259	3,509
Commercial real estate: multifamily	224,823	—	—	927	507
Residential: first lien	438,773	—	142	641	6,244
Residential: junior lien	725,538	—	862	—	901
Consumer	45,141	—	—	—	1,175
Foreign	150,224	—	—	—	293
Total	\$ 6,126,933	\$ 64,135	\$ 92,976	\$ 253,345	\$ 23,900

The decrease in Special Review credits in the commercial real estate: farmland and commercial category of the portfolio at December 31, 2019 compared to December 31, 2018 can be primarily attributed to a relationship secured by real estate on which children's learning centers are operated that was downgraded to Watch-List Substandard. The increase in Special Review credits in the commercial real estate: other construction and land development category can be primarily attributed to two relationships that were downgraded to Special Review from the Pass categories. Both are relationships secured by real estate on which commercial buildings are being constructed. The decrease in Watch-List Pass credits in the commercial category can be primarily attributed to the reclassification of a relationship in the oil and gas production business to the Pass category. The increase in Watch-List Pass credits in the commercial real estate: other construction and land development category can be primarily attributed to a reclassification of a relationship secured by real estate on which commercial buildings are being constructed from the Watch-List Substandard classification offset by a downgrade of a relationship also secured by real estate on which commercial buildings are being constructed from Pass to Watch-List Pass. The decrease in Watch-List Pass commercial real estate: farmland and commercial credits at December 31, 2019 compared to December 31, 2018 can be primarily attributed to the payoff of a relationship secured by real estate on which boat storage slips were operated and the upgrade of a relationship secured by a retail center from Watch-List Pass to Pass. The decrease in Watch-List Substandard credits in the commercial category at December 31, 2019 compared to December 31, 2018 can be primarily attributed to the previously mentioned relationship secured by real estate on which car dealerships were operated was foreclosed upon and the pay-off of a relationship secured by equipment. The decrease in Watch-List Substandard commercial real estate: farmland and commercial credits at December 31, 2019 compared to December 31, 2018 can be primarily attributed to the upgrade of the previously mentioned relationship secured by real estate on which commercial buildings are being constructed to Watch-List-Pass. The increase in Watch-List Substandard commercial real estate: farmland and commercial credits at December 31, 2019 compared to December 31, 2018 can be primarily attributed to the downgrade of the previously mentioned relationship secured by real estate on which children's education centers are operated from Special Review.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(5) Bank Premises and Equipment

A summary of bank premises and equipment, by asset classification, at December 31, 2019 and 2018 were as follows:

	Estimated useful lives	2019	2018
(Dollars in Thousands)			
Bank buildings and improvements	5 - 40 years	\$ 573,257	\$ 563,302
Furniture, equipment and vehicles	1 - 20 years	313,880	292,958
Land		118,099	118,806
Real estate held for future expansion:			
Land, building, furniture, fixture and equipment	7 - 27 years	—	—
Less: accumulated depreciation		(498,641)	(468,167)
Bank premises and equipment, net		<u>\$ 506,595</u>	<u>\$ 506,899</u>

(6) Goodwill and Other Intangible Assets

The majority of our identified intangibles are in the form of amortizable core deposit premium. A small portion of the fully amortized identified intangibles represent identified intangibles in the acquisition of the rights to the insurance agency contracts of InsCorp, Inc., acquired in 2008. Information on our identified intangible assets follows:

	Carrying Amount	Accumulated Amortization	Net
(Dollars in Thousands)			
December 31, 2019:			
Core deposit premium	\$ 58,675	\$ 58,675	\$ —
Identified intangible (contract rights)	2,022	2,022	—
Total identified intangibles	<u>\$ 60,697</u>	<u>\$ 60,697</u>	<u>\$ —</u>
December 31, 2018:			
Core deposit premium	\$ 58,675	\$ 58,675	\$ —
Identified intangible (contract rights)	2,022	2,022	—
Total identified intangibles	<u>\$ 60,697</u>	<u>\$ 60,697</u>	<u>\$ —</u>

Amortization expense of intangible assets was \$0, \$0 and \$25 for the years ended December 31, 2019, 2018 and 2017.

There were no changes in the carrying amount of goodwill for the years ended December 31, 2019 and 2018.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(7) Deposits

Deposits as of December 31, 2019 and 2018 and related interest expense for the years ended December 31, 2019, 2018 and 2017 were as follows:

	2019	2018
	(Dollars in Thousands)	
Deposits:		
Demand - non-interest bearing		
Domestic	\$ 2,815,835	\$ 2,758,768
Foreign	730,070	696,072
Total demand non-interest bearing	3,545,905	3,454,840
Savings and interest bearing demand		
Domestic	2,477,668	2,531,854
Foreign	790,161	736,383
Total savings and interest bearing demand	3,267,829	3,268,237
Time, certificates of deposit \$100,000 or more		
Domestic	636,005	590,895
Foreign	827,031	807,486
Less than \$100,000		
Domestic	302,620	323,377
Foreign	246,644	251,710
Total time, certificates of deposit	2,012,300	1,973,468
Total deposits	\$ 8,826,034	\$ 8,696,545

	2019	2018	2017
	(Dollars in Thousands)		
Interest expense:			
Savings and interest bearing demand			
Domestic	\$ 13,462	\$ 11,029	\$ 5,453
Foreign	2,917	1,735	755
Total savings and interest bearing demand	16,379	12,764	6,208
Time, certificates of deposit \$100,000 or more			
Domestic	7,804	4,741	3,644
Foreign	9,407	5,798	4,105
Less than \$100,000			
Domestic	2,232	1,589	1,312
Foreign	1,527	968	675
Total time, certificates of deposit	20,970	13,096	9,736
Total interest expense on deposits	\$ 37,349	\$ 25,860	\$ 15,944

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Scheduled maturities of time deposits as of December 31, 2019 were as follows:

	<u>Total</u>
	<u>(in thousands)</u>
2020	\$ 1,848,026
2021	111,775
2022	38,415
2023	13,112
2024	944
Thereafter	28
Total	\$ 2,012,300

Scheduled maturities of time deposits in amounts of \$100,000 or more at December 31, 2019, were as follows:

	<u>Total</u>
	<u>(in thousands)</u>
Due within 3 months or less	\$ 536,400
Due after 3 months and within 6 months	351,059
Due after 6 months and within 12 months	465,735
Due after 12 months	109,842
	<u>\$ 1,463,036</u>

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2019 and December 31, 2018 were \$929,860 and \$869,000, in thousands, respectively.

(8) Securities Sold Under Repurchase Agreements

Our Subsidiary Banks have entered into repurchase agreements with an investment banking firm and individual customers of the Subsidiary Banks. The purchasers have agreed to resell to the Subsidiary Banks identical securities upon the maturities of the agreements. Securities sold under repurchase agreements were mortgage-backed securities and averaged \$267,439,000 and \$314,876,000 during 2019 and 2018, respectively, and the maximum amount outstanding at any month end during 2019 and 2018 was \$299,827,000 and \$370,495,000 respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Further information related to repurchase agreements at December 31, 2019 and 2018 is set forth in the following table:

	Collateral Securities		Repurchase Borrowing	
	Book Value of Securities Sold	Fair Value of Securities Sold	Balance of Liability	Weighted Average Interest Rate
(Dollars in Thousands)				
December 31, 2019 term:				
Overnight agreements	\$ 317,107	\$ 318,397	\$ 225,243	0.87 %
1 to 29 days	—	—	—	—
30 to 90 days	—	—	—	—
Over 90 days	11,564	11,529	11,293	1.28
Total	<u>\$ 328,671</u>	<u>\$ 329,926</u>	<u>\$ 236,536</u>	0.89 %
December 31, 2018 term:				
Overnight agreements	\$ 357,642	\$ 349,081	\$ 218,852	0.85 %
1 to 29 days	—	—	—	—
30 to 90 days	—	—	—	—
Over 90 days	11,444	11,096	11,137	1.27
Total	<u>\$ 369,086</u>	<u>\$ 360,177</u>	<u>\$ 229,989</u>	0.87 %

The book value and fair value of securities sold includes the entire book value and fair value of securities partially or fully pledged under repurchase agreements.

(9) Other Borrowed Funds

Other borrowed funds include Federal Home Loan Bank borrowings, which are short and long-term fixed borrowings issued by the Federal Home Loan Bank of Dallas and the Federal Home Loan Bank of Topeka at the market price offered at the time of funding. These borrowings are secured by mortgage-backed investment securities and a portion of our loan portfolio.

Further information regarding our other borrowed funds at December 31, 2019 and 2018 is set forth in the following table:

	December 31,	
	2019	2018
(Dollars in Thousands)		
Federal Home Loan Bank advances—short-term		
Balance at year end	\$ 190,000	\$ 268,975
Rate on balance outstanding at year end	1.48 %	2.70 %
Average daily balance	\$ 190,431	\$ 621,357
Average rate	2.60 %	1.97 %
Maximum amount outstanding at any month end	\$ 371,775	\$ 1,007,100
Federal Home Loan Bank advances—long-term ⁽¹⁾		
Balance at year end	\$ 436,511	\$ 436,690
Rate on balance outstanding at year end	1.73 %	1.73 %
Average daily balance	\$ 436,593	\$ 302,373
Average rate	1.71 %	1.71 %
Maximum amount outstanding at any month end	\$ 436,675	\$ 436,700

- (1) Long-term advances at December 31, 2019 and December 31, 2018 consisted of both amortizing and non-amortizing advances. The non-amortizing advances mature in the following increments: \$75,000,000 in July 2028, \$100,000,000 in March 2033 and \$250,000,000 in August 2033 and are callable by the FHLB on a quarterly basis. Two amortizing advances are outstanding at December 31, 2019 in the amounts of \$3,146,000 and \$8,365,000 and mature in December 2033 and November 2033, respectively. The amortization on the amortizing long-term advances totals approximately \$179,000 per year for each of the next five years.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(10) Junior Subordinated Deferrable Interest Debentures

We have formed five statutory business trusts under the laws of the State of Delaware for the purpose of issuing trust preferred securities. These statutory business trusts (the “Trusts”) have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the “Debentures”) we issued. As of December 31, 2019 and December 31, 2018, the principal amount of debentures outstanding totaled \$134,642,000 and \$160,416,000, respectively.

The Debentures are subordinated and junior in right of payment to all our present and future senior indebtedness (as defined in the respective indentures) and are *pari passu* with one another. The interest rate payable on, and the payment terms of the Debentures are the same as the distribution rate and payment terms of the respective issues of Capital and Common Securities issued by the Trusts. We have fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. We have the right, unless an Event of Default (as defined in the Indentures) has occurred and is continuing, to defer payment of interest on the Debentures for up to twenty consecutive quarterly periods on Trusts VIII, IX, X, XI and XII. If interest payments on any of the Debentures are deferred, distributions on both the Capital and Common Securities related to that Debenture would also be deferred. The redemption prior to maturity of any of the Debentures may require the prior approval of the Federal Reserve and/or other regulatory bodies.

For financial reporting purposes, the Trusts are treated as investments and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders’ equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. At December 31, 2019 and December 31, 2018, the total \$134,642,000 and \$160,416,000, respectively, of the Capital Securities outstanding qualified as Tier 1 capital.

The following table illustrates key information about each of the Debentures and their interest rates at December 31, 2019:

	Junior Subordinated Deferrable Interest Debentures (Dollars in Thousands)	Repricing Frequency	Interest Rate	Interest Rate Index(1)	Maturity Date	Optional Redemption Date⁽¹⁾
Trust VIII	\$ 25,774	Quarterly	5.04 %	LIBOR + 3.05	October 2033	October 2008
Trust IX	41,238	Quarterly	3.72 %	LIBOR + 1.62	October 2036	October 2011
Trust X	21,021	Quarterly	3.56 %	LIBOR + 1.65	February 2037	February 2012
Trust XI	25,990	Quarterly	3.72 %	LIBOR + 1.62	July 2037	July 2012
Trust XII	20,619	Quarterly	3.36 %	LIBOR + 1.45	September 2037	September 2012
	<u>\$ 134,642</u>					

(1) The Capital Securities may be redeemed in whole or in part on any interest payment date after the Optional Redemption Date.

(11) Earnings per Share (“EPS”)

Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding. The computation of diluted EPS assumes the issuance of common shares for all dilutive potential common shares

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

outstanding during the reporting period. The calculation of the basic EPS and the diluted EPS for the years ended December 31, 2019, 2018, and 2017 is set forth in the following table:

	<u>Net Income</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per Share</u> <u>Amount</u>
	(Dollars in Thousands, Except Per Share Amounts)		
December 31, 2019:			
Basic EPS			
Net income available to common shareholders	\$ 205,104	65,476,606	\$ 3.13
Potential dilutive common shares and warrants	—	209,078	
Diluted EPS	<u>\$ 205,104</u>	<u>65,685,684</u>	\$ 3.12
December 31, 2018:			
Basic EPS			
Net income available to common shareholders	\$ 215,931	66,106,580	\$ 3.27
Potential dilutive common shares and warrants	—	527,240	
Diluted EPS	<u>\$ 215,931</u>	<u>66,633,820</u>	\$ 3.24
December 31, 2017:			
Basic EPS			
Net income available to common shareholders	\$ 157,436	66,046,155	\$ 2.38
Potential dilutive common shares	—	732,281	
Diluted EPS	<u>\$ 157,436</u>	<u>66,778,436</u>	\$ 2.36

(12) Employees' Profit Sharing Plan

We have a deferred profit sharing plan for full-time employees with a minimum of one year of continuous employment. Our annual contribution to the plan is based on a percentage, as determined by our Board of Directors, of income before income taxes, as defined, for the year. Allocation of the contribution among officers and employees' accounts is based on length of service and amount of salary earned. Profit sharing costs of \$4,200,000, \$3,850,000 and \$3,750,000 were charged to income for the years ended December 31, 2019, 2018, and 2017, respectively.

(13) International Operations

We provide international banking services for our customers through our Subsidiary Banks. Neither we nor our Subsidiary Banks have facilities located outside the United States. International operations are distinguished from domestic operations based upon the domicile of the customer.

Because the resources we employ are common to both international and domestic operations, it is not practical to determine net income generated exclusively from international activities.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

A summary of assets attributable to international operations at December 31, 2019 and 2018 are as follows:

	2019	2018
	(Dollars in Thousands)	
Loans:		
Commercial	\$ 88,979	\$ 101,955
Others	52,070	48,562
	141,049	150,517
Less allowance for probable loan losses	(823)	(871)
Net loans	\$ 140,226	\$ 149,646
Accrued interest receivable	\$ 743	\$ 811

At December 31, 2019, we had \$124,543,000 in outstanding standby and commercial letters of credit to facilitate trade activities.

Revenues directly attributable to international operations were approximately \$5,445,000, \$5,412,000 and \$5,248,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

(14) Income Taxes

We file a consolidated U.S. Federal and State income tax return. The current and deferred portions of net income tax expense included in the consolidated statements of income are presented below for the years ended December 31:

	2019	2018	2017
	(Dollars in Thousands)		
Current			
U.S.	\$ 48,559	\$ 48,144	\$ 56,974
State	2,944	3,370	2,662
Foreign	38	(5)	—
Total current taxes	51,541	51,509	59,636
Deferred			
U.S.	2,979	5,130	4,620
State	330	13	(50)
Total deferred taxes	3,309	5,143	4,570
Total income taxes	\$ 54,850	\$ 56,652	\$ 64,206

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Total income tax expense differs from the amount computed by applying the U.S. Federal income tax rate of 21% for 2019 and 2018 and 35% for 2017 to income before income taxes. The reasons for the differences for the years ended December 31 are as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(Dollars in Thousands)		
Computed expected tax expense	\$ 55,086	\$ 57,831	\$ 77,643
Change in taxes resulting from:			
Tax-exempt interest income	(2,550)	(3,101)	(4,701)
State tax, net of federal income taxes, tax credit and refunds	2,587	2,673	1,697
Resolution of IRS exam	—	—	(4,985)
Other investment income	(1,480)	(1,561)	(3,198)
Deferred tax adjustment due to federal tax rate change	—	(1,618)	(3,168)
Net investment in low income housing investments	623	2,518	387
Other	584	(90)	531
Actual tax expense	<u>\$ 54,850</u>	<u>\$ 56,652</u>	<u>\$ 64,206</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are reflected below:

	<u>2019</u>	<u>2018</u>
	(Dollars in Thousands)	
Deferred tax assets:		
Loans receivable, principally due to the allowance for probable loan losses	\$ 12,050	\$ 12,257
Other real estate owned	2,501	2,459
Impairment charges on available-for-sale securities	1,054	1,054
Accrued expenses	98	81
Net unrealized losses on available for sale investment securities	—	15,182
Other	6,019	5,076
Total deferred tax assets	<u>21,722</u>	<u>36,109</u>
Deferred tax liabilities:		
Bank premises and equipment, principally due to differences on depreciation	(12,478)	(12,596)
Net unrealized gains on available for sale investment securities	(508)	—
Identified intangible assets and goodwill	(13,649)	(13,490)
Other	(18,849)	(14,787)
Total deferred tax liabilities	<u>(45,484)</u>	<u>(40,873)</u>
Net deferred tax liability	<u>\$ (23,762)</u>	<u>\$ (4,764)</u>

The net deferred tax liability of \$23,762,000 at December 31, 2019 and \$4,764,000 at December 31, 2018 is included in other liabilities in the consolidated statements of condition.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

On December 22, 2017, the Tax Cuts and Jobs Act (“Tax Act”) was signed into law. The Tax Act materially changes U.S. corporate income tax rates, among other things. We were in a net deferred tax liability position at the time the Tax Act was enacted and subsequently revalued the carrying value of the net deferred liability and its components to the new 21% effective tax rate. The change in the tax rate resulted in a net benefit to us of \$4,786,000 and was included as a reduction to income tax expense in the consolidated income statement.

(15) Stock Options

On April 5, 2012, the Board of Directors adopted the 2012 International Bancshares Corporation Stock Option Plan (the “2012 Plan”). There are 800,000 shares available for stock option grants under the 2012 Plan. Under the 2012 Plan, both qualified incentive stock options (“ISOs”) and non-qualified stock options (“NQSOS”) may be granted. Options granted may be exercisable for a period of up to 10 years from the date of grant, excluding ISOs granted to 10% shareholders, which may be exercisable for a period of up to only five years. As of December 31, 2019, 28,651 shares were available for future grants under the 2012 Plan.

The fair value of each option award granted under the plan is estimated on the date of grant using a Black-Scholes-Merton option valuation model that uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the price of our stock. We use historical data to estimate the expected dividend yield and employee termination rates within the valuation model. The expected term of options is derived from historical exercise behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2019	2018
Expected Life (Years)	7.00	7.00
Dividend yield	2.93 %	1.73 %
Interest rate	1.97 %	2.68 %
Volatility	26.97 %	31.65 %

A summary of option activity under the stock option plans for the twelve months ended December 31, 2019 is as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value (\$) (in Thousands)
Options outstanding at December 31, 2018	788,977	\$ 25.91		
Plus: Options granted	16,500	35.34		
Less:				
Options exercised	110,938	17.29		
Options expired	—	—		
Options forfeited	35,951	26.74		
Options outstanding at December 31, 2019	<u>658,588</u>	27.55	5.76	\$ 10,219
Options fully vested and exercisable at December 31, 2019	319,085	\$ 22.14	4.38	\$ 6,680

Stock-based compensation expense included in the consolidated statements of income for the years ended December 31, 2019, 2018 and 2017 was approximately \$980,000, \$1,035,000 and \$903,000, respectively. As of December 31, 2019, there was approximately \$1,922,000 of total unrecognized stock-based compensation cost related to non-vested options granted under our plans that will be recognized over a weighted average period of 1.9 years.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Other information pertaining to option activity during the twelve months ended December 31, 2019, 2018 and 2017 is as follows:

	Twelve Months Ended December 31,		
	2019	2018	2017
Weighted average grant date fair value of stock options granted	\$ 7.38	\$ 11.78	\$ —
Total fair value of stock options vested	\$ 1,333,000	\$ 1,077,000	\$ 1,182,000
Total intrinsic value of stock options exercised	\$ 2,373,000	\$ 2,045,000	\$ 2,595,000

(1) No stock options were granted during the twelve months ended December 31, 2017.

(16) Long Term Restricted Stock Units

As a former participant in the Troubled Asset Relief Program Capital Purchase Program (the “CPP”) we were subject to certain compensation restrictions, including a prohibition on the payment or accrual of any bonuses to certain officers and employees except for awards of CPP-compliant long-term restricted stock and stock units.

On December 18, 2009, our board of directors (the “Board”) adopted the 2009 International Bancshares Corporation Long-Term Restricted Stock Unit Plan (the “Plan”) to give us additional flexibility in the compensation of our officers, employees, consultants and advisors in compliance with all applicable laws and restrictions.

The Plan authorizes us to issue Restricted Stock Units (“RSUs”) to our officers, employees, consultants and advisors. On December 18, 2009, pursuant to the Plan, the Board adopted resolutions creating the Long-Term Restricted Stock Unit Plan Committee to administer the Plan. RSUs issued under the Plan are not equity and are payable only in cash. The Plan provides for both the issuance of CPP-compliant long-term RSUs as well as RSUs that are not CPP-compliant. No grants have been made under the Plan since December 2012 and there are currently no outstanding grants under the Plan. The plan was terminated on August 6, 2019.

(17) Commitments, Contingent Liabilities and Other Matters

Cash of approximately \$125,764,000 and \$115,721,000 at December 31, 2019 and 2018, respectively, was maintained to satisfy regulatory reserve requirements.

We are involved in various legal proceedings that are in various stages of litigation. We have determined, based on discussions with our counsel that any material loss in such actions, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to our consolidated statements of condition and related statements of income, comprehensive income, shareholders’ equity and cash flows. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

(18) Transactions with Related Parties

In the ordinary course of business, the Subsidiary Banks make loans to our directors and executive officers, including their affiliates, families and companies in which they are principal owners. In the opinion of management, these loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than normal risk of collectability or present other unfavorable features. The aggregate amounts receivable from such related parties amounted to approximately \$37,605,000 and \$33,042,000 at December 31, 2019 and 2018, respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(19) Financial Instruments with Off-Statement of Condition Risk and Concentrations of Credit Risk

In the normal course of business, the Subsidiary Banks are party to financial instruments with off-statement of condition risk to meet the financing needs of their customers. These financial instruments include commitments to their customers. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated statement of condition. The contract amounts of these instruments reflect the extent of involvement the Subsidiary Banks have in particular classes of financial instruments. At December 31, 2019, the following financial amounts of instruments, whose contract amounts represent credit risks, were outstanding:

Commitments to extend credit	\$	2,622,491,000
Credit card lines		11,098,000
Standby letters of credit		124,054,000
Commercial letters of credit		489,000

We enter into a standby letter of credit to guarantee performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved is represented by the contractual amounts of those instruments. Under the standby letters of credit, we are required to make payments to the beneficiary of the letters of credit upon request by the beneficiary so long as all performance criteria have been met. At December 31, 2019, the maximum potential amount of future payments is approximately \$124,054,000. At December 31, 2019, the fair value of these guarantees is not significant. Unsecured letters of credit totaled approximately \$49,965,000 and \$42,729,000 at December 31, 2019 and 2018, respectively.

We enter into commercial letters of credit on behalf of our customers which authorize a third party to draw drafts upon us up to a stipulated amount and with specific terms and conditions. A commercial letter of credit is a conditional commitment on our part to provide payment on drafts drawn in accordance with the terms of the commercial letter of credit.

The Subsidiary Banks' exposure to credit loss in the event of nonperformance by the other party to the above financial instruments is represented by the contractual amounts of the instruments. The Subsidiary Banks use the same credit policies in making commitments and conditional obligations as they do for on-statement of condition instruments. The Subsidiary Banks control the credit risk of these transactions through credit approvals, limits and monitoring procedures. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates normally less than one year or other termination clauses and may require the payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Subsidiary Banks evaluate each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Subsidiary Banks upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include residential and commercial real estate, bank certificates of deposit, accounts receivable and inventory.

The Subsidiary Banks make commercial, real estate and consumer loans to customers principally located in South, Central and Southeast Texas and the State of Oklahoma. Although the loan portfolio is diversified, a substantial portion of its debtors' ability to honor their contracts is dependent upon the economic conditions in these areas, especially in the real estate and commercial business sectors.

(20) Capital Requirements

On December 23, 2008, as part of the Troubled Asset Relief Program Capital Purchase Program of the United States Department of the Treasury ("Treasury"), we issued to the Treasury a warrant to purchase 1,326,238 shares of our common stock at a price per share of \$24.43 and with a term of ten years (the "Warrant").

On June 12, 2013, the U.S. Treasury sold the Warrant to a third party. On September 19, 2018, we entered into an agreement to repurchase the Warrant from the third party at an aggregate purchase price of \$29,005,000, which

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

transaction was consummated in the third quarter of 2018. The repurchase of the outstanding Warrant eliminated any restrictions on certain shareholder distributions or payment of cash dividends in excess of \$0.33 per semi-annual period that would have impacted the exercise price of the Warrant while it remained outstanding.

Bank regulatory agencies limit the amount of dividends, which the Subsidiary Banks can pay, without obtaining prior approval from such agencies. At December 31, 2019, the Subsidiary Banks could pay dividends of up to \$891,500,000 without prior regulatory approval and without adversely affecting their “well-capitalized” status under regulatory capital rules in effect at December 31, 2019. In addition to legal requirements, regulatory authorities also consider the adequacy of the Subsidiary Banks’ total capital in relation to their deposits and other factors. These capital adequacy considerations also limit amounts available for payment of dividends. We historically have not allowed any Subsidiary Bank to pay dividends in such a manner as to impair its capital adequacy.

We and the Subsidiary Banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-statement of condition items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Current quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the table on the following page) of Total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2019, that we met all capital adequacy requirements to which we are subject.

In July 2013, the Federal Deposit Insurance Corporation (“FDIC”) and other regulatory bodies established a new, comprehensive capital framework for U.S. banking organizations, consisting of minimum requirements that increase both the quantity and quality of capital held by banking organizations. The final rules are a result of the implementation of the BASEL III capital reforms and various Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank”) related capital provisions. Consistent with the Basel international framework, the rules include a new minimum ratio of Common Equity Tier 1 (“CET1”) to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets. The capital conservation buffer began phasing-in on January 1, 2016 at .625% and increased each year until January 1, 2019, when we were required to have a 2.5% capital conservation buffer, effectively resulting in a minimum ratio of CET1 capital to risk-weighted assets of at least 7% upon full implementation. The rules also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. Regarding the quality of capital, the rules emphasize CET1 capital and implements strict eligibility criteria for regulatory capital instruments. The rules also improve the methodology for calculating risk-weighted assets to enhance risk sensitivity. The rules were subject to a four-year phase-in period for mandatory compliance and we were required to begin to phase-in the new rules beginning on January 1, 2015. We believe that as of December 31, 2019, we meet all fully phased-in capital adequacy requirements.

On November 21, 2017, the OCC, the Federal Reserve and the FDIC finalized a proposed rule that extends the current treatment under the regulatory capital rules for certain regulatory capital deductions and risk weights and certain minority interest requirements, as they apply to banking organizations that are not subject to the advanced approaches capital rules. Effective January 1, 2018, the rule also paused the full transition to the Basel III treatment of mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions and minority interests. The agencies are also considering whether to make adjustments to the capital rules in response to CECL (the FASB Standard relating to current expected credit loss) and its potential impact on regulatory capital.

On December 7, 2017, the Basel Committee on Banking Supervision unveiled the latest round of its regulatory capital framework, commonly called “Basel IV.” The framework makes changes to the capital framework first introduced as “Basel III” in 2010. The committee targeted 2022-2027 as the timeframe for implementation by regulators in individual countries, including the U.S. federal bank regulatory agencies (after notice and comment).

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 capital to risk-weighted assets above the minimum but below the conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

As of December 31, 2019, our capital levels exceed all capital adequacy requirements under the Basel III Capital Rules as currently applicable to us. Based on the ratios presented below, capital levels as of December 31, 2019 exceed the minimum levels necessary to be considered “well-capitalized.”

On May 24, 2018, the EGRRCPA was enacted and, among other things, it includes a simplified capital rule change which effectively exempts banks with assets of less than \$10 billion that exceed the “community bank leverage ratio,” from all risk-based capital requirements, including Basel III and its predecessors. The federal banking agencies must establish the “community bank leverage ratio” (a ratio of tangible equity to average consolidated assets) between 8% and 10% before community banks can begin to take advantage of this regulatory relief provision. Some of the Subsidiary Banks, with assets of less than \$10 billion, may qualify for this exemption. Additionally, under the EGRRCPA, qualified bank holding companies with assets of up to \$3 billion (currently \$1 billion) will be eligible for the Federal Reserve’s Small Bank Holding Company Policy Statement, which eases limitations on the issuance of debt by holding companies. On August 28, 2018, the Federal Reserve issued an interim final rule expanding the applicability of its Small Bank Holding Company Policy Statement. While holding companies that meet the conditions of the policy statement are excluded from consolidated capital requirements, their depository institutions continue to be subject to minimum capital requirements. Finally, for banks that continue to be subject to the risk-based capital rules of Basel III (e.g., 150%), certain commercial real estate loans that were formally classified as high volatility commercial real estate 31 (“HVCRE”) will not be subject to heightened risk weights if they meet certain criteria. Also, while acquisition, development, and construction (“ADC”) loans will generally be subject to heightened risk weights, certain exceptions will apply. On September 18, 2018, the federal banking agencies issued a proposed rule modifying the agencies’ capital rules for HVCRE.

As of December 31, 2019, the most recent notification from the Federal Deposit Insurance Corporation categorized all the Subsidiary Banks as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as “well-capitalized,” we must maintain minimum Total risk-based, Tier 1 risk based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed our categorization as well-capitalized.

In December 2018, the federal bank regulators issued a final rule that would provide an optional three-year phase-in period for the day-one regulatory capital effects of the adoption of ASU 2016-13 to ASC 326 “Financial Instruments – Credit Losses,” as amended, on January 1, 2020.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Our actual capital amounts and ratios for 2019 under current guidelines are presented in the following table:

	Actual		For Capital Adequacy Purposes Phase-In Schedule		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount (greater than or equal to)	Ratio (greater than or equal to)	Amount (greater than or equal to)	Ratio (greater than or equal to)
(Dollars in Thousands)						
As of December 31, 2019:						
Common Equity Tier 1 (to Risk Weighted Assets):						
Consolidated	\$ 1,833,174	18.58 %	\$ 690,746	7.000 %	N/A	N/A
International Bank of Commerce, Laredo	1,268,078	18.23	486,950	7.000	\$ 452,168	6.50 %
International Bank of Commerce, Oklahoma	201,202	16.91	83,303	7.000	77,353	6.50
International Bank of Commerce, Brownsville	185,112	22.70	57,084	7.000	53,006	6.50
International Bank of Commerce, Zapata	72,402	36.46	13,902	7.000	12,909	6.50
Commerce Bank	91,239	34.83	18,336	7.000	17,026	6.50
Total Capital (to Risk Weighted Assets):						
Consolidated	\$ 2,018,488	20.46 %	\$ 1,036,118	10.500 %	N/A	N/A
International Bank of Commerce, Laredo	1,315,453	18.91	730,425	10.500	\$ 695,643	10.00 %
International Bank of Commerce, Oklahoma	206,807	17.38	124,955	10.500	119,004	10.00
International Bank of Commerce, Brownsville	192,417	23.60	85,626	10.500	81,548	10.00
International Bank of Commerce, Zapata	74,737	37.63	20,853	10.500	19,860	10.00
Commerce Bank	93,396	35.65	27,504	10.500	26,195	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,953,711	19.80 %	\$ 838,762	8.500 %	N/A	N/A
International Bank of Commerce, Laredo	1,268,078	18.23	591,296	8.500	\$ 556,514	8.00 %
International Bank of Commerce, Oklahoma	201,202	16.91	101,154	8.500	95,203	8.00
International Bank of Commerce, Brownsville	185,112	22.70	69,316	8.500	65,239	8.00
International Bank of Commerce, Zapata	72,402	36.46	16,881	8.500	15,888	8.00
Commerce Bank	91,239	34.83	22,265	8.500	20,956	8.00
Tier 1 Capital (to Average Assets):						
Consolidated	\$ 1,953,711	16.65 %	\$ 469,267	4.00 %	N/A	N/A
International Bank of Commerce, Laredo	1,268,078	15.21	333,576	4.00	416,970	5.00 %
International Bank of Commerce, Oklahoma	201,202	14.79	54,406	4.00	68,007	5.00
International Bank of Commerce, Brownsville	185,112	17.41	42,529	4.00	53,161	5.00
International Bank of Commerce, Zapata	72,402	19.08	15,179	4.00	18,974	5.00
Commerce Bank	91,239	18.18	20,073	4.00	25,091	5.00

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Our actual capital amounts and ratios for 2018 are also presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(greater than or equal to)	(greater than or equal to)	(greater than or equal to)	(greater than or equal to)
(Dollars in Thousands)						
As of December 31, 2018:						
Common Equity Tier 1 (to Risk Weighted Assets):						
Consolidated	\$ 1,711,682	17.55 %	\$ 621,850	6.375 %	N/A	N/A
International Bank of Commerce, Laredo	1,201,462	17.24	444,207	6.375	\$ 452,917	6.50 %
International Bank of Commerce, Oklahoma	188,997	13.95	86,344	6.375	88,037	6.50
International Bank of Commerce, Brownsville	177,456	24.73	45,741	6.375	46,638	6.50
International Bank of Commerce, Zapata	70,984	30.77	14,707	6.375	14,996	6.50
Commerce Bank	89,305	32.95	17,276	6.375	17,615	6.50
Total Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,925,905	19.74 %	\$ 963,258	9.875 %	N/A	N/A %
International Bank of Commerce, Laredo	1,248,107	17.91	688,086	9.875	\$ 696,796	10.00
International Bank of Commerce, Oklahoma	198,293	14.64	133,749	9.875	135,442	10.00
International Bank of Commerce, Brownsville	183,554	25.58	70,854	9.875	71,750	10.00
International Bank of Commerce, Zapata	73,726	31.96	22,782	9.875	23,070	10.00
Commerce Bank	90,894	33.54	26,761	9.875	27,100	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,859,536	19.06 %	\$ 768,168	7.875 %	N/A	N/A %
International Bank of Commerce, Laredo	1,201,462	17.24	548,727	7.875	\$ 557,437	8.00
International Bank of Commerce, Oklahoma	188,997	13.95	106,660	7.875	108,354	8.00
International Bank of Commerce, Brownsville	177,456	24.73	56,503	7.875	57,400	8.00
International Bank of Commerce, Zapata	70,984	30.77	18,168	7.875	18,456	8.00
Commerce Bank	89,305	32.95	21,341	7.875	21,680	8.00 %
Tier 1 Capital (to Average Assets):						
Consolidated	\$ 1,859,536	15.87 %	\$ 468,593	4.00 %	\$ N/A	N/A
International Bank of Commerce, Laredo	1,201,462	14.45	332,507	4.00	415,634	5.00
International Bank of Commerce, Oklahoma	188,997	12.53	60,344	4.00	75,430	5.00
International Bank of Commerce, Brownsville	177,456	17.25	41,144	4.00	51,430	5.00
International Bank of Commerce, Zapata	70,984	16.22	17,507	4.00	21,884	5.00
Commerce Bank	89,305	15.53	23,000	4.00	28,750	5.00

(21) Fair Value

ASC Topic 820, “Fair Value Measurements and Disclosures” (“ASC 820”) defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. ASC 820 applies to all financial instruments that are being measured and reported on a fair value basis. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date; it also establishes a fair value hierarchy that prioritizes the inputs used in valuation methodologies into the following three levels:

- Level 1 Inputs—Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Inputs—Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Inputs—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or other valuation techniques,

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy is set forth below.

The following table represents financial instruments reported on the consolidated statements of condition at their fair value as of December 31, 2019 by level within the fair value measurement hierarchy.

		Fair Value Measurements at Reporting Date Using		
		(in Thousands)		
	Assets/Liabilities Measured at Fair Value December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>Measured on a recurring basis:</i>				
Assets:				
Available for sale debt securities				
Residential mortgage-backed securities	\$ 3,285,548	\$ —	\$ 3,285,548	\$ —
States and political subdivisions	93,375	—	93,375	—
Equity Securities	6,095	6,095	—	—
	<u>\$ 3,385,018</u>	<u>\$ 6,095</u>	<u>\$ 3,378,923</u>	<u>\$ —</u>

The following table represents financial instruments reported on the consolidated balance sheets at their fair value as of December 31, 2018 by level within the fair value measurement hierarchy.

		Fair Value Measurements at Reporting Date Using		
		(in Thousands)		
	Assets/Liabilities Measured at Fair Value December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>Measured on a recurring basis:</i>				
Assets:				
Available for sale securities				
Residential mortgage - backed securities	\$ 3,223,010	\$ —	\$ 3,223,010	\$ —
States and political subdivisions	188,340	—	188,340	—
Equity Securities	5,937	5,937	—	—
	<u>\$ 3,417,287</u>	<u>\$ 5,937</u>	<u>\$ 3,411,350</u>	<u>\$ —</u>

For the years ended December 31, 2019 and December 31, 2018, debt investment securities available-for-sale are classified within Level 2 of the valuation hierarchy. Equity securities with readily determinable fair values are classified within Level 1. For debt securities classified as Level 2 in the fair value hierarchy, we obtain 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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Certain financial instruments are measured at fair value on a nonrecurring basis. They 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).

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended December 31, 2019 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in thousands)				
	Assets/Liabilities Measured at Fair Value Period ended December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision (Credit) During Period	
Measured on a non-recurring basis:						
Assets:						
Impaired loans	\$ 826	\$ —	\$ —	\$ 826	\$ 43	
Other real estate owned	21,614	—	—	21,614	322	
Equity investments without readily determinable fair values	28,166	—	—	28,166	4,775	

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the year ended December 31, 2018 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in thousands)				
	Assets/Liabilities Measured at Fair Value Year ended December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net (Credit) Provision During Period	
<i>Measured on a non-recurring basis:</i>						
Assets:						
Impaired loans	\$ 1,563	\$ —	\$ —	\$ 1,563	\$ 356	
Other real estate owned	38,871	—	—	38,871	3,071	

Our assets measured at fair value on a non-recurring basis are limited to impaired loans and other real estate owned. Impaired loans are classified within Level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, "Receivables". Impaired loans are primarily comprised of collateral-dependent commercial loans. Understanding that as the primary sources of loan repayments decline, the secondary repayment source comes into play and correctly evaluating the fair value of that secondary source, the collateral, becomes even more important. Re-measurement of the impaired loan to fair value is done through a specific valuation allowance included in the allowance for probable loan losses. The fair value of impaired loans is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for our appraisal and appraisal review process is based on regulatory guidelines and strives to comply with all regulatory appraisal laws, regulations and the Uniform Standards of Professional Appraisal Practice. All appraisals and evaluations are "as is" (the property's highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of December 31, 2019, we had approximately \$2,955,000 of impaired commercial collateral dependent loans, of which approximately \$1,426,000 had an appraisal performed within the immediately preceding twelve months and of which approximately \$847,000 had an evaluation performed within the immediately preceding twelve months. As

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

of December 31, 2018, we had approximately \$14,306,000 of impaired commercial collateral dependent loans, of which approximately \$10,911,000 had an appraisal performed within the immediately preceding twelve months and of which approximately \$0 had an evaluation performed within the immediately preceding twelve months.

The determination to either seek an appraisal or to perform an evaluation begins in weekly credit quality meetings, where the committee analyzes the existing collateral values of the impaired loans and where obsolete appraisals are identified. In order to determine whether we would obtain a new appraisal or perform an internal evaluation to determine the fair value of the collateral, the credit committee reviews the existing appraisal to determine if the collateral value is reasonable in view of the current use of the collateral and the economic environment related to the collateral. If the analysis of the existing appraisal does not find that the collateral value is reasonable under the current circumstances, we would obtain a new appraisal on the collateral or perform an internal evaluation of the collateral. The ultimate decision to get a new appraisal rests with the independent credit administration group. A new appraisal is not required if an internal evaluation, as performed by in-house experts, is able to appropriately update the original appraisal assumptions to reflect current market conditions and provide an estimate of the collateral's market value for impairment analysis. The internal evaluations must be in writing and contain sufficient information detailing the analysis, assumptions and conclusions and they must support performing an evaluation in lieu of ordering a new appraisal.

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate owned is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal) within Level 3 of the fair value hierarchy. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. The fair value is reviewed periodically and subsequent write downs are made accordingly through a charge to operations. Other real estate owned is included in other assets on the consolidated financial statements. For the twelve months ended December 31, 2019, December 31, 2018 and December 31, 2017, respectively we recorded approximately \$9,611,000, \$170,000 and \$30,000 in charges to the allowance for probable loan losses in connection with loans transferred to other real estate owned. For the twelve months ended December 31, 2019, December 31, 2018 and December 31, 2017, respectively, we recorded approximately \$322,000, \$3,071,000 and \$710,000 in adjustments to fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for our financial instruments at December 31, 2019 and December 31, 2018 are outlined below.

Cash and Cash Equivalents

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment securities held-to-maturity

The carrying amounts of investments held-to-maturity approximate fair value.

Investment Securities

For debt investment securities, which include U.S. Treasury securities, obligations of other U.S. government agencies, obligations of states and political subdivisions and mortgage pass through and related securities, fair values are 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. See disclosures of fair value of investment securities in Note 2.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Loans

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate and consumer loans as outlined by regulatory reporting guidelines. Each category is segmented into fixed and variable interest rate terms and by performing and non-performing categories.

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed rate performing loans are within Level 3 of the fair value hierarchy. At December 31, 2019 and December 31, 2018, the carrying amount of fixed rate performing loans was \$1,503,811,000 and \$1,515,437,000, respectively, and the estimated fair value was \$1,481,239,000 and \$1,469,231,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest-bearing demand deposit accounts, was equal to the amount payable on demand as of December 31, 2019 and December 31, 2018. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. Time deposits are within Level 3 of the fair value hierarchy. At December 31, 2019 and December 31, 2018, the carrying amount of time deposits was \$2,012,300,000 and \$1,973,468,000, respectively, and the estimated fair value was \$2,011,950,000 and \$1,976,156,000, respectively.

Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at December 31, 2019 and December 31, 2018. The fair value of the long-term instruments is based on established market spread using option adjusted spread methodology. Long-term repurchase agreements are within Level 3 of the fair value hierarchy. The only remaining long-term repurchase agreement outstanding matured in the first quarter of 2018 and was not renewed.

Junior Subordinated Deferrable Interest Debentures

We currently have floating rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at December 31, 2019 and December 31, 2018.

Other Borrowed Funds

We currently have short and long-term borrowings issued from the Federal Home Loan Bank ("FHLB"). Due to the contractual terms of the short-term borrowings, the carrying amounts approximated fair value at December 31, 2019 and December 31, 2018. The long-term borrowings outstanding at December 31, 2019 and December 31, 2018 are fixed-rate borrowings and the fair value is based on established market spreads for similar types of borrowings. The fixed-rate long-term borrowings are included in Level 2 of the fair value hierarchy. At December 31, 2019, and December 31, 2018 the carrying amount of the fixed-rate long-term FHLB borrowings was \$436,511,000 and \$436,690,000, respectively and the estimated fair value was \$465,017,000 and \$436,238,000 respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Commitments to Extend Credit and Letters of Credit

Commitments to extend credit and fund letters of credit are principally at current interest rates and therefore the carrying amount approximates fair value.

Limitations

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time of our entire holdings of a particular financial instrument. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial 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 assumptions could significantly affect the estimates.

Fair value estimates are based on existing on-and off-statement of condition financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Other significant assets and liabilities that are not considered financial assets or liabilities include the bank premises and equipment and core deposit value. In addition, the tax ramifications related to the effect of fair value estimates have not been considered in the above estimates.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(22) International Bancshares Corporation (Parent Company Only) Financial Information

Statements of Condition

(Parent Company Only)

December 31, 2019 and 2018

(Dollars in Thousands)

	2019	2018
ASSETS		
Cash	\$ 24,290	\$ 19,065
Other investments	106,284	105,377
Notes receivable	12,100	—
Investment in subsidiaries	2,120,391	1,987,293
Goodwill	3,365	—
Other assets	264	—
Total assets	<u>\$ 2,266,694</u>	<u>\$ 2,111,735</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Junior subordinated deferrable interest debentures	\$ 134,642	\$ 160,416
Due to IBC Trading	21	21
Other liabilities	13,978	11,716
Total liabilities	<u>148,641</u>	<u>172,153</u>
Shareholders' equity:		
Common shares	96,215	96,104
Surplus	148,075	145,283
Retained earnings	2,200,568	2,064,134
Accumulated other comprehensive income (loss)	2,345	(54,634)
	<u>2,447,203</u>	<u>2,250,887</u>
Less cost of shares in treasury	<u>(329,150)</u>	<u>(311,305)</u>
Total shareholders' equity	<u>2,118,053</u>	<u>1,939,582</u>
Total liabilities and shareholders' equity	<u>\$ 2,266,694</u>	<u>\$ 2,111,735</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(23) International Bancshares Corporation (Parent Company Only) Financial Information

Statements of Income

(Parent Company Only)

Years ended December 31, 2019, 2018 and 2017

(Dollars in Thousands)

	2019	2018	2017
Income:			
Dividends from subsidiaries	\$ 127,750	\$ 105,000	\$ 64,600
Interest income on notes receivable	922	—	—
Interest income on other investments	(514)	8,208	8,100
Other	<u>18</u>	<u>1,988</u>	<u>26</u>
Total income	128,176	115,196	72,726
Expenses:			
Interest expense (Debentures)	6,435	6,989	5,392
Other	<u>2,749</u>	<u>2,930</u>	<u>5,648</u>
Total expenses	9,184	9,919	11,040
Income before federal income taxes and equity in undistributed net income of subsidiaries	118,992	105,277	61,686
Income tax expense	<u>(1,878)</u>	<u>481</u>	<u>(2,076)</u>
Income before equity in undistributed net income of subsidiaries	120,870	104,796	63,762
Equity in undistributed net income of subsidiaries	84,234	111,135	93,674
Net income	<u>\$ 205,104</u>	<u>\$ 215,931</u>	<u>\$ 157,436</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(24) International Bancshares Corporation (Parent Company Only) Financial Information

**Statements of Cash Flows
(Parent Company Only)**

**Years ended December 31, 2019, 2018 and 2017
(Dollars in Thousands)**

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Operating activities:			
Net income	\$ 205,104	\$ 215,931	\$ 157,436
Adjustments to reconcile net income to net cash provided by operating activities:			
Investment securities transactions, net	—	—	(23)
Unrealized (gain) loss on equity securities with readily determinable fair values	(16)	330	—
Stock compensation expense	980	1,035	903
Decrease in other liabilities	(58)	(1,479)	(3,453)
Equity in undistributed net income of subsidiaries	(84,234)	(111,135)	(93,674)
Net cash provided by operating activities	<u>121,776</u>	<u>104,682</u>	<u>61,189</u>
Investing activities:			
Principal collected on mortgage-backed securities	—	—	6,328
Net increase in notes receivable	(12,100)	—	—
Decrease (increase) in other assets and other investments	5,915	(7,891)	(25,348)
Net cash used in investing activities	<u>(6,185)</u>	<u>(7,891)</u>	<u>(19,020)</u>
Financing activities:			
Redemption of long-term debt	(25,774)	—	—
Proceeds from stock transactions	1,923	1,522	1,455
Payments of cash dividends - common	(68,670)	(49,599)	(43,594)
Repurchase of outstanding common stock warrant	—	(29,005)	—
Purchase of treasury stock	(17,845)	(19,042)	(187)
Net cash used in financing activities	<u>(110,366)</u>	<u>(96,124)</u>	<u>(42,326)</u>
Increase (decrease) in cash	5,225	667	(157)
Cash at beginning of year	<u>19,065</u>	<u>18,398</u>	<u>18,555</u>
Cash at end of year	<u>\$ 24,290</u>	<u>\$ 19,065</u>	<u>\$ 18,398</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES
Condensed Quarterly Income Statements
(Dollars in Thousands, Except Per Share Amounts)

	<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
2019				
Interest income	\$ 117,359	\$ 124,119	\$ 126,860	\$ 124,063
Interest expense	13,996	14,901	15,078	14,654
Net interest income	103,363	109,218	111,782	109,409
Provision for probable loan losses	3,480	5,278	2,665	7,420
Non-interest income	41,584	42,697	34,416	36,129
Non-interest expense	76,171	81,066	79,613	72,951
Income before income taxes	65,296	65,571	63,920	65,167
Income taxes	13,562	14,127	13,900	13,261
Net income	<u>\$ 51,734</u>	<u>\$ 51,444</u>	<u>\$ 50,020</u>	<u>\$ 51,906</u>
Per common share:				
Basic				
Net income	<u>\$ 0.79</u>	<u>\$ 0.79</u>	<u>\$ 0.76</u>	<u>\$ 0.79</u>
Diluted				
Net income	<u>\$ 0.78</u>	<u>\$ 0.79</u>	<u>\$ 0.76</u>	<u>\$ 0.79</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES
Condensed Quarterly Income Statements
(Dollars in Thousands, Except Per Share Amounts)

	<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
2018				
Interest income	\$ 120,975	\$ 118,374	\$ 115,066	\$ 111,407
Interest expense	14,240	13,500	12,793	12,135
Net interest income	106,735	104,874	102,273	99,272
Provision for probable loan losses	2,900	4,280	(2,730)	1,662
Non-interest income	41,261	42,503	42,303	38,975
Non-interest expense	71,924	78,067	80,601	68,909
Income before income taxes	73,172	65,030	66,705	67,676
Income taxes	14,643	13,935	13,818	14,256
Net income	<u>\$ 58,529</u>	<u>\$ 51,095</u>	<u>\$ 52,887</u>	<u>\$ 53,420</u>
Per common share:				
Basic				
Net income	<u>\$ 0.89</u>	<u>\$ 0.77</u>	<u>\$ 0.80</u>	<u>\$ 0.81</u>
Diluted				
Net income	<u>\$ 0.88</u>	<u>\$ 0.77</u>	<u>\$ 0.79</u>	<u>\$ 0.80</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES
Condensed Average Statements of Condition
(Dollars in Thousands)
(Unaudited)

Distribution of Assets, Liabilities and Shareholders' Equity

The following table sets forth a comparative summary of average interest earning assets and average interest bearing liabilities and related interest yields for the years ended December 31, 2019, 2018, and 2017. Tax-exempt income has not been adjusted to a tax-equivalent basis:

	2019			2018			2017		
	Average Balance	Interest	Average Rate/Cost	Average Balance	Interest	Average Rate/Cost	Average Balance	Interest	Average Rate/Cost
(Dollars in Thousands)									
Assets									
Interest earning assets:									
Loan, net of unearned discounts:									
Domestic	\$ 6,720,765	\$ 408,166	6.07 %	\$ 6,374,979	\$ 369,761	5.80 %	\$ 6,026,180	\$ 317,320	5.27 %
Foreign	131,356	5,445	4.15	142,999	5,412	3.78	157,684	5,188	3.29
Investment securities:									
Taxable	3,244,021	72,485	2.23	3,635,675	81,484	2.24	3,954,632	82,347	2.08
Tax-exempt	126,792	4,885	3.85	200,978	8,141	4.05	235,253	9,656	4.10
Other	109,965	1,420	1.29	95,559	1,024	1.07	84,752	625	0.74
Total interest-earning assets	10,332,899	492,401	4.77 %	10,450,190	465,822	4.46 %	10,458,501	415,136	3.97 %
Non-interest earning assets:									
Cash and cash equivalents	168,224			178,873			179,134		
Bank premises and equipment, net	478,159			485,978			494,327		
Other assets	1,120,706			1,073,534			957,270		
Less allowance for probable loan losses	(63,328)			(67,031)			(68,312)		
Total	\$ 12,036,660			\$ 12,121,544			\$ 12,020,920		
Liabilities and Shareholders' Equity									
Interest bearing liabilities:									
Savings and interest bearing demand deposits	\$ 3,288,376	\$ 16,379	0.50 %	\$ 3,273,355	\$ 12,764	0.39 %	\$ 3,230,463	\$ 6,208	0.19 %
Time deposits:									
Domestic	918,545	10,036	1.09	946,231	6,330	0.67	1,074,199	4,956	0.46
Foreign	1,068,653	10,934	1.02	1,055,090	6,766	0.64	1,097,240	4,780	0.44
Securities sold under repurchase agreements	267,439	2,432	0.91	314,876	2,415	0.77	402,396	6,617	1.64
Other borrowings	627,024	12,413	1.98	923,729	17,404	1.88	891,611	10,978	1.23
Junior subordinated interest deferrable debentures	145,234	6,435	4.43	160,416	6,989	4.36	160,416	5,392	3.36
Total interest bearing liabilities	6,315,271	58,629	0.93 %	6,673,697	52,668	0.79 %	6,856,325	38,931	0.57 %
Non-interest bearing liabilities:									
Demand Deposits	3,517,455			3,366,040			3,230,708		
Other liabilities	147,604			157,907			107,952		
Shareholders' equity	2,056,330			1,923,900			1,825,935		
Total	\$ 12,036,660			\$ 12,121,544			\$ 12,020,920		
Net interest income		\$ 433,772			\$ 413,154			\$ 376,205	
Net yield on interest earning assets			4.20 %			3.60 %			3.34 %

**INTERNATIONAL BANCSHARES CORPORATION
OFFICERS AND DIRECTORS**

OFFICERS

DENNIS E. NIXON
Chairman of the Board and President

JULIE L. TARVIN
Vice President

JUDITH I. WAWROSKI
Treasurer

WILLIAM J. CUELLAR
Auditor

MARISA V. SANTOS
Secretary

HILDA V. TORRES
Assistant Secretary

DIRECTORS

DENNIS E. NIXON
Chairman of the Board
International Bank of Commerce

JAVIER DE ANDA
Senior Vice President
B.P. Newman Investment Company

IRVING GREENBLUM
International Investments/Real Estate

DOUG HOWLAND
Investments

RUDOLPH M. MILES
Investments

LARRY NORTON
Investments

ROBERTO R. RESENDEZ
Owner
Cattle Ranching and Investments

ANTONIO R. SANCHEZ, JR.
Chairman of the Board
Sanchez Oil & Gas Corporation
Investments

**DESCRIPTION OF SECURITIES
REGISTERED UNDER SECTION 12 OF THE SECURITIES EXCHANGE ACT OF 1934**

The following is a summary of International Bancshares Corporation's ("IBC", "we", "us", or "our") classes of securities registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act"). We have two classes of securities registered under the Exchange Act: (i) our common stock, par value \$1.00 per share (the "Common Stock"); and (ii) 216,000 shares of preferred stock designated as Series A preferred stock and 24,784,000 unissued shares of preferred stock referred to as "Blank Check" preferred stock (collectively, the "Preferred Stock").

DESCRIPTION OF COMMON STOCK

The following description of our Common Stock is a summary and does not describe every right, term, or condition of owning our Common Stock. It is subject to and qualified in its entirety by reference to our amended articles of incorporation (the "Articles of Incorporation") and amended and restated by-laws (the "By-laws"). For a complete description, refer to the Articles of Incorporation and the By-laws and any applicable provisions of relevant law, including the applicable provisions of the Texas Business Organizations Code and federal law governing bank holding companies.

General

Pursuant to the Articles of Incorporation, we are authorized to issue 275,000,000 shares of our Common Stock, par value \$1.00 per share. Our Common Stock is listed on the NASDAQ Stock Market under the ticker symbol "IBOC." Outstanding shares of our Common Stock are validly issued, fully paid, and non-assessable. Holders of our Common Stock are not, and will not be, subject to any liability as shareholders.

Dividends

Holders of our Common Stock are entitled to receive dividends if, as, and when declared by our board of directors out of any funds legally available for the payment of dividends. We will pay dividends on our Common Stock only if we have paid or provided for the payment of all dividends on our then outstanding series of Preferred Stock entitled to preference in the receipt of dividends, for the then current period and, in the case of any cumulative Preferred Stock, all prior periods. Our Preferred Stock also has such other preferences over our Common Stock as currently, or as may be, fixed by our board of directors. We are subject to various regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The Board of Governors of the Federal Reserve System, which is also referred to as the Federal Reserve Board, is authorized under applicable law and regulations to determine, under certain circumstances relating to the financial condition of a bank holding company that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. In addition, we are subject to Texas state laws relating to the payment of dividends.

Voting Rights

Holders of our Common Stock are entitled to one vote for each share held of record on all matters submitted to a vote of shareholders. Holders of shares of Common Stock are not entitled to cumulative voting rights in the election of directors.

Preemptive Rights

Holders of our Common Stock have no subscription, conversion, or preemptive rights to acquire any additional shares of Common Stock and the Common Stock is not redeemable.

Liquidation Rights

Holders of our Common Stock are also entitled, upon our liquidation, and after payment of all valid claims of creditors and the preferences of Preferred Stock outstanding at the time of liquidation, to receive pro rata distributions of our net assets.

Classification of the Board

Our board of directors is not classified.

DESCRIPTION OF THE PREFERRED STOCK

The following description of the Preferred Stock is a summary and does not describe every right, term, or condition of owning the Preferred Stock. It is subject to and qualified in its entirety by reference to the pertinent sections of our Articles of Incorporation and By-Laws, including the certificate of designations creating the Preferred Stock, and any applicable provisions of relevant law, including the applicable provisions of the Texas Business Organizations Code and federal law governing bank holding companies.

General

Our Articles of Incorporation authorize us to issue 216,000 shares of Series A Preferred Stock and 24,784,000 shares of preferred stock typically referred to as “Blank Check” preferred stock. The Blank Check preferred stock refers to stock for which the rights and restrictions are determined by our board of directors. We currently have no Series A Preferred Stock outstanding. In limited circumstances, our Articles of Incorporation authorize our board of directors to issue new shares of Common Stock or Preferred Stock without further shareholder action.

Dividend Rights

The issuance of Preferred Stock may be viewed as having adverse effects upon the dividend rights of holders of our Common Stock.

Preemptive and Conversion Rights

Holders of our Common Stock do not have any preemptive rights with respect to any newly issued Preferred Stock. Our board of directors could adversely affect the voting power of holders of our Common Stock by issuing shares of Preferred Stock with certain voting, conversion, and/or redemption rights.

Certain Anti-Takeover Matters

In the event of a proposed merger, tender offer, or other attempt to gain control of the Company, which the board of directors does not believe to be in the best interests of its shareholders, the board of directors can issue Preferred Stock which could make any such takeover attempt more difficult to complete. Blank Check Preferred Stock may also be used in connection with the issuance of a shareholder rights plan, sometimes called a poison pill. Our board of directors has not approved any plan to issue Preferred Stock for this purpose. Our board of directors does not intend to issue any Preferred Stock except on terms that the board deems to be in the best interests of IBC and its shareholders.

DESCRIPTION OF THE ANTI-TAKEOVER PROVISIONS

General

The provisions of our Articles of Incorporation and By-Laws, which we summarize below, may have an anti-takeover effect and may delay, defer, or prevent a tender offer or takeover attempt that a shareholder might consider in his or her best interest, including those attempts that might result in a premium over the market price for the Common Stock.

Advance Notice Procedure for Shareholder Proposals.

Our By-laws establish an advance notice procedure for the nomination of candidates for election as directors as well as for shareholder proposals to be considered at annual meetings of shareholders. In general, notice of intent to nominate a director must contain specific information concerning the person to be nominated and must be delivered to or mailed and received at our principal executive offices as follows:

With respect to an election to be held at a special meeting of shareholders for the election of directors, not earlier than the 90th day prior to the special meeting and not later than the close of business on the later of the 60th day prior to the special meeting or the 10th day following the day on which public disclosure is first made of the date of the special meeting and of the nominees proposed by the board of directors to be elected at such meeting. Shareholders may not nominate persons for election to the board of directors at any special meeting of shareholders unless the business to be transacted at the special meeting, as set forth in the notice of the special meeting, includes the election of directors.

Notice of shareholders' intent to raise business at an annual meeting, including a nomination of candidate for election as director, must be delivered to or mailed and received at our principal executive offices not later than 60 days nor more than 90 days prior to the first anniversary of the date of the preceding year's annual meeting. Proposals from shareholders which are intended to be included in the proxy statement relating to an annual meeting of shareholders must comply with Rule 14a-8 under the Exchange Act, which requires that the proposal be received not less than 120 calendar days before the date of IBC's proxy statement released to shareholders in connection with the previous year's annual meeting. These procedures may operate to limit the ability of shareholders to bring business before a shareholders meeting, including with respect to the nomination of directors or considering any transaction that could result in a change of control.

Limitation of Liability of Directors.

Our Articles of Incorporation and By-laws provide for indemnification of our directors to the fullest extent permitted by applicable law. Article 2.02-1 of the Texas Business Organizations Code provides that a Texas corporation may indemnify its directors and officers against expenses, judgments, fines, and amounts paid in settlement actually and reasonably incurred by them in connection with any suit or proceeding, whether civil, criminal, administrative or investigative if, in connection with the matters in issue, they acted in good faith and in a manner they reasonably believed to be in, or not opposed to, the best interests of the corporation and, in connection with any criminal suit or proceeding, if in connection with the matters in issue, they had no reasonable cause to believe their conduct was unlawful. These provisions may have the practical effect in certain cases of eliminating the ability of our shareholders to collect monetary damages from directors and executive officers. We believe that the provisions in our Articles of Incorporation and By-laws are necessary to attract and retain qualified persons as directors and executive officers.

Regulatory Restrictions on Ownership

The Bank Holding Company Act requires any "bank holding company," as defined in the Bank Holding Company Act, to obtain the approval of the Federal Reserve Board prior to the acquisition of 5% or more of our Common Stock. Any person, other than a bank holding company, is required to obtain prior approval of the Federal Reserve Board to acquire 10% or more of our Common Stock under the Change in Bank Control Act. Any holder of 25% or more of our Common Stock, or a holder of 5% or more if such holder otherwise exercises a "controlling influence" over us, may be subject to regulation as a bank holding company under the Bank Holding Company Act.

List of Subsidiaries

Subsidiaries of International Bancshares Corporation

Name	State of Incorporation or Organization	Business	% of Ownership	
IBC Trading Company	Texas	Export Trading	100	%
IBC Capital Corporation	Texas	Investments	100	%
IBC Charitable and Community Development Corporation	Texas	Community Development	100	%
Premier Tierra Holdings, Inc.	Texas	Liquidating Subsidiary	100	%
International Bank of Commerce	Texas	State Bank	100	%
Commerce Bank	Texas	State Bank	100	%
International Bank of Commerce, Zapata	Texas	State Bank	100	%
International Bank of Commerce, Brownsville	Texas	State Bank	100	%
International Bank of Commerce, Oklahoma	Oklahoma	State Bank	100	%
Gulfstar Merchant Banking I, Ltd.	Texas	Merchant Banking	70	%
Gulfstar Merchant Banking II, Ltd.	Texas	Merchant Banking	70	%
Gulfstar Merchant Banking III, Ltd.	Texas	Merchant Banking	50	%
Gulfstar Merchant Banking IV, Ltd.	Texas	Merchant Banking	50	%

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement (No. 333-183958) on Form S-8 filed on September 18, 2012 of International Bancshares Corporation of our reports dated February 27, 2020, relating to our audits of the consolidated financial statements and internal control over financial reporting, included in and incorporated by reference in the Annual Report on Form 10-K of International Bancshares Corporation for the year ended December 31, 2019.

/s/ RSM US LLP

Austin, Texas
February 27, 2020

Certification

I, Dennis E. Nixon, certify that:

1. I have reviewed this Annual Report on Form 10-K of International Bancshares Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2020

By: /s/ DENNIS E. NIXON

Dennis E. Nixon
President (Chief Executive Officer)

Certification

I, Judith I. Wawroski, certify that:

1. I have reviewed this Annual Report on Form 10-K of International Bancshares Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2020

By: /s/ JUDITH I. WAWROSKI

Judith I. Wawroski

Treasurer (Principal Financial Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of International Bancshares Corporation (the “Company”) on Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Dennis E. Nixon, President and Principal Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), as applicable; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ DENNIS E. NIXON

Dennis E. Nixon

President

Date: February 27, 2020

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, and not being filed for purposes of Section 18 of the Securities Exchange Act, as amended, and is not to be incorporated by reference into any filing of the Company, whether on and before or after the date hereof, regardless of any general incorporation language in such filing.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of International Bancshares Corporation (the “Company”) on Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Judith I. Wawroski, Treasurer and Principal Financial Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), as applicable; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ JUDITH I. WAWROSKI

Judith I. Wawroski

Treasurer

Date: February 27, 2020

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, and not being filed for purposes of Section 18 of the Securities Exchange Act, as amended, and is not to be incorporated by reference into any filing of the Company, whether on and before or after the date hereof, regardless of any general incorporation language in such filing.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.