
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, 2013

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(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
None	None

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

Common Stock (\$1.00 par value)

(Title of Class)

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 and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (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 disclosure of delinquent filers pursuant to Item 405 of Regulation S-K Section 229.405 of this chapter is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of June 30, 2013 was \$1,501,098,000 based on the closing sales price per share of the Registrant's common stock on such date as reported by NASDAQ.

As of February 19, 2014, there were 67,208,261 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, 2013 (in Parts I and II) and (b) Proxy Statement relating to the Company's 2014 Annual Meeting of Shareholders (in Part III).

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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 International Bancshares Corporation (the “Company”) believes 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 are projected, forecasted, estimated or budgeted by the Company 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 the Company, the Company’s customers, and such customers’ ability to transact profitable business with the Company, including the ability of its 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 Company relies, in part, on external financing to fund the Company’s operations from the FHLB, the Fed and other sources and the unavailability of such funds in the future could adversely impact the Company’s growth strategy, prospects and performance.
- Changes in consumer spending, borrowings and savings habits.
- Changes in interest rates and market prices, which could reduce the Company’s net interest margins, asset valuations and expense expectations, including, without limitation, the repeal of federal prohibitions on the payment of interest on demand deposits.
- Changes in the capital markets utilized by the Company and its subsidiaries, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations to which the Company and its subsidiaries, as well as their customers, competitors and potential competitors, are subject, including, without limitation, the impact of the Consumer Financial Protection Bureau as a new 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 and employment, environmental and immigration laws and regulations and the risk of litigation that may follow.
- Changes in U.S.—Mexico trade, including, without limitation, reductions in border crossings and commerce resulting from the Homeland Security Programs called “US-VISIT,” which is derived from Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.
- The reduction of deposits from nonresident alien individuals due to the new IRS rules requiring U.S. financial institutions to report to the IRS deposit interest payments made to nonresident alien individuals.
- The loss of senior management or operating personnel.
- Increased competition from both within and outside the banking industry.

- The timing, impact and other uncertainties of the Company's potential future acquisitions including the Company's ability to identify suitable potential future acquisition candidates, the success or failure in the integration of their operations and the Company's ability to maintain its current branch network and to enter new markets successfully and capitalize on growth opportunities.
- Changes in the Company's ability to pay dividends on its Common Stock.
- Additions to the Company's loan loss allowance as a result of changes in local, national or international conditions which adversely affect the Company's customers, including, without limitation, lower real estate values or environmental liability risks associated with foreclosed properties.
- 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 the Company interacts.
- Political instability in the United States or Mexico.
- Technological changes or system failure or breaches of our network security could subject us to increased operating costs as well as 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 portfolio following a determination that the securities are other-than-temporarily impaired.
- The effect of changes in accounting policies and practices as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.
- The costs and effects of regulatory developments, including the resolution of regulatory or other governmental inquiries and the results of regulatory examinations or reviews.
- 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, unless the consumer consents or opts-in to the overdraft service for those types of 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 new legislation, including, without limitation, the Dodd-Frank Regulatory Reform Act and the implementing rules and regulations, including the Federal Reserve's rule that establishes debit card interchange fee standards and prohibits network exclusivity arrangements and routing restrictions that is negatively affecting interchange revenue from debit card transactions as well as revenue from consumer services.
- The possible increase in required capital and liquidity 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 which may result in a limitation on the types of securities certain banks will be able to purchase as a result of the due diligence burden.
- The Company's success at managing the risks involved in the foregoing items, or a failure or circumvention of the Company's 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. The Company makes 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.

Item 1. *Business*

General

The Company is a financial holding company with its principal corporate offices in Laredo, Texas. Four bank subsidiaries provide commercial and retail banking services through main banking and branch facilities located in communities in South, Central and Southeast Texas and the State of Oklahoma. The Company was originally incorporated under the General Corporation Law of the State of Delaware in 1979. Effective June 7, 1995, the Company's state of incorporation was changed from Delaware to Texas. The Company was organized for the purpose of operating as a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "BHCA"), and as such, is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "FRB"). As a registered bank holding company, the Company may own one or more banks and may engage directly, or through subsidiary corporations, in those activities closely related to banking which are specifically permitted under the BHCA and by the FRB. Effective March 13, 2000, the Company became certified as a financial holding company. As a financial holding company, the Company may engage in a broad list of financial and non-financial activities. The Company's principal assets at December 31, 2013 consisted of all the outstanding capital stock of four Texas state banking associations (the "Banks" or "bank subsidiaries"). All of the Company's bank subsidiaries are members of the Federal Deposit Insurance Corporation (the "FDIC").

The bank subsidiaries are in the business of gathering funds from various sources and investing these funds in order to earn a return. Funds gathering primarily takes the form of accepting demand and time deposits from individuals, partnerships, corporations and public entities. Investments principally are made in loans to various individuals and entities as well as in debt securities of the U.S. Government and various other entities whose payments are guaranteed by the U.S. Government. Historically, the bank subsidiaries have primarily focused on providing commercial banking services to small and medium sized businesses located in their trade areas and international banking services. In recent years, the bank subsidiaries have also emphasized consumer and retail banking, including mortgage lending, as well as branches situated in retail locations and shopping malls; however, during the fourth quarter of 2011 the Company closed fifty-five in-store branches as a result of reduced levels of revenue resulting from regulatory changes limiting interchange fee income. The branches were closed in order to align the Company's expenses with the reduced levels of revenue.

The Company's philosophy focuses on customer service as represented by its motto, "We Do More." The Banks maintain a strong commitment to their local communities by, among other things, appointing selected members of the communities in which the Banks' branches are located to local advisory boards (the "local boards"). The local boards direct the operations of the branches, with the supervision of the lead Bank's board of directors, and assist in introducing prospective customers to the Banks as well as developing or modifying products and services to meet customer needs. The Banks function largely on a decentralized basis and the Company believes that such decentralized structure enhances the commitment of the Banks to the communities in which their branches are located. In contrast to many of their principal

competitors, the credit decisions of the Banks are made locally and promptly. The Company believes that the knowledge and expertise afforded by the local boards are key components to sound credit decisions. Expense control is an essential element in the Company's profitability. The Company has centralized virtually all of the Banks' back office support and investment functions in order to achieve consistency and cost efficiencies in the delivery of products and services.

On July 28, 1980, the Company acquired all of the outstanding shares of its predecessor, International Bank of Commerce ("IBC"), which is today the flagship bank of the Company, representing the majority of the Company's banking assets. IBC was chartered under the banking laws of Texas in 1966 and has its principal place of business at 1200 San Bernardo Avenue, Laredo, Webb County, Texas. It is a wholly-owned subsidiary of the Company. Since the acquisition of the flagship bank in 1980, the Company has formed three banks: (i) Commerce Bank, a Texas state banking association which commenced operations in 1982, located in Laredo, Texas ("Commerce Bank"); (ii) International Bank of Commerce, Brownsville, a Texas state banking association which commenced operations in 1984, located in Brownsville, Texas ("IBC-Brownsville"); and (iii) International Bank of Commerce, Zapata, a Texas state banking association which commenced operations in 1984, located in Zapata, Texas ("IBC-Zapata").

Historically, the Company has acquired various financial institutions and banking assets in its trade area. The community-focus of the subsidiary banks and the involvement of the local boards resulted in the Company becoming aware of acquisition possibilities in the ordinary course of its business. The Company's decision to pursue an acquisition is based on a multitude of factors, including the ability to efficiently assimilate the operations and assets of the acquired entity, the cost efficiencies to be attained and the growth potential of the market. While the Company has not acquired a financial institution in a number of years, the Company will continue to consider potential acquisition transactions based on the analysis of such factors.

The Company also has five direct non-banking subsidiaries. They are (i) IBC Life Insurance Company, a Texas chartered subsidiary which reinsures a small percentage of credit life and accident and health risks related to loans made by bank subsidiaries, (ii) IBC Trading Company, an export trading company which is currently inactive, (iii) IBC Subsidiary Corporation, a second-tier bank holding company incorporated in the State of Delaware, (iv) IBC Capital Corporation, a company incorporated in the State of Delaware for the purpose of holding certain investments of the Company and (v) Premier Tierra Holdings, Inc., a liquidating subsidiary formed under the laws of the State of Texas. The Company owns a fifty percent interest in Gulfstar Group I and II, Ltd. and related entities, which are involved in investment banking activities. The Company also owns a controlling interest in four merchant banking entities.

Website Access to Reports

The Company makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 available free of charge on or through the Company's internet website, www.ibc.com, as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the Securities and Exchange Commission ("SEC"). Additionally, the Company has posted on its website a code of ethics that applies to its directors and executive officers (including the Company's chief executive officer and financial officer). The Company's website also includes the charter for its Audit Committee and the Company's Excessive or Luxury Expenditure Policy. The Company's website will also include the Proxy Statement relating to the Company's 2014 Annual Meeting of Shareholders upon filing of the definitive Proxy Statement with the SEC.

Services and Employees

The Company, through its bank subsidiaries, IBC, Commerce Bank, IBC-Zapata and IBC-Brownsville, is 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. Certain of the bank subsidiaries are very active in facilitating international trade along the United States border with Mexico and elsewhere. The international banking business of the Company includes providing letters of credit, making commercial and industrial loans, and providing a nominal amount of currency exchange. Each bank subsidiary also offers other related services, such as credit cards, travelers' checks, safety deposit, collection, notary public, escrow, drive-up and walk-up facilities and other customary banking services. Additionally, each bank subsidiary makes available certain securities products through third party providers. The bank subsidiaries also make banking services available during traditional and nontraditional banking hours through their network of automated teller machines, and through their 211 facilities situated in retail locations, shopping malls and other convenient locations. Additionally, IBC introduced IBC Bank Online, an Internet banking product, in order to provide customers online access to banking information and services 24 hours a day.

The Company owns U.S. service mark registrations for "INTERNATIONAL BANK OF COMMERCE," "INTERNATIONAL BANK OF COMMERCE CENTRE," "OVERDRAFT COURTESY," "IBC," "IBC CONNECTION," "IBC ELITE," "IBC ELITE ADVANTAGE," "IBC BANK," "BIZ RITE CHECKING," "GOT YOU COVERED," "FREE BEE," "IT'S A BRIGHTER CHRISTMAS," "MINITROPOLIS," "WE DO MORE RX," "WE'VE GOT IT," a design mark depicting a bee character, a design mark depicting the United States and Mexico, and a design mark depicting "IBC" with the United States and Mexico. In addition, the Company owns Texas service mark registrations for "RITE CHECKING," "THE CLUB," "WALL STREET INTERNATIONAL," "INTERNATIONAL BANK OF COMMERCE," "WE DO MORE," a composite mark depicting "CHECK'N SAVE" with a design, a composite mark depicting "WALL STREET INTERNATIONAL," with a design and a design mark depicting the United States and Mexico. The Company also owns Oklahoma service mark registrations for "CHECK 'N SAVE," "RITE CHECKING," "THE CLUB," and "WE DO MORE." The Company regularly investigates the availability of service mark registrations related to certain proprietary products.

No material portion of the business of the Company may be deemed seasonal and the deposit and loan base of the Company's bank subsidiaries is diverse in nature. There has been no material effect upon the Company's capital expenditures, earnings or competitive position as a result of Federal, State or local environmental regulation.

As of December 31, 2013, the Company and its subsidiaries employed approximately 2,712 persons full-time and 511 persons part-time.

Competition

The Company is one of the largest independent Texas bank holding companies. The primary market area of the Company is South, Central and Southeast Texas, an area bordered on the east by the Galveston area, to the northwest by Round Rock, to the southwest by Del Rio and to the southeast by Brownsville, as well as the State of Oklahoma. The Company has increased its market share in its primary market area over the last several years through strategic acquisitions. The Company, through its bank subsidiaries, competes for deposits and loans with other commercial banks, savings and loan associations, credit unions and non-bank entities, which non-bank entities serve as an alternative to traditional financial institutions and are considered to be formidable competitors. The percentage of bank-related services being provided by non-bank entities has increased dramatically during the last several years.

The Company and its bank subsidiaries 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 Company's bank subsidiaries. Such deposits comprised approximately 28%, 28% and 29% of the bank subsidiaries' total deposits for the three years ended December 31, 2013, 2012 and 2011, respectively.

Under the Gramm-Leach-Bliley Act of 1999 (“GLBA”), effective March 11, 2000, 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. GLBA has significantly changed the competitive environment in which the Company and its subsidiaries 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 diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

Supervision and Regulation

GENERAL-THE COMPANY. In addition to the generally applicable state and Federal laws governing businesses and employers, the Company and its bank subsidiaries are further extensively regulated by special Federal and state laws governing financial institutions. These laws comprehensively regulate the operations of the Company’s bank subsidiaries 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. The descriptions are qualified in their entirety by reference to the full text of the applicable statutes, regulations and policies. 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 shareholders of the Company. Further, the earnings of the Company 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 influence to a significant extent the overall growth of bank loans, investments and deposits and 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 the future earnings and business of the Company 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” (the “Dodd-Frank Act”) was signed into law. The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape, including provisions that, among other things, will:

- Centralize responsibility for consumer financial protection by creating a new agency, the Bureau of Consumer Financial Protection (the “CFPB”), responsible for implementing, examining and enforcing compliance with federal consumer financial laws.
- Restrict the preemption of state law by federal law and disallow subsidiaries and affiliates of banks from availing themselves of such preemption.
- Apply the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies.
- Require each federal bank regulatory agency to seek to make its capital requirement for banks countercyclical so that capital requirements increase in times of economic expansion and decrease in times of economic contraction.
- Require financial holding companies, such as the Company, to be well-capitalized and well-managed. Bank holding companies and banks must also 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 \$10 billion in assets or more, like the Company, to create a risk committee responsible for the oversight of risk management of the enterprise. On December 20, 2011, the FRB proposed a rule requiring each publicly-traded bank holding company with total consolidated assets of \$10 billion or more to establish a risk committee of its board of directors, to be chaired by an independent director, with at least one member with risk management expertise. The FRB is expected to issue a final rule in 2014, which will be applicable to the Company.
- Require stress testing of certain financial institutions. On June 15, 2011, the FRB published for comment proposed guidance (“Stress Testing Guidance Proposal”) that would require bank holding companies with over \$10 billion in total consolidated assets to conduct stress testing as a part of overall institution risk management. The Stress Testing Guidance Proposal includes stress testing capital and non-capital related aspects of financial condition, provides an overview of how a banking organization should develop a structure for stress testing, outlines general principles for a satisfactory stress testing framework, and describes how stress testing should be used at various levels within a banking organization. The Stress Testing Guidance Proposal also discusses the importance of stress testing in liquidity planning and the importance of strong internal governance and controls in an effective stress-testing framework. On October 9, 2012, the FRB issued its final stress testing rule for bank holding companies with over \$10 billion in total consolidated assets. The FRB’s rule was effective on November 15, 2012; however, the rule delayed implementation for bank holding companies with total consolidated assets between \$10 billion and \$50 billion, such as the Company, until October 2013. The Company was required to commence conducting the stress testing described in the Stress Testing Guidance Proposal in late 2013. On January 17, 2012, the FDIC issued a similar proposal that would require state nonmember banks with over \$10 billion in assets to conduct annual stress tests, report the results to the FDIC, and make the results available to the public. On October 9, 2012, the FDIC issued its final rule which became effective on October 15, 2012; however, the rule delays implementation for state nonmember banks with total consolidated assets between \$10 billion and \$50 billion until October 2013. At this time, none of the subsidiary banks of the Company would meet the \$10 billion asset threshold required to conduct the bank stress tests under the FDIC’s final rule.
- Implement corporate governance revisions, including executive compensation and proxy access by shareholders that apply to all public companies, not just financial institutions.
- 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 and provided unlimited federal deposit insurance for non-interest bearing demand transaction accounts at all insured depository institutions until December 31, 2012.
- Repeal the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts. In July 2011, the FRB issued a final rule, effective July 21, 2011, repealing Regulation Q, which had prohibited the payment of interest on demand deposits.
- Amend the Electronic Fund Transfer Act (“EFTA”) to, among other things, give the FRB the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that

such fees be reasonable and proportional to the actual cost of a transaction to the issuer. In June 2011, the FRB issued a final rule, effective October 1, 2011, which established the maximum permissible interchange fee that an issuer may receive for an electronic debit transaction at 21 cents per transaction and 5 basis points multiplied by the value of the transaction. The FRB also approved an interim final rule that allows for an upward adjustment of no more than 1 cent to an issuer's debit card interchange fee if the issuer develops and implements appropriate fraud-prevention policies and procedures.

- Increase the authority of the FRB to examine the Company and its non-bank subsidiaries.
- Permit interstate de novo branching without the need to acquire an existing bank.
- Require extensive new restrictions and requirements relating to residential mortgage transactions. The CFPB has already issued final mortgage lending rules relating to mortgage loan origination standards, borrower ability to repay, mandatory escrow accounts for higher priced mortgage loans, qualified mortgages, integrated disclosures, mortgage loan appraisals, force-placement of hazard insurance and expanded Home Mortgage Disclosure Act ("HMDA") collection and reporting requirements.
- Eliminate the use of credit ratings in bank regulations, including capital regulations. On November 18, 2011, the OCC proposed guidance on due diligence requirements in determining whether investment securities are eligible for investment and on January 11, 2012, the FDIC and the other Federal bank agencies proposed a rule to modify the agencies' market risk capital rules by incorporating into the rules various alternatives and complex methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings.
- Establish a Whistleblower Incentives and Protection Program for public company employees. On May 25, 2011, the SEC approved final rules whereby whistleblowers may receive 10% to 30% of the SEC-levied sanctions when a whistleblower voluntarily provides original information to the SEC and the sanctions levied against the culpable party exceed \$1 million in an enforcement proceeding.
- On October 23, 2013, the federal bank agencies and the SEC proposed joint standards for assessing the diversity policies and practices of each agency's respective regulated entities, implementing Section 342 of the Dodd-Frank Act, which requires 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. The agencies propose uniform standards in the following four areas: (1) organizational commitment to diversity and inclusion, (2) workforce profile and employment practices, (3) procurement and business practices (supplier diversity), and (4) practices to promote transparency of organizational diversity and inclusion. The proposal stresses that assessments should take into consideration an entity's size and other characteristics such as total assets, number of employees, revenues, governance structures, and the number of members and/or customers, contract volume, geographic location, and community characteristics. The agencies are expected to issue a final rule sometime in 2014. Once the final rule is issued, it is likely that regulated entities will need to adjust their existing policies and practices to conform.
- Requires the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the "Volcker Rule." In October 2011, federal regulators proposed rules to implement the Volcker Rule that included an extensive request for comments on the proposal, which were due by February 13, 2012. On December 10, 2013, the federal financial regulatory agencies issued final rules which prohibit insured depository institutions and companies affiliated with insured depository institutions from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on these instruments, for their own account. The final rules also impose limits on banking entities' investments in, and other relationships with,

hedge funds or private equity funds. Like Section 619 of the Dodd-Frank Act, the final rules provide exemptions for certain activities, including market making, underwriting, hedging, trading in government obligations, insurance company activities, and organizing and offering hedge funds or private equity funds. The final rules also clarify that certain activities are not prohibited, including acting as agent, broker or custodian. The compliance requirements under the final rules vary based on the size of the banking entity and the scope of activities conducted. The conformance period begins on July 21, 2015, giving banking entities an additional year to comply. However, the final rule's reporting requirements will be phased in starting on June 30, 2014 for banking entities with \$50 billion or more in trading assets and liabilities; on April 30, 2016 for banking entities with at least \$25 billion, but less than \$50 billion, in trading assets and liabilities; and on December 31, 2016 for banking entities with at least \$10 billion, but less than \$25 billion, in trading assets and liabilities. The Company does not currently anticipate that the Volcker Rule will have a material effect on the operations of the Company and its subsidiaries, as the Company does not engage in the businesses prohibited by the Volcker Rule.

- Authorizes the Federal Reserve Board to adopt enhanced supervision and prudential standards generally for bank holding companies with total consolidated assets of \$50 billion or more (often referred to as “systemically important financial institutions” or “SIFI”), and authorizes the FRB to establish such standards either on its own or upon the recommendations of the Financial Stability Oversight Council (“FSOC”), a new systemic risk oversight body created by Dodd-Frank. The FSOC has the authority to veto a financial rule of the CFPB if the rule would threaten the safety and soundness of the entire U.S. banking system. In December 2011, the FRB issued for public comment a notice of proposed rulemaking establishing such enhanced supervision and prudential standards. Most of the proposed SIFI rules will not apply to the Company because the Company has total consolidated assets in an amount less than \$50 billion. Two aspects of the proposed SIFI rules—requirements for annual stress testing of capital and certain corporate governance provisions requiring, among other things, that each bank holding company establish a risk committee of its board of directors, apply to bank holding companies with total consolidated assets of \$10 billion or more, including the Company.

Many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more generally. 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 in the legislation that require revisions to the capital requirements of the Company could require the Company to seek other sources of capital in the future. Some of the rules that have been adopted or proposed to comply with the Dodd-Frank Act are discussed further below.

EMERGENCY ECONOMIC STABILIZATION ACT. On October 3, 2008, the President signed into law the Emergency Economic Stabilization Act of 2008 or (“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. On December 23, 2008, the Company sold \$216 million of Series A Preferred Stock to the Treasury under the CPP (the “Series A Preferred Stock”) and a warrant to purchase 1,326,238 shares of Company Common Stock at a price per share of \$24.43 and with a term of ten years (the “Warrant” or “Warrants”). As of November 28, 2012, the Company had repurchased all of the Series A Preferred Stock and exited the TARP Program. On June 12, 2013, the U.S. Treasury sold the Warrant to a third party. As of December 31, 2013, none of the Warrant had been exercised. The Warrant expires on December 23, 2018.

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the “ARRA”). ARRA was intended to provide a stimulus to the U.S. economy in the wake of the economic downturn brought about by the subprime mortgage crisis and the resulting credit crunch. ARRA includes federal tax cuts, expansion of unemployment benefits and other social welfare provisions, and domestic spending in education, healthcare, and infrastructure, including the energy structure. ARRA also includes numerous non-economic recovery related items, including a limitation on executive compensation of certain of the most highly-compensated employees and executive officers of financial institutions, such as the Company, during the period that they participated in the TARP Capital Purchase Program.

FRB APPROVALS. The Company is a registered bank holding company within the meaning of the BHCA, and is subject to supervision by the FRB and to a certain extent the Texas Department of Banking (the “DOB”). The Company is required to file with the FRB annual reports and other information regarding the business operations of itself and its subsidiaries. It is also subject to examination by the FRB. Under the BHCA, a bank holding company is, with limited exceptions, prohibited from acquiring direct or indirect ownership or control of any voting stock of any company which 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. One of the exceptions to this prohibition is the ownership of shares of any company provided such shares do not constitute more than 5% of the outstanding voting shares of the company and so long as the FRB does not disapprove such ownership. Another exception to this prohibition is the ownership of shares of a company the activities of which the FRB has specifically determined 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, depending on the circumstances, 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, such as the Company, subject to certain exceptions for certain transactions. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is rebuttably presumed to exist if a person acquires 10% or more but less than 25% of any class of voting securities where the bank holding company, such as the Company, has registered Securities under Section 12 of the Securities Exchange Act of 1934 (the “Exchange Act”).

As a bank holding company, the Company is 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, the Company would directly or indirectly own or control 5% or more of the voting shares of such bank or bank holding company.

THE USA PATRIOT ACT. Combating money laundering and terrorist financing is a major focus of financial institution regulatory policy. The USA PATRIOT Act of 2001 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 USA 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. The Company has a program in place to monitor and enforce its policies on money laundering, corruption and bribery as well as its 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 January 2011, the IRS published a notice of proposed rulemaking to provide guidance on the reporting requirements for interest on deposits paid to nonresident alien individuals. Rules currently in effect require reporting of U.S. bank deposit interest only if the interest is paid to a U.S. person or nonresident alien individual who is a resident of Canada. The proposed rule, however, would extend the reporting requirements to include bank deposit interest paid to nonresident alien individuals who are residents of any foreign country. On May 14, 2012, the IRS issued its final rule which became effective on January 1, 2013. Under the final rule, U.S. banks are required 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. Implementation of the final rule could lead to deposit withdrawals by individuals who were not previously subject to the reporting requirement.

OFFICE OF FOREIGN ASSETS CONTROL REGULATION. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the “OFAC” rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control (“OFAC”). The OFAC administered sanctions take many forms, including without limitation, 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 Gramm-Leach-Bliley Act of 1999 (“GLBA”) eliminates the barriers to affiliations among banks, securities firms, insurance companies and other financial service providers. GLBA provides for a new type of financial holding company structure under which affiliations among these entities may occur. Under 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, GLBA permitted certain non-banking financial and financially related activities to be conducted by financial subsidiaries of banks.

Under 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”). The Company has elected to become a financial holding company under GLBA 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 which acquired two insurance agencies. A financial holding company that has a securities affiliate registered under the Act or a qualified insurance affiliate may make permissible merchant banking investments. As of December 31, 2013, the Company has made 35 merchant banking investments.

The FRB and the Secretary of the Treasury have regulations governing the scope of permissible merchant banking investments. The investments that may be made under this authority 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.” Before making a merchant banking investment, a financial holding company must either be or have a securities affiliate registered under the Exchange Act 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 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 of its portfolio companies. 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 (the “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 rule applies a graduated capital charge on covered equity investments which would increase as the proportion of such investments to Tier 1 Capital increases.

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. However, the Dodd-Frank Act limits the applicability of the preemption doctrine so that state laws affecting national banks are preempted only in certain circumstances. In May 2011, the OCC first proposed new regulations to implement the Dodd-Frank Act’s preemption provision. On July 20, 2011, the OCC issued its final preemption rule wherein it concluded that the Dodd-Frank Act does not create a new, stand-alone preemption standard, but rather, incorporates the conflict preemption legal standard and the reasoning that supports it in the Supreme Court’s *Barnett* decision. The OCC confirmed that precedent consistent with the standard set forth in *Barnett Bank v. Nelson*, 417 U.S. 25 (1996), including existing OCC regulations, are “preserved,” including federal preemption over state consumer protection laws. The OCC also confirmed its belief that the procedural requirement applicable to an OCC determination that a state consumer financial law is preempted, apply prospectively and do not invalidate prior precedent. The OCC determined that its existing preemption rules conformed with *Barnett Bank*. The OCC did make modifications to its rules to clarify that *Barnett Bank* is controlling. Finally, the OCC 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. Since Texas state chartered banks have parity with national banks as to their powers (discussed further herein), the preemption rule has significance for the Company’s bank subsidiaries.

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

NASDAQ LISTING STANDARDS. The Company is traded on the NASDAQ Stock Market. The Company must comply with the 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 (up to a maximum of five years, which is the maximum Texas has adopted) established by the host State. 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 (10%) of all deposits nationwide or thirty percent (30%) of any one State’s deposits, or such higher or lower percentage established by the host State. The anti-concentration limit in Texas has been set at twenty percent (20%) of all federally insured deposits in Texas. As allowed by the Interstate Banking Act, the Company acquired LFIN, including its Oklahoma financial institution, during 2004. 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 cease-and-desist and divestiture 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 bank subsidiary experiences either a significant loan loss or rapid growth of loans or deposits, the Company may be compelled by the FRB to invest additional capital in the bank subsidiary. Further, the Company would be required to guaranty performance of the capital restoration plan of any undercapitalized bank subsidiary. 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, to order termination of non-banking activities of non-banking subsidiaries of bank holding companies and to 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. The Company is subject to regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The FRB is authorized 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, in the current financial and economic environment, the FRB has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong.

CROSS-GUARANTEE PROVISIONS. The Financial Institutions Reform Recovery and Enforcement Act of 1989 (“FIRREA”) contains a “cross-guarantee” provision which generally makes commonly controlled insured depository institutions liable to the FDIC for any losses incurred in connection with the failure of a commonly controlled depository institution.

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 codifies this policy as a statutory requirement and the federal financial regulatory agencies are expected to issue a rule implementing this statutory requirement in 2014. Under this requirement, the Company is expected to commit resources to support its subsidiary banks, including at times when the Company may not be in a financial position to provide such resources. Any capital loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. 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.

GENERAL—BANK SUBSIDIARIES. All of the bank subsidiaries of the Company are state banks subject to regulation by, and supervision of, the Texas DOB and the FDIC.

DEPOSIT INSURANCE. All of the bank subsidiaries of the Company are examined by the FDIC, which currently insures the deposits of each member bank up to applicable limits. Deposits of each of the bank subsidiaries 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.

In December 2008, the FDIC issued a final rule that raised the then current assessment rates uniformly by 7 basis points for the first quarter of 2009 assessment, which resulted in annualized assessment rates for institutions, such as the subsidiary banks in Risk Category 1 (“Risk Category 1 institutions”), ranging from 12 to 14 basis points (basis points representing cents per \$100 of assessable deposits). In February 2009, the FDIC issued final rules to amend the DIF restoration plan, change the

risk-based assessment system and set assessment rates for Risk Category 1 institutions beginning in the second quarter of 2009. The initial base assessment rates for Risk Category 1 institutions range from 12 to 16 basis points, on an annualized basis. After the effect of potential base-rate adjustments, total base assessment rates range from 7 to 24 basis points.

In November 2009, the FDIC issued a rule that required all deposit institutions, with limited exceptions, to prepay their estimated quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011, and 2012.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. Under the new restoration plan, the FDIC will forego the uniform three-basis point increase in initial assessment rates scheduled to take place on January 1, 2011, and maintain the current schedule of assessment rates for all depository institutions. At least semi-annually, the FDIC will update its loss and income projections for the fund and, if needed, will increase or decrease assessment rates, following notice-and-comment rulemaking if required.

In November 2010, the FDIC issued a final rule to implement provisions of the Dodd-Frank Act that provide for temporary unlimited coverage for non-interest bearing transaction accounts. The separate coverage for non-interest bearing transaction accounts became effective on December 31, 2010 and terminated on December 31, 2012.

In February 2011, the FDIC issued a final rule effective April 1, 2011 that set a target size for the insurance fund and changed the deposit insurance assessment base from total domestic deposits to average total assets minus average tangible equity, as required by the Dodd-Frank Act. The rule finalizes a target size for the DIF at 2 percent of insured deposits. It also implements a lower assessment rate schedule when the fund reaches 1.15 percent and, in lieu of dividends, provides for a lower rate schedule when the reserve ratio reaches 2 percent and 2.5 percent. The final rule creates a risk-based scorecard assessment system for banks with more than \$10 billion in assets. The scorecards include financial measures that the FDIC believes are predictive of long-term performance. In September 2011, the FDIC issued new guidelines that reflect the methodology it now uses to determine assessment rates for large and highly complex institutions. A “large institution” is defined as an insured depository institution with assets of \$10 billion or more, and a “highly complex institution” is defined as an insured depository institution with assets of \$50 billion or more. Total scores are determined according to the April 1, 2011 final rule. While none of the Company’s subsidiary banks currently meet the definition of a large institution under the new guidelines, the Company cannot provide any assurance as to the effect of any further change in its deposit insurance premium rate, should such a change occur, as such changes are dependent upon a variety of factors, some of which are beyond the Company’s control.

Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the 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.

CAPITAL ADEQUACY. The Company and its bank subsidiaries are currently required to meet certain minimum regulatory capital guidelines utilizing total capital-to-risk-weighted assets and Tier 1 Capital elements. 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 must be comprised of Core Capital or Tier 1 Capital elements. Tier 1 Capital of the Company 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 the financial institution acquisitions of the Company after February 1992 are deducted from the sum of core capital elements when determining the capital ratios of the Company.

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. The Company’s leverage ratio at December 31, 2013 was 11.61%. 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. Furthermore, the guidelines indicate that the FRB will continue to consider a “tangible tier 1 leverage ratio” (deducting all intangibles) in evaluating proposals for expansion or new activity. The FRB has not advised the Company of any specific minimum leverage ratio or tangible Tier 1 leverage ratio applicable to it. For a bank holding company to be considered “well-capitalized” under the regulatory framework for prompt corrective action, its leverage ratio must be at least 5.0%.

Each of the Company’s bank subsidiaries is subject to similar capital requirements adopted by the FDIC. Each of the Company’s bank subsidiaries had a leverage ratio in excess of five percent as of December 31, 2013. As of that date, the federal banking agencies had not advised any of the bank subsidiaries of any specific minimum leverage ratio applicable to it.

In March 2005, the FRB issued a final rule that would continue to allow the inclusion of trust preferred securities in Tier 1 capital, but with stricter quantitative limits. Under the final rule, after a five-year transition period ending March 31, 2009, the aggregate amount of trust preferred securities and certain other capital elements would be limited to 25% of Tier 1 capital elements, net of goodwill, less any associated deferred tax liability. The amount of trust preferred securities and certain other elements in excess of the limit could be included in Supplementary Capital or Tier 2 capital, subject to restrictions. Tier 2 capital includes among other things, perpetual preferred stock, qualifying mandatory convertible debt securities, qualifying subordinated debt, and allowances for probable loan and lease losses, subject to limitations. Bank holding companies with significant international operations will be expected to limit trust preferred securities to 15% of Tier 1 capital elements, net of goodwill; however, they may include qualifying mandatory convertible preferred securities up to the 25% limit. On March 16, 2009, the FRB extended for two years the transition period. Substantially all of the trust preferred securities issued by the Company qualified as Tier 1 capital after the transition period ended on March 31, 2011. The Collins Amendment to the Dodd-Frank Act further restricts the use of trust preferred securities by excluding them from the regulatory capital of banking holding companies more broadly. However, for institutions with consolidated assets of less than \$15 billion on December 31, 2009, such as the Company, the Collins Amendment will not apply to securities issued before May 19, 2010 and all the Company’s trust preferred securities were issued before such date.

Effective December 19, 1992, the federal bank regulatory agencies 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 FDICIA mandate corrective actions are taken if a bank is undercapitalized. Based on the Company’s and each of the bank subsidiaries’ capital ratios as of December 31, 2013, the Company and each of the bank subsidiaries 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. The Company does not have any Tier 3 capital and did not need Tier 3 capital to offset market risks. In January 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. Dodd-Frank directs 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.

The federal regulatory authorities' risk-based capital guidelines are based upon the 1988 capital accord of the Basel Committee on Banking Supervision (the "BIS"). The BIS is a committee of central banks and bank supervisors/regulators from the major industrialized countries that develops broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply. In June 2004, the BIS released a new capital accord to replace the 1988 capital accord with an update in November 2005 ("BIS II"). BIS II would set capital requirements for operational risk, and refine the existing capital requirements for credit risk and market risk exposures. The United States federal banking agencies are developing proposed revisions to their existing capital adequacy regulations and standards based on BIS II. A definitive final rule for implementing BIS II in the United States that would apply only to internationally active banking organizations, or "core banks"—defined as those with consolidated total assets of \$250 billion or more or consolidated on-balance sheet foreign exposures of \$10 billion or more became effective as of April 1, 2008. Other U.S. banking organizations may elect to adopt the requirements of this rule (if they meet applicable qualification requirements), but they will not be required to apply them. The rule also allows a banking organization's primary federal supervisor to determine that the application of the rule would not be appropriate in light of the bank's asset size, level of complexity, risk profile, or scope of operations. The Company is not required to comply with BIS II at this time.

In July 2008, the banking agencies issued a proposed rule that would give banking organizations that are not required to comply with Basel II the option to implement a new risk-based capital framework. This framework would adopt the standardized approach of Basel II for credit risk, the basic indicator approach of Basel II for operational risk, and related disclosure requirements. While this proposed rule generally parallels the relevant approaches under Basel II, it diverges where United States markets have unique characteristics and risk profiles, most notably with respect to risk weighting residential mortgage exposures. Comments on the proposed rule were due to the agencies by October 27, 2008, but a definitive final rule has not been issued.

The Dodd-Frank Act requires the FRB, the OCC and the FDIC to adopt regulations imposing a continuing "floor" of the BIS risk-based capital requirements in cases where the BIS risk-based capital requirements and any changes in capital regulations resulting from Basel-III (see below) otherwise would permit lower requirements. In December 2010, the FRB, the OCC and the FDIC issued a joint notice of proposed rulemaking that would implement this requirement. On June 24, 2011, the agencies approved this rule in final form and it became effective on July 28, 2011.

In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III." Basel III, when implemented by the U.S. banking agencies and fully phased-in, will require bank holding companies and their bank subsidiaries 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. Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III, including the imposition of additional capital surcharges on globally systemically important financial institutions.

In addition to Basel III, the Dodd-Frank Act requires or permits the Federal banking agencies to adopt regulations affecting banking institutions’ capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. In January 2011, the FRB, OCC and FDIC requested comment on a proposal to implement various revisions to the market risk framework adopted by the Basel Committee between July 2005 and June 2010. The revisions would significantly modify the agencies’ market risk capital rules to better capture those positions for which application of the market risk capital rules are appropriate, address shortcomings in the modeling of certain risks, address procyclicality concerns, enhance the rules’ sensitivity to risks that are not adequately captured under the current regulatory capital measurement methodologies, and increase transparency through enhanced disclosures.

The January 2011 proposal did not include the methodologies adopted by the Basel Committee for calculating the standard specific risk capital requirements for certain debt and securitization positions, because the BCBS methodologies generally rely on credit ratings. Under section 939A of the Dodd-Frank Act, all federal agencies must remove references to and requirements of reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness. Accordingly, in November 2011, the agencies proposed to incorporate into the proposed market risk capital rules certain alternative methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings. On August 30, 2012, the agencies issued their final rule. In November 2011, the OCC requested comment on proposed guidance related to due diligence requirements in determining whether investment securities are eligible for investment, and on June 26, 2012, the OCC issued a final rule. The OCC rule is expected to influence the FDIC’s treatment of due diligence for state-chartered nonmember banks, such as the Company’s bank subsidiaries. The OCC rule greatly complicates the due diligence that financial institutions must conduct on securities prior to purchasing the securities due to the inability of financial institutions to rely on credit ratings.

On June 12, 2012, the FRB, OCC and FDIC formally proposed for comment, three separate, but related proposals, which would significantly revise the regulatory capital requirements for all U.S. banking organizations with over \$500 million in assets by, among other things, implementing the BASEL III capital reforms and incorporating various Dodd-Frank Act-related capital provisions. Based on the core requirements of the 2011 International Basel III Accord, and in significant part on the “standardized approach” for the weighting and calculation of risk-based capital requirements under the 2004-2006 Basel II Accord, the June 2012 proposals would extend large parts of a regulatory capital regime that was originally intended only for large, internationally active banks to all U.S. banks and their holding companies, except for small bank holding companies (generally, those with under \$500 million in consolidated assets).

The June 2012 proposal is complex and sets forth minimum regulatory capital requirements and a standardized approach for risk-weighted assets. With respect to the Company, the June 2012 proposal would:

- Revise the definition of regulatory capital components and related calculations;

- Add a new Common Equity Tier 1 Risk-Based Capital Ratio;
- Incorporate the revised regulatory capital requirements into the Prompt Corrective Action regulatory framework;
- Implement a new Capital Conservation Buffer;
- Revise rules for calculating risk-weighted assets; and
- Provide a transition period for several aspects of the proposal.

The June 2012 proposal includes a new definition of Common Equity Tier 1 and includes the new components of “Accumulated Other Comprehensive Income (Loss)” that factors into the calculation of Common Equity Tier 1 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. The proposal creates a category referred to as “High Volatility CRE” which would have a risk weight of 150% and generally include nonresidential acquisition development or construction financing. The proposal would require the phase-out from Tier 1 Capital of trust preferred securities and cumulative preferred stock over a ten-year time period.

The June 2012 proposal also would 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.

The effective dates for the June 2012 proposal’s requirements were proposed to be phased in between January 1, 2013 to January 1, 2022; however, the agencies extended the comment deadline and have delayed the issuance of a final rule. In July 2013, the agencies separately issued a final rule consisting of minimum requirements that increase for both the quantity and quality of capital held by banking organizations. Consistent with the international Basel framework, the rule included a new minimum ratio of common equity tier 1 to risk-weighted assets of 4.5 percent and a common equity tier 1 capital conservation buffer of 2.5 percent of risk-weighted assets that will apply to all supervised financial institutions. The rule also raised the minimum ratio of tier 1 capital to risk-weighted assets from 4 percent to 6 percent and includes a minimum leverage ratio of 4 percent for all banking organizations. In addition, for the largest, most internationally active banking organizations, the final rule included a new minimum supplementary leverage ratio that takes into account off-balance sheet exposures.

On the quality of capital side, the final 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 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.

The phase-in period for mandatory compliance with the final rule was January 1, 2014 for most advanced approach banking organizations, and January 1, 2015 for all other covered banking organizations, including the Company.

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. On January 7, 2013, Basel III liquidity coverage ratio was published and it uses international liquidity standards that serves to reconcile the differences of the liquidity standards of countries. The Basel Committee will 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. On October 30, 2013, the federal bank regulatory agencies 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 in January 2013, 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. Also on October 30, 2013, a separate proposed rule was issued by the Federal Reserve to apply a modified version of the LCR to certain depository institution holding companies with assets greater than \$50 billion.

STATE ENFORCEMENT POWERS. The Banking Commissioner of Texas may determine to close a Texas state bank when he 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 also has broad enforcement powers over the bank subsidiaries, including the power to impose orders, remove officers and directors, impose fines and appoint supervisors and conservators.

DEPOSITOR PREFERENCE. Because the Company is a legal entity separate and distinct from its bank subsidiaries, its right to participate in the distribution of assets of any subsidiary upon the subsidiary’s liquidation or reorganization will be subject to the prior claims of the subsidiary’s creditors. In the event of a liquidation or other resolution of 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 (such as the Company) or any shareholder or creditor thereof.

COMMUNITY REINVESTMENT ACT (“CRA”). Under the CRA, the FDIC is required to assess the record of each bank subsidiary 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. The FIRREA requires federal banking agencies to make public a rating of a bank’s performance under the CRA. The Company’s bank subsidiaries conduct an award-winning financial literacy program in their communities as part of their community outreach. Further, there are fair lending laws, including the Equal Credit Opportunity Act and the Fair Housing Act, which prohibit discrimination in connection with lending decisions. The bank regulators periodically conduct fair lending evaluations of banks. Each of the subsidiary banks of the Company received a “Satisfactory” CRA rating in its most recently completed examination. 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, 2014. “Large institution” now means a bank with total assets of at least \$1.202 billion for December 31 of both of the prior two calendar years and “intermediate small institution” means an institution with assets of at least \$300 million and less than \$1.202 billion as of December 31 of both of the prior two calendar years. Three of the Company’s subsidiary banks are “intermediate small institutions” and the flagship bank is a “large institution” under the new asset thresholds.

CONSUMER LAWS. In addition to the laws and regulations discussed herein, the Bank is 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 Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations. The Dodd-Frank Act provides for comprehensive new rules regulating mortgage activities and creates the new CFPB with direct supervisory authority over banks with assets of \$10 billion or more and certain nonbank entities. Authority to implement almost all federal consumer financial protection laws and regulations was transferred to the CFPB on July 21, 2011. The CFPB has broad authority, among other matters, to declare acts or practices to be “unfair, deceptive, or abusive,” to develop and require new consumer disclosures, and to restrict the use of certain arbitration clauses. While the CFPB does not currently have direct supervisory authority over any of the Company’s 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 Company’s subsidiary bank’s consumer compliance programs. On January 20, 2012, the CFPB issued a final rule that imposes new disclosure requirements for foreign remittance transfer transactions, including disclosures giving the consumer thirty minutes after payment is made to cancel the transaction, and providing new consumer protections, including error resolution rights. The 2012 final rule’s February 7, 2013 effective date was delayed as the CFPB proposed modifying the rule. On May 22, 2013, the CFPB issued final rule amendments which addressed three specific issues and the amendments were effective in October 2013. First, the 2013 final rule modified the 2012 final rule to make optional, in certain circumstances, the requirement to disclose fees imposed by a designated recipient’s institution. Second, the 2013 final rule also made optional the requirement to disclose taxes collected by a person other than the remittance transfer provider. In place of these two former requirements, the 2013 final rule required disclaimers to be added to the rule’s disclosures indicating that the recipient may receive less than the disclosed total due to the fees and taxes for which disclosure is now optional. Finally, the 2013 final rule revised the error resolution provisions that apply when a remittance transfer is not delivered to a designated recipient because the sender provided incorrect or insufficient information, and, in particular, when a sender provides an incorrect account number or recipient institution identifier that results in the transferred funds being deposited in the wrong account.

ELECTRONIC BANKING. In 2005, the Federal Financial Institutions Examination Council (the “FFIEC”) issued guidance entitled “Authentication in an Internet Banking Environment” (the “2005 Guidance”), which provided a risk management framework for financial institutions offering Internet-based products and services to their customers. It 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. On June 29, 2011, the FDIC and the 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 indicates that layered security controls should include processes to detect and respond to suspicious or anomalous activity and, for business accounts, administrative controls. In September 2011, the Texas Bankers Electronic Crimes Task Force, formed by the Texas Banking Commissioner and the U.S. Secret Service, issued guidance entitled “Best Practices: Reducing the Risks of Corporate Account Takeovers.” In accordance with FDIC FIL-2011, this guidance sets forth nineteen best practices to reduce the risk of corporate account takeover thefts. The Company’s subsidiary banks are required to comply with these guidelines and best practices.

AFFILIATE TRANSACTIONS. The Company, IBC and the other bank subsidiaries of the Company are “affiliates” within the meaning of Section 23A of the Federal Reserve Act which sets forth certain restrictions on loans and extensions of credit between a bank subsidiary and affiliates, on investments in an affiliate’s stock or other securities, and on acceptance of such stock or other securities as collateral for loans. Such 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 bank subsidiary of the Company is wholly-owned by the 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, and it will require that the 10% of capital limit on covered transactions begin to apply to non-bank financial subsidiaries. "Covered transactions" are defined by statute 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 Federal Reserve Board) 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. The FRB is expected to amend Regulation W to address changes made by the Dodd-Frank Act.

INSIDER LOANS. The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as "insiders") contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower, prohibition on preferential terms, and other conditions that must be met before such a loan can be made. 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.

LENDING RESTRICTIONS. The operations of the Banks are also subject to lending limit restrictions pertaining to the extension of credit and making of loans to one borrower. Further, under the BHCA and the regulations of the FRB thereunder, the Company and its subsidiaries are prohibited from engaging in certain tie-in arrangements with respect to any extension of credit or provision of property or services; however, the FRB adopted a rule relaxing tying restrictions by permitting a bank holding company to offer a discount on products or services if a customer obtains other products or services from such company. In February 2005, the banking agencies issued best practices guidelines on overdraft protection programs which state that overdraft protection programs are an extension of credit, but are not subject to Truth-in-Lending disclosure requirements. On November 12, 2009, the FRB issued final rules amending Regulation E that prohibit financial institutions from charging consumers fees for paying overdrafts on ATM and on-time debit card transactions, unless the consumer consents or opts-in to the overdraft service for those types of transactions. In November 2010, the FDIC issued final overdraft protection guidance, effective July 1, 2011, which focuses on automated overdraft programs and encourages banks to offer less costly alternatives. Additionally, the FDIC requires banks to monitor programs for excessive or chronic customer use and to undertake meaningful and effective follow-up action thereafter, institute appropriate daily limits on customer costs, consider eliminating overdraft fees for transactions that overdraw an account by a de minimis amount, ensure that transactions are not processed in a manner designed to maximize the costs to consumers, and ensure that boards of directors provide appropriate oversight of overdraft protection programs.

MORTGAGE LENDING. On January 10, 2013, the CFPB issued its final rule on ability to repay and qualified mortgage standards to implement various requirements of the Dodd-Frank Act amending the Truth in Lending Act. The final rule requires mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer will have the ability to repay a mortgage loan according to its terms before making the loan. The final rule also includes a definition of a qualified mortgage, which provides the lender with the presumption that the ability to repay requirements have been met. This presumption is rebuttable if the loan is a "sub-prime" loan or conclusive if the loan is a "prime" loan. However, whether a prime or sub-prime loan, the borrower can challenge the loan's status as a qualified mortgage in a direct cause of action for three years from the origination date and as a defense in a foreclosure action at any time.

The final rules were effective on January 10, 2014. The final rules contain specific and substantive requirements and limitations on mortgage banking that have required creditors to revise loan products and origination and underwriting policies and procedures, practices and systems. Substantial penalties may apply if a lender fails to meet ability to repay standards for a loan, including actual damages (which could include the borrower's down payment), statutory damages up to \$4,000, all fees paid by the borrower, up to three years of finance charges paid by the borrower, and court costs and reasonable attorney's fees. Additionally, during 2013, the CFPB finalized a number of rules regarding mortgage lending, including appraisal and escrow requirements for higher-priced mortgages, new integrated RESPA/Regulation Z disclosures, mortgage servicing, and loan originator compensation requirements.

DIVIDENDS. The ability of the Company to pay dividends is largely dependent on the amount of cash derived from dividends declared by its bank subsidiaries. The payment of dividends by any bank or bank holding company is affected by the requirement to maintain adequate capital as discussed above. The ability of the Banks, as Texas banking associations, to pay dividends is restricted under Texas law. A Texas bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. 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. Additionally, as a result of the Company's participation in the CPP, the Company was restricted in the payment of dividends and was not allowed without the Treasury Department's consent to declare or pay any dividend on the Company Common Stock other than a regular semi-annual cash dividend of not more than \$.33 per share, as adjusted for any stock dividend or stock split. The restriction ceased to exist on December 23, 2011 and the Company exited the TARP program when it finalized the repayment of all of the TARP funds on November 28, 2012. At December 31, 2013, there was an aggregate of approximately \$584,000,000 available for the payment of dividends to the Company by IBC, Commerce Bank, IBC-Zapata and IBC-Brownsville under the applicable restrictions, assuming that each of such banks continues to be classified as "well capitalized." Further, the Company could expend the entire \$584,000,000 and continue to be classified as "well capitalized". Note 20 of Notes to Consolidated Financial Statements of the Company in the 2013 Annual Report is incorporated herein by reference.

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

INCENTIVE COMPENSATION. In June 2010, the Federal Reserve, 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 Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company. 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 Securities and Exchange Commission 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, like the Company. 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.

Effective April 1, 2011, Regulation Z was amended 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 in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect the Company's ability to hire, retain and motivate its 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 the operating environment of the Company in substantial and unpredictable ways. Such changes could have a material effect on the business of the Company. The Company cannot predict whether any such changes will be adopted and the Company cannot determine the ultimate effect that potential legislation, if enacted, or implementing regulations with respect thereto, would have upon the financial condition or results of operations of the Company or its subsidiaries.

Item 1A. *Risk Factors*

Risk Factors

An investment in the Company's common stock is subject to risks inherent to the Company's business. Described below are the material risks and uncertainties that management believes may affect the Company. You should carefully consider the risks and uncertainties the Company describes below and the

other information in this Annual Report or incorporated by reference before deciding to invest in, or retain, shares of the Company's common stock. These are not the only risks and uncertainties that the Company faces. Additional risks and uncertainties that the Company does not know about or that the Company currently believes are immaterial, or that the Company has not predicted, may also harm the Company's business operations or adversely affect the Company. If any of these risks or uncertainties actually occurs, the Company's business, financial condition, operating results or liquidity could be materially harmed. This report is qualified in its entirety by these risk factors.

Risks Related to the Company's Business

Losses from loan defaults may exceed the allowance the Company establishes for that purpose, which could have an adverse effect on the Company's business.

There are inherent risks associated with the Company's lending activities. Losses from loan defaults may exceed the allowance the Company establishes for that purpose. Like all financial institutions, the Company maintains an allowance for probable loan losses to provide for losses inherent in the loan portfolio. The allowance for probable loan losses reflects management's best estimate of loan losses in the loan portfolio at the relevant balance sheet date. The level of the allowance reflects management's continuing evaluation of the specific credit risks, the Company's historical loan loss experience, current loan portfolio quality, composition and growth of the loan portfolio, and economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of an appropriate level of loan loss allowance is an inherently difficult process and is based on numerous assumptions. In addition, bank regulatory agencies periodically review the Company's allowance for loan losses and may require an increase in the provision for probable loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. As a result, the Company's allowance for loan losses may not be adequate to cover actual losses, and future provisions for loan losses may adversely affect the Company's earnings. The Company believes its allowance for probable loan losses is adequate at December 31, 2013.

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

A significant portion of the Company's loan portfolio consists of loans secured by real estate located in the markets served by the Company. Real estate values and real estate markets are generally affected by, among other things, changes in national, regional, or local economic conditions; fluctuations in interest rates and the availability of loans to potential purchases, changes in the tax laws and other governmental statutes, regulations, and policies; and acts of nature. If real estate prices decline significantly in any of these markets, the value of the real estate collateral securing the Company's loans would be reduced. Such a reduction in the value of the Company's collateral could increase the number of impaired loans and adversely affect the Company's financial performance.

The Company's subsidiary banks face strong competition in their market areas, which may limit their asset growth and profitability.

The Company's primary market areas are South, Central and Southeast Texas, including Austin and Houston, and the State of Oklahoma. The banking business in these areas is extremely competitive, and the level of competition facing the Company may increase further, which may limit the growth and profitability of the Company. Each of the Company's subsidiary banks experience competition in both lending and attracting funds from other banks, savings institutions, credit unions and non-bank financial institutions located within its market area, many of which are significantly larger institutions. Non-bank competitors competing for deposits and deposit type accounts include mortgage bankers and brokers, finance companies, credit unions, securities firms, money market funds, life insurance companies, and mutual funds. For loans, the Company encounters competition from other banks, savings associations, finance companies, mortgage bankers and brokers, insurance companies, small loan and credit card

companies, credit unions, pension trusts, and securities firms. Many of the Company's competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Company offers. 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 the related income generated from those deposits. The loss of revenue streams and the reduction of lower cost deposits as a source of funds could have a material adverse affect on the Company's financial condition and results of operations.

The Company relies, in part, on external financing to fund the Company's operations and the unavailability of such funds in the future could adversely impact the Company's growth strategy and prospects.

The Company relies on deposits, repurchase agreements, advances from the Federal Home Loan Bank ("FHLB") of Dallas and other borrowings to fund its operations. The unavailability of such funds in the future could adversely impact the Company's growth strategy, prospects and performance. The subsidiary banks have also historically relied on certificates of deposit. While the Company has reduced its reliance on certificates of deposit and has been successful in promoting its transaction and non-transaction deposit products (demand deposit accounts, money market, savings and checking), jumbo deposits nevertheless constituted a large portion of total deposits at December 31, 2013. Jumbo deposits tend to be a more volatile source of funding. Although management has historically been able to replace such deposits on maturity if desired, no assurance can be given that the Company would be able to replace such funds at any given point in time. The new rule of the IRS that extends the reporting requirements for interest on deposits to nonresident alien individuals that applies to interest payments made on or after January 1, 2013, may result in deposit withdrawals by nonresident alien individuals who were not previously subject to the reporting requirements, including residents of Mexico.

The Company's business is subject to interest rate risk and variations in interest rates may negatively affect the Company's financial performance.

The Company is unable to predict fluctuations of market interest rates, which are affected by many factors, including:

- Inflation;
- Recession;
- Changes in consumer spending, borrowing and saving habits;
- A rise in unemployment;
- Tightening of the money supply; and
- Domestic and international disorder and instability in domestic and foreign financial markets.

Changes in the interest rate environment may reduce the Company's profits. The Company expects that the bank subsidiaries will continue to realize income from the differential or "spread" between the interest earned on loans, securities and other interest-earning assets, and the interest paid on deposits, borrowings and other interest-bearing liabilities. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. Earnings could be adversely affected if the net interest spreads are reduced. Changes in interest rates and other factors could result in write downs of carrying values of securities held in our securities available-for-sale portfolio and such changes could reduce earnings of the Company.

The Company is subject to extensive regulation which could adversely affect the Company including, without limitation, changes in U.S.—Mexico trade and travel along the Texas border, increased costs related to healthcare reform and other labor developments and possible enforcement and other legal actions.

The Company's 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 the Company's operations. Because the Company's business is highly regulated, the laws, rules and regulations applicable to the Company are subject to regular modification and change. There can be no assurance that there will be no laws, rules or regulations adopted in the future, or changes in accounting policies and practices, which could make compliance more difficult or expensive, or otherwise adversely affect the Company's business, financial condition or prospects. The Dodd-Frank Act, enacted in July 2010, instituted major changes to the banking and financial institutions regulatory regimes. Healthcare reform and other labor developments are expected to increase labor costs of the Company. These changes and other changes to statutes and regulations, including changes in the interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. Additionally, any reductions in border crossings and commerce resulting from the Homeland Security Programs called "US-VISIT," which is derived from Section 110 of the Illegal Immigration Reform and Immigration Responsibility Act of 1996 could affect the Company negatively, and any possible negative consequences from an adverse immigration law could also have a negative effect on the Company's operations.

Failure to comply with laws, regulations, policies or supervisory guidance could result in enforcement and other legal actions by Federal or state authorities, including criminal and civil penalties, the loss of FDIC insurance, the revocation of a banking charter, other sanctions by regulatory agencies, civil money penalties and/or reputational damage. In this regard, government authorities, including the bank regulatory agencies, are pursuing aggressive enforcement actions with respect to compliance and other legal matters involving financial activities, which heightens the risks associated with actual and perceived compliance failures. Any of the foregoing could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company's 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 the Company's growth. There are a number of factors that may impact the ability of the Company to continue to grow through acquisition transactions, including strong competition from other financial institutions who are active or potential acquirers of financial institutions in the existing or future markets of the Company. 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.

The Company relies heavily on its chief executive officer.

The Company has experienced substantial growth in assets and deposits during the past, particularly since Dennis E. Nixon became President of the Company in 1979. Although Mr. Nixon is the chief executive officer and one of the Company's substantial shareholders, the Company does not have an employment agreement with Mr. Nixon and the loss of his services could have a material adverse effect on the Company's business and prospects.

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

The computer systems and network infrastructure our Company uses could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from fire, power loss, telecommunications failure or a similar catastrophic event. Any damage or failure that causes an interruption in our operations could have an adverse effect on our customers. In addition, we must be able to protect the computer systems and network infrastructure utilized by us against physical damage, security breaches and service disruption caused by the Internet or other users. Such computer break-ins and other disruptions would jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us. While the Company conducts its own data processing, it is reliant on certain external vendors to provide products and services necessary to maintain day-to-day operations of the Company. Accordingly, the Company's operations are exposed to risks that these vendors will not perform in accordance with contracted arrangements and in a manner that adequately protects the operations of the Company.

The Company may desire or need to raise additional capital or increase liquidity levels in the future, and such capital may not be available when needed or at all and the ability of the Company to increase liquidity levels may be limited.

The Company may desire or need to raise additional capital or increase liquidity levels in the future to provide it with sufficient capital resources and liquidity to meet its commitments and business needs, particularly if its asset quality or earnings were to deteriorate significantly. The Company's ability to raise additional capital, if needed, will depend on, among other things, conditions in the capital markets at that time, which are outside of its control, and the Company's financial performance. The Company cannot assure that such capital will be available on acceptable terms or at all. If the Company needs to raise capital in the future, it may have to do so when many other financial institutions are also seeking to raise capital and would have to compete with those institutions for investor. The impact of the regulatory liquidity proposal may result in a shortfall of high-quality liquid assets. An inability to raise additional capital on acceptable terms when needed or the unavailability of high-quality liquid assets could have a materially adverse effect on the Company's business.

Severe weather, natural disasters, acts of war or terrorism and other external events could significantly impact the Company's business.

Severe weather, natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on the Company's ability to conduct business. In addition, such events could affect the stability of the Company's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and cause the Company to incur additional expenses. Although management has established disaster recovery policies and procedures, the occurrence of any such event in the future could have a material adverse effect on the Company's 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. Given the current economic environment and conditions in the financial markets, we could be required to evaluate the recoverability of goodwill prior to our normal annual assessment if we experience disruption in our business, unexpected significant declines in our operating results, or sustained market capitalization declines. These types of events and the resulting analyses could result in goodwill impairment charges in the future, which would be recorded as charges against earnings. The decrease in

earnings resulting from impairment charges could also negatively impact other performance measures; however, for regulatory purposes, goodwill is eliminated in calculating the Company's regulatory ratios such as its regulatory capital ratios. We performed an annual goodwill impairment assessment as of October 1, 2013. 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 and such changes may require certain financial institutions to take a goodwill impairment charge to account for anticipated reduction in revenue related to such changes.

The Company Is Subject To Environmental Liability Risk Associate With Lending Activities.

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

The Company's Controls and Procedures May Fail or be Circumvented

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

New Lines of Business or New Products and Services May be Subject the Company to Additional Risks

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

The downgrade of the U.S. credit rating and Europe's ongoing debt crisis could negatively impact our business, financial condition and liquidity.

Standard and Poor's lowered the U.S. long term sovereign credit rating from AAA to AA+ on August 5, 2011. The downgrade and a further downgrade or a downgrade by other ratings agencies of the U.S. government's sovereign credit rating, or its perceived creditworthiness, could adversely affect the

financial markets and economic conditions in the United States and worldwide. Many of our investment securities are issued by U.S. government agencies and U.S. government sponsored entities (“GSEs”). The rating downgrade could affect the stability of residential mortgage-backed securities issued or guaranteed by GSEs. These factors could affect the liquidity or valuation of our current portfolio of residential mortgage-backed securities issued or guaranteed by GSEs, and could result in our counterparties requiring additional collateral for our borrowings and could increase our borrowing costs. Because of the unprecedented nature of any negative credit rating actions with respect to U.S. government obligations, the ultimate impact on global markets and our business, financial condition and liquidity are unpredictable and may not be immediately apparent; however, any adverse impact related to the downgrade of the U.S. sovereign credit rating could have a material adverse effect on the Company’s liquidity, financial condition and results of operations. Additionally, concerns about the European Union’s sovereign debt crisis have also caused uncertainty for financial markets globally. Such risks could indirectly affect the Company by affecting the Company’s customers with European businesses or assets denominated in the euro or companies in the Company’s market with European businesses or affiliates.

The Company’s Accounting Estimates and Risk Management Processes Rely On Analytical and Forecasting Tools and Models

The processes the Company uses to estimate its 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 the Company’s 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 the Company’s analytical or forecasting tools or models could have a material adverse effect on the Company’s business, financial condition and results of operations.

Risks Related to the Company’s Industry

Changes in economic and political conditions could adversely affect the Company’s earnings, as our borrowers’ ability to repay loans and the value of the collateral securing our loans decline.

The Company’s success depends, to a certain extent, upon economic and political conditions, local, national and international with respect to Mexico, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, changes in capital markets, money supply, political issues, legislative and regulatory changes and other factors beyond the Company’s control may adversely affect the Company’s asset quality, deposit levels and loan demand and, therefore, the Company’s earnings. The Company is particularly affected by conditions in its primary market areas of South, Central and Southeast Texas, including Austin and Houston, and the State of Oklahoma. While economic conditions in the Company’s primary markets have begun to improve, there is no assurance that the improvement will continue. If the weakened economic conditions in the Company’s primary market areas worsen or fail to improve, the Company could experience an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for the Company’s products and services, any of which could have a material adverse impact on the Company’s financial condition and results of operations.

The Company depends on the accuracy and completeness of information about customers and counterparties as well as the soundness of other financial institutions with which the Company interacts.

In deciding whether to extend credit or enter into other transactions, the Company may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. The Company may 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 the Company interacts could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

If the Company does not adjust to rapid changes in the financial services industry, its financial performance may suffer.

The Company's ability to deliver strong financial performance and returns on investment to shareholders will depend in part on its ability to expand the scope of available financial services to meet the needs and demands of its customers and its ability to stay abreast of technological innovations and evaluate those technologies that will enable it to compete on a cost-effective basis.

In addition to the challenge of competing against other banks in attracting and retaining customers for traditional banking services, the Company's 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 increasingly competitive environment is primarily a result of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial service providers. Such 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 the Company's 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 the Company's technology, either purchased or developed internally, will meet or continue to meet the needs of the Company and the needs of our customers.

The Recent Repeal of Federal Prohibitions on Payment of Interest on Demand Deposits Could Increase the Company's Interest Expense.

All federal prohibitions on the ability of financial institutions to pay interest on demand deposit accounts were repealed as part of the Dodd-Frank Act. As a result, beginning on July 21, 2011, financial institutions were allowed to commence offering interest on demand deposits to compete for clients and the Company does have such a program. The Company's interest expense may increase and its net interest margin may decrease if it begins paying interest on a significant amount of demand deposits in order to attract additional customers or maintain current customers, which could have an adverse effect on the Company's business, financial condition and results of operations.

The Dodd-Frank Regulatory Reform Act and other regulatory developments could negatively impact the revenue streams of the Company related to interchange fees and consumer services and result in a contraction of retail banking of the Company.

The Dodd-Frank Reform Act authorizes the Federal Reserve to regulate interchange fees paid to banks on debit card transactions to ensure that they are reasonable and proportional to the cost of processing individual transactions, and prohibits debit card networks and issuers from requiring transactions to be processed on a single payment network. The impact of the FDIC Overdraft Payment Supervisory Guidance could jeopardize the profitability of a number of retail sites of the Company and could result in a reduction of revenue from the Company's overdraft courtesy services. The Reform Act created the CFPB. While banks with less than \$10 billion in assets, such as each of the subsidiary banks of the Company, are exempt from the primary examination, and enforcement powers of the CFPB, the new

agency's rulemaking will affect all banks. The impact of the CFPB is uncertain at this time, but the initiatives of the CFPB could negatively impact revenue streams of the Company related to consumer services. The reduction of revenue from retail banking services coupled with the repeal of the federal prohibition on the payment of interest on demand deposits, could result in a contraction of retail banking of the Company. The Company closed fifty-five in-store branches during the fourth quarter of 2011 due to reduced levels of revenue resulting from regulatory changes limiting interchange fees in order to align the Company's expenses with the reduced levels of revenue.

The Company Is Subject to Claims and Litigation Pertaining to Intellectual Property

Banking and other financial services companies, such as the Company, rely on technology companies to provide information technology products and services necessary to support the Company's day-to-day operations. Technology companies frequently enter into litigation based on allegations of patent infringement or other violations of intellectual property rights. Such claims may increase in the future as the financial services sector becomes more reliant on information technology vendors. The plaintiffs in these actions frequently seek injunctions and substantial damages.

Regardless of the scope or validity of such patents or other intellectual property rights, or the merits of any claims by potential or actual litigants, the Company may have to engage in protracted litigation. Such litigation is often expensive, time-consuming, disruptive to the Company's operations, and distracting to management. If legal matters related to intellectual property claims were resolved against the Company, the Company could be required to make payments in amounts that could have a material adverse effect on its business, financial condition and results of operations.

The limitation of preemption in the Dodd-Frank Reform Act, the powers of the new Consumer Financial Protection Bureau, and the FDIC Overdraft Payment Supervisory Guidance may increase the likelihood of lawsuits against financial institutions, and increased costs related to such lawsuits if the CFPB restricts the use of arbitration and/or class action waivers in consumer banking contracts.

The Dodd-Frank Reform 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. The new CFPB is specifically 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. The Company's 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 based on the results of the CFPB's preliminary study of such matters that were released during the third quarter of 2013.

Risks Related to the Company's Stock

The Company's stock price may be volatile.

Several factors could cause the Company's stock price to fluctuate substantially in the future. These factors include among other things:

- Actual or anticipated variations in earnings;
- Recommendations by securities analysts;
- The Company's announcements of developments related to its businesses;
- Operating and stock performance of other companies deemed to be peers;
- New technology used or services offered by traditional and non-traditional competitors;
- Continued low trading volume in the Company's stock;

- The volatile impact of short selling activity in the Company's stock;
- News reports of trends, concerns and other issues related to the financial services industry; and
- Changes in the Company's ability to pay dividends;
- Changes in government regulations, policies and guidance.

The Company's stock price may fluctuate significantly in the future, and these fluctuations may be unrelated to the Company's performance. General market price declines or market volatility in the future could adversely affect the price of its common stock, and the current market price may not be indicative of future market prices.

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

As of December 31, 2013, we had approximately \$191 million in junior subordinated debentures outstanding that were issued to our statutory trusts. The trusts purchased the junior subordinated debentures from us using the proceeds from the sale of trust preferred securities to third party investors. 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, provided the trust has funds available for such obligations.

The junior subordinated debentures are senior to our shares of common stock and the Senior Preferred Stock. As a result, we must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock or preferred stock and, in the event of our bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to our shareholders. If certain conditions are met, we have the right to defer interest payments on the junior subordinated debentures (and the related trust preferred securities) at any time or from time to time for a period not to exceed up to 20 consecutive quarters in a deferral period, during which time no dividends may be paid to holders of our common stock or preferred stock.

Risks Related to Participation in the CPP

We may be adversely affected by our participation in the CPP.

In connection with our sale of Senior Preferred Stock to the Treasury Department under the Capital Purchase Program, the Company also issued to the Treasury Department a warrant to purchase 1,326,238 shares of our common stock (the "Warrants"). While the Company exited the TARP program when it repurchased all of the remaining Senior Preferred Stock on November 28, 2012, the Warrants remain outstanding and were sold by the U.S. Treasury to a third party on June 12, 2013. The dilutive impact of the Warrants may have a negative effect on the market price of our common stock. The Warrant expires on December 23, 2018.

Item 1B. Unresolved Staff Comments

N/A

Item 2. Properties

The principal offices of the Company and IBC are located at 1200 San Bernardo Avenue, Laredo, Texas and 2418 Jacaman Road, Laredo, Texas in buildings owned and completely occupied by the Company and IBC and containing approximately 147,000 square feet. The bank subsidiaries of IBC have 211 main banking and branch facilities. All the facilities are customary to the banking industry. The bank subsidiaries own most of their banking facilities and the remainder are leased. The facilities are located in the regions of Laredo, San Antonio, Houston, Zapata, Eagle Pass, the Rio Grande Valley of Texas, the Coastal Bend area of Texas, and throughout the State of Oklahoma.

As Texas state-chartered banks, no bank subsidiary of the Company may, without the prior written consent of the Banking Commissioner, invest an amount in excess of its Tier 1 capital in bank facilities, furniture, fixtures and equipment. None of the Company's bank subsidiaries exceeds such limitation.

Item 3. *Legal Proceedings*

The Company and its bank subsidiaries are involved in various legal proceedings that are in various stages of litigation. Some of these actions allege "lender liability" claims on a variety of theories and claim substantial actual and punitive damages. The Company and its subsidiaries have determined, based on discussions with their 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 the consolidated financial position or results of operations of the Company and its subsidiaries. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its 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 70 of the 2013 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 2013 Annual Meeting of Shareholders and until his successor is duly elected and qualified.

<u>Name</u>	<u>Age</u>	<u>Position of Office</u>	<u>Officer of the Company Since</u>
Dennis E. Nixon . .	71	Chairman of the Board of the Company since 1992 and President of the Company since 1979, Chief Executive Officer and Director of IBC	1979
R. David Guerra .	61	Vice President of the Company since 1986 and President of IBC McAllen Branch and Director of IBC	1986
Imelda Navarro . .	56	Treasurer of the Company since 1982 and Senior Executive Vice President of IBC and Director of IBC since 2002	1982

There are no family relationships among any of the named persons. Each executive officer has held the same position or another executive position with the Company 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 25 through 27 of Registrant's 2013 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 Registrant's 2013 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 28 of Registrant’s 2013 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 18 through 23 of Registrant’s 2013 Annual Report is incorporated herein by reference.

Item 8. *Financial Statements and Supplementary Data*

The consolidated financial statements located on pages 29 through 84 of Registrant’s 2013 Annual Report are incorporated herein by reference.

The condensed quarterly income statements located on pages 85 and 86 of Registrant’s 2013 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 the management of International Bancshares Corporation, (the “Company”) with the participation of its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company’s 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 Financial 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 the Company’s internal control over financial reporting that occurred during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Management’s Report on Internal Control Over Financial Reporting

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

As of December 31, 2013, management assessed the effectiveness of the design and operation of the Company’s 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. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2013, based on those criteria.

McGladrey LLP, the independent registered public accounting firm that audited the 2013 consolidated financial statements of the Company included in this Annual Report on Form 10-K, has audited the effectiveness of the Company’s internal control over financial reporting as of December 31, 2013. Their report, which expresses an unqualified opinion, on the effectiveness of the Company’s internal control over financial reporting as of December 31, 2013 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:

We have audited International Bancshares Corporation and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 1992. International Bancshares Corporation and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, 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.

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 (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) 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 authorization of management and directors of the company; and (c) 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.

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

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of condition as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows of International Bancshares Corporation and subsidiaries and our report dated February 24, 2014 expressed an unqualified opinion.

/s/ McGladrey LLP

Dallas, TX
February 24, 2014

Item 9B. Other Information

None.

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

There is incorporated in this Item 10 by reference (i) that portion of the Company's definitive proxy statement relating to the Company's 2014 Annual Meeting of Shareholders entitled "ELECTION OF DIRECTORS," (ii) the portion of the Company's definitive proxy statement entitled "Audit Committee" in the portion entitled "MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS," (iii) the portion of the Company's definitive proxy statement entitled "Code of Ethics," in the portion entitled "CORPORATE GOVERNANCE," (iv) that portion of the Company's definitive proxy statement entitled "SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE," and (v) Item 4A of this report entitled "Executive Officers of the Registrant."

Item 11. Executive Compensation

There is incorporated in this Item 11 by reference (i) that portion of the Company's definitive proxy statement relating to the Company's 2014 Annual Meeting of Shareholders entitled "EXECUTIVE COMPENSATION," and (ii) that portion entitled "Salary and Steering 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 the Company's definitive proxy statement relating to the Company's 2014 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 (i) that portion of the Company's definitive proxy statement relating to the Company's 2014 Annual Meeting of Shareholders 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 the Company's definitive proxy statement relating to the Company's 2014 Annual Meeting of Shareholders entitled "PRINCIPAL ACCOUNTANT FEES AND SERVICES."

PART IV

Item 15. *Exhibits, Financial Statement Schedules*

(a) *Documents*

1. The consolidated financial statements of the Company and subsidiaries are incorporated into Item 8 of this report by reference from the 2013 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, 2013 and 2012

Statements of Income for the years ended December 31, 2013, 2012 and 2011

Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011

Statements of Shareholders' Equity for the years ended December 31, 2013, 2012 and 2011

Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011

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 by the Registrant or are included in this report following the Index to Exhibits:

(3)(a)* —Articles of Incorporation of International Bancshares Corporation incorporated herein as an exhibit by reference to the Current Report, Exhibit 3.1 therein, under the Securities Exchange Act of 1934, filed by Registrant on Form 8-K with the Securities and Exchange Commission on June 20, 1995, SEC File No. 09439.

(3)(b)* —Articles of Amendment to the Articles of Incorporation of International Bancshares Corporation dated May 22, 1998 incorporated herein by reference to Exhibit 3(c) of the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 1999, SEC file No. 09439.

(3)(c)* —Articles of Amendment to the Articles of Incorporation of International Bancshares Corporation dated May 21, 2002 incorporated herein by reference to Exhibit 3(d) of the Registrant's Annual Report on form 10-K filed with the Securities and Exchange Commission on March 12, 2004, SEC File No. 09439.

(3)(d)* —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, incorporated herein as an exhibit by reference to the Current Report, Exhibit 3.1 therein, under the Securities Exchange Act of 1934, filed by Registrant on Form 8-K with the Securities and Exchange Commission on May 20, 2005, SEC File No. 09439.

(3)(e)* 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, incorporated herein as an exhibit by reference to the Current Report, Exhibit 3.1 therein, filed by registrant on Form 8-K with the Commission on December 23, 2008, Commission File No. 09439.

- (3)(f)* Certificate of Designations for 216,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, of International Bancshares Corporation, filed with the Secretary of State of the State of Texas on December 22, 2008, incorporated herein as an exhibit by reference to the Current Report, Exhibit 3.2 therein, filed by registrant on Form 8-K with the Commission on December 23, 2008, Commission File No. 09439.
- (3)(g)* Amended and Restated By-Laws of International Bancshares Corporation, incorporated herein as an exhibit by reference to the Current Report, Exhibit 3.1 therein, filed by registrant on Form 8-K with the Commission on December 18, 2009, Commission File No. 09439.
- (3)(h)* Certificate of Amendment to Articles of Incorporation of International Bancshares Corporation filed with the Secretary of State of Texas on May 21, 2013, incorporated herein as an exhibit by reference to the Current Report, Exhibit 3.1 therein, under the Securities Exchange Act of 1934, filed by the Registrant on Form 8-K with the Securities and Exchange Commission on May 22, 2013, SEC File Number 09439.
- (4)(a)* Warrant, dated December 23, 2008, to purchase shares of common stock of International Bancshares Corporation, incorporated herein as an exhibit by reference to the Current Report, Exhibit 4.1 therein, filed by registrant on Form 8-K with the Commission on December 23, 2008, Commission File No. 09439.
- (4)(b)* Form of Certificate for the Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value \$0.01 per share incorporated herein as an exhibit by reference to the Current Report, Exhibit 4.2 therein, filed by registrant on Form 8-K with the Commission on December 23, 2008, Commission File No. 09439.
- (10a)*+ —Letter Agreement, dated as of December 23, 2008, and the Securities Purchase Agreement—Standard Terms, which the Letter Agreement incorporates by reference, between International Bancshares Corporation and the United States Department of the Treasury, incorporated herein as an exhibit by reference to the Current Report, Exhibit 10.1 therein, filed by registrant on Form 8-K with the Commission on December 23, 2008, Commission File No. 09439.
- (10b)*+ —The 1996 International Bancshares Corporation Stock Option Plan incorporated herein by reference to Exhibit 99.1 to the Post Effective Amendment No. 1 to Form S-8 filed with the Securities and Exchange Commission on March 21, 1997, SEC File No. 333-11689.
- (10c)*+ —2005 International Bancshares Corporation Stock Option Plan incorporated herein as an exhibit by reference to the Current Report, Exhibit 10.1 therein, under the Securities Exchange Act of 1934, filed by the Company on Form 8-K with the Securities and Exchange Commission on April 1, 2005, SEC File No. 09439.

- (10d)* —Agreement and Plan of Merger dated as of January 22, 2004, among International Bancshares Corporation, LFC Acquisitions Corp. and Local Financial Corporation incorporated herein as an exhibit by reference to the Current Report, under the Securities Exchange Act of 1934, filed by Registrant on Form 8-K with the Securities and Exchange Commission on January 22, 2004, SEC File No. 09439.
- (10e)*+ —International Bancshares Corporation 2006 Executive Incentive Compensation Plan, filed by Registrant on Form DEF 14A with the Securities and Exchange Commission on April 17, 2008, SEC File No. 09439.
- (10f)*+ —International Bancshares Corporation Long-Term Restricted Stock Unit Plan, filed by Registrant on Form 8-K with the Securities and Exchange Commission on December 12, 2009, SEC File No. 09439.
- (10g)*+ —2012 International Bancshares Corporation Stock Option Plan incorporated herein by reference to Exhibit A of the Registrant's Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 20, 2012.
- (10h)*+ —International Bancshares Corporation 2013 Management Incentive Plan incorporated herein by reference to Exhibit A of the Registrant's Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 19, 2013.
- (13)** —International Bancshares Corporation 2013 Annual Report
- (21) —List of Subsidiaries of International Bancshares Corporation as of February 19, 2014
- (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

* 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, 2013, 2012 and 2011 (ii) the Condensed Consolidated Balance Sheet as of December 31, 2013 and 2012, and (iii) the Condensed Consolidated Statement of Cash Flows for the years ended December 31, 2013, 2012 and

2011. Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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 24, 2014

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 24, 2014
<u> /s/ IMELDA NAVARRO </u> Imelda Navarro	Treasurer (Principal Financial Officer and Principal Accounting Officer)	February 24, 2014
<u> /s/ IRVING GREENBLUM </u> Irving Greenblum	Director	February 24, 2014
<u> /s/ R. DAVID GUERRA </u> R. David Guerra	Director	February 24, 2014
<u> /s/ DOUG HOWLAND </u> Doug Howland	Director	February 24, 2014
<u> /s/ PEGGY J. NEWMAN </u> Peggy J. Newman	Director	February 24, 2014
<u> /s/ LARRY NORTON </u> Larry Norton	Director	February 24, 2014
<u> /s/ LEONARDO SALINAS </u> Leonardo Salinas	Director	February 24, 2014
<u> /s/ ANTONIO R. SANCHEZ, JR. </u> Antonio R. Sanchez, Jr.	Director	February 24, 2014

Exhibit Index

Exhibit 13—	International Bancshares Corporation 2013 Annual Report, Exhibit 13, page 1
Exhibit 21—	List of Subsidiaries of International Bancshares Corporation as of February 19, 2014
Exhibit 23—	Consent of Independent Registered Public Accounting Firm
Exhibit 31(a)—	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31(b)—	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32(a)—	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 32(b)—	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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES
(Consolidated)

The following consolidated selected financial data is derived from the Corporation's audited financial statements as of and for the five years ended December 31, 2013. 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,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands, Except Per Share Data)				
STATEMENT OF CONDITION					
Assets	\$12,079,477	\$11,882,673	\$11,739,649	\$11,943,469	\$11,762,543
Investment securities					
available-for-sale	5,304,579	5,525,015	5,213,915	5,086,457	4,644,083
Net loans	5,129,074	4,716,811	4,969,283	5,325,521	5,571,869
Deposits	8,243,425	8,287,213	7,946,092	7,599,558	7,178,007
Other borrowed funds	1,223,950	749,027	494,161	1,026,780	1,347,625
Junior subordinated deferrable interest debentures	190,726	190,726	190,726	201,117	201,082
Shareholders' equity	1,424,408	1,435,708	1,600,165	1,459,217	1,407,470
INCOME STATEMENT					
Interest income	\$ 363,217	\$ 375,639	\$ 418,124	\$ 458,769	\$ 527,377
Interest expense	54,632	74,499	94,298	114,036	139,796
Net interest income	308,585	301,140	323,826	344,733	387,581
Provision for probable loan losses	22,968	27,959	17,318	22,812	58,833
Non-interest income	189,605	200,591	201,493	218,784	201,013
Non-interest expense	292,632	315,372	316,774	339,725	309,031
Income before income taxes . .	182,590	158,400	191,227	200,980	220,730
Income taxes	56,239	50,565	64,078	70,957	77,988
Net income	126,351	107,835	127,149	130,023	142,742
Preferred stock dividends and discount accretion	—	14,362	13,280	13,126	12,984
Net income available to common shareholders	\$ 126,351	\$ 93,473	\$ 113,869	\$ 116,897	\$ 129,758
Per common share:					
Basic	\$ 1.88	\$ 1.39	\$ 1.69	\$ 1.72	\$ 1.90
Diluted	\$ 1.88	\$ 1.39	\$ 1.69	\$ 1.72	\$ 1.90

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

Management's discussion and analysis represents an explanation of significant changes in the financial position and results of operations of International Bancshares Corporation and its subsidiaries (the "Company" or the "Corporation") on a consolidated basis for the three-year period ended December 31, 2013. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2013, 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 the Company believes 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 are projected, forecasted, estimated or budgeted by the Company 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 the Company, the Company's customers, and such customers' ability to transact profitable business with the Company, including the ability of its 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 Company relies, in part, on external financing to fund the Company's operations from the FHLB, the Fed and other sources and the unavailability of such funding sources in the future could adversely impact the Company's growth strategy, prospects and performance.
- Changes in consumer spending, borrowings and savings habits.
- Changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations, including, without limitation, the repeal of federal prohibitions on the payment of interest on demand deposits.
- Changes in the capital markets utilized by the Company and its subsidiaries, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations to which the Company and its subsidiaries, as well as their customers, competitors and potential competitors, are subject, including, without limitation, the impact of the Consumer Financial Protection Bureau as a new 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, without limitation, reductions in border crossings and commerce resulting from the Homeland Security Programs called “US-VISIT,” which is derived from Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.
- The reduction of deposits from nonresident alien individuals due to the new IRS rules requiring U.S. financial institutions to report to the IRS deposit interest payments made to nonresident alien individuals.
- The loss of senior management or operating personnel.
- Increased competition from both within and outside the banking industry.
- The timing, impact and other uncertainties of the Company’s potential future acquisitions including the Company’s ability to identify suitable potential future acquisition candidates, the success or failure in the integration of their operations and the Company’s ability to maintain its current branch network and to enter new markets successfully and capitalize on growth opportunities.
- Changes in the Company’s ability to pay dividends on its Common Stock.
- Additions to the Company’s loan loss allowance as a result of changes in local, national or international conditions which adversely affect the Company’s customers, including, without limitation, lower real estate values or environmental liability risks associated with foreclosed properties.
- 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 the Company interacts.
- Political instability in the United States or Mexico.
- Technological changes or system failure or breaches of our network security could subject us to increased operating costs as well as 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 portfolio following a determination that the securities are other-than-temporarily impaired.
- The effect of changes in accounting policies and practices as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.
- The costs and effects of regulatory developments, including the resolution of regulatory or other governmental inquiries and the results of regulatory examinations or reviews.
- 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, unless the consumer consents or opts-in to the overdraft service for those types of 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 new legislation, including, without limitation, the Dodd-Frank Regulatory Reform Act (the “Dodd-Frank Act”) and the implementing rules and regulations, including the Federal Reserve’s rule that establishes debit card interchange fee standards and prohibits network exclusivity arrangements and routing restrictions that is negatively affecting interchange revenue from debit card transactions as well as revenue from consumer services.
- The possible increase in required capital levels related to the proposed capital rules of the federal banking agencies that address the Basel III capital standards.
- The enhanced due diligence burden imposed on banks related to the banks’ inability to rely on credit ratings under Dodd-Frank which may result in a limitation on the types of securities certain banks will be able to purchase as a result of the due diligence burden.
- The Company’s success at managing the risks involved in the foregoing items, or a failure or circumvention of the Company’s 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. The Company makes 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

The Company, which is headquartered in Laredo, Texas, with 211 facilities and 321 ATMs, provides banking services for commercial, consumer and international customers of South, Central and Southeast Texas and the State of Oklahoma. The Company is one of the largest independent commercial bank holding companies headquartered in Texas. The Company, through its bank subsidiaries, is in the business of gathering funds from various sources and investing those funds in order to earn a return. The Company either directly or through a bank subsidiary owns two insurance agencies, a liquidating subsidiary, and a fifty percent interest in an investment banking unit that owns a broker/dealer. The Company’s primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, the Company generates income from fees on products offered to commercial, consumer and international customers.

A primary goal of the Company 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 a critical objective of the Company. A key measure of the performance of a banking institution is the return on average common equity (“ROE”). The Company’s ROE for the year ended December 31, 2013 was 8.95% as compared to 7.17% for the year ended December 31, 2012.

The Company is very active in facilitating trade along the United States border with Mexico. The Company does a large amount of business with customers domiciled in Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of the Company’s bank subsidiaries. The loan policies of the Company’s bank subsidiaries 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 Company also serves the growing Hispanic population through the Company’s facilities located throughout South, Central and Southeast Texas and the State of Oklahoma.

Expense control is an essential element in the Company’s long-term profitability. As a result, the Company monitors the efficiency ratio, which is a measure of non-interest expense to net interest income plus non-interest income closely. As the Company adjusts to regulatory changes related to the Dodd-Frank Act, the Company’s efficiency ratio may suffer because the additional regulatory compliance costs are expected to increase non-interest expense. The Company monitors this ratio over time to assess the

Company's efficiency relative to its peers. The Company uses this measure as one factor in determining if the Company is accomplishing its long-term goals of providing superior returns to the Company's shareholders. On September 22, 2011, the Company announced the approval of a restructuring plan that resulted in the closing of fifty-five (55) in store branches by December 31, 2011. The branch closures were a result of reduced levels of revenue resulting from regulatory changes related to interchange fee income. The branches were closed in order to align the Company's expenses with reduced levels of revenue, protecting the Company's financial strength while preserving IBC's free products program.

Results of Operations

Summary

Consolidated Statements of Condition Information

	December 31, 2013	December 31, 2012	Percent Increase (Decrease)
	(Dollars in Thousands)		
Assets	\$12,079,477	\$11,882,673	1.7%
Net loans	5,129,074	4,716,811	8.7
Deposits	8,243,425	8,287,213	(0.5)
Other borrowed funds	1,223,950	749,027	63.4
Junior subordinated deferrable interest debentures	190,726	190,726	—
Shareholders' equity	1,424,408	1,435,708	(.8)

Consolidated Statements of Income Information

	Year Ended December 31, 2013	Year Ended December 31, 2012	Percent Increase (Decrease) 2013 vs. 2012	Year Ended December 31, 2011	Percent Increase (Decrease) 2012 vs. 2011
	(Dollars in Thousands)				
Interest income	\$363,217	\$375,639	(3.3)%	\$418,124	(10.2)%
Interest expense	54,632	74,499	(26.7)	94,298	(21.0)
Net interest income	308,585	301,140	2.5	323,826	(7.0)
Provision for probable loan losses	22,968	27,959	(17.9)	17,318	61.4
Non-interest income	189,605	200,591	(5.5)	201,493	(.4)
Non-interest expense	292,632	315,372	(7.2)	316,774	(.4)
Net income	126,351	107,835	17.2	127,149	(15.2)
Net income available to common shareholders	126,351	93,473	35.2	113,869	(17.9)
Per common share:					
Basic	\$ 1.88	\$ 1.39	35.3%	\$ 1.69	(17.8)%
Diluted	1.88	1.39	35.3	1.69	(17.8)

Net Income

Net income available to common shareholders for the year ended December 31, 2013 increased by 35.2% as compared to the same period in 2012. Net income available to common shareholders for the year ended December 31, 2013 was positively affected by the repayment of the TARP funds in the fourth quarter of 2012, which eliminated the continued payment of dividends on the Senior Preferred Stock that had been held by the U.S. Treasury, as well as the sale of available for sale securities totaling \$6.2 million, net of tax. The securities sales were a result of the Company re-positioning a portion of the investment portfolio. Net income for the same period was negatively impacted by a charge of \$8.0 million, net of tax, as a result of the Company's lead bank subsidiary's early termination of a portion of its long-term

repurchase agreements in order to help manage its long-term funding costs. Net income for the year ended December 31, 2013 was positively impacted by improving net interest margins as a result of lower rates paid on securities sold under repurchase agreements and time deposits. Net income for the years ended December 31, 2013 and 2012 was negatively impacted by slow loan demand, although it is improving, and yields in the bond markets. Net income also continues to be negatively affected by the burden of increasing compliance costs arising from the Dodd-Frank Act and heightened regulatory oversight. Net income for the year ended December 31, 2012 was negatively impacted by lower levels of revenue on interchange fee income and overdraft programs due to regulatory changes, as well as the burden of increasing compliance costs arising from the Dodd-Frank Act and heightened regulatory oversight. Net income for the year ended December 31, 2012 was positively impacted by the sale of available-for-sale investments securities totaling \$25 million, net of tax. The securities sales were a result of the Company re-positioning a portion of the investment portfolio. Net income for the year ended December 31, 2012 was negatively impacted by a one-time charge of \$20.5 million, net of tax, recorded in the third quarter as a result of the Company's lead bank subsidiary's early termination of a portion of its long-term repurchase agreements in order to help manage its long-term funding costs.

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 the Company's 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.

	For the years ended December 31,		
	2013 Average Rate/Cost	2012 Average Rate/Cost	2011 Average Rate/Cost
<i>Assets</i>			
Interest earning assets:			
Loan, net of unearned discounts:			
Domestic	5.35%	5.51%	5.63%
Foreign	3.44	3.82	4.13
Investment securities:			
Taxable	1.73	1.95	2.40
Tax-exempt	5.54	5.55	5.29
Other	.25	.25	1.55
Total interest-earning assets	3.52%	3.68%	4.06%
<i>Liabilities</i>			
Interest bearing liabilities:			
Savings and interest bearing demand deposits	.13%	.19%	.30%
Time deposits:			
Domestic	.60	.79	1.03
Foreign	.51	.67	.84
Securities sold under repurchase agreements	2.80	2.95	2.99
Other borrowings	.19	.24	.22
Junior subordinated deferrable interest debentures	2.45	3.46	5.66
Total interest bearing liabilities	.71%	.93%	1.13%

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 decreased 4.3%

from 3.68% in 2012 to 3.52% in 2013, and the rates paid on average interest-bearing liabilities decreased 23.7% from .93% in 2012 to .71% in 2013. The yield on average interest-earning assets decreased 9.4% from 4.06% in 2011 to 3.68% in 2012, and the rates paid on average interest-bearing liabilities decreased 17.7% from 1.13% in 2011 to .93% in 2012. The majority of the Company's 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 2013, 2012 and 2011 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:

	2013 compared to 2012			2012 compared to 2011		
	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	\$ 3,927	\$ (7,859)	\$ (3,932)	\$(15,564)	\$ (4,571)	\$(20,135)
Foreign	(960)	(669)	(1,629)	(391)	(1,162)	(1,553)
Investment securities:						
Taxable	3,395	(11,082)	(7,687)	20,976	(42,432)	(21,456)
Tax-exempt	1,217	(3)	1,214	2,346	505	2,851
Other	(387)	(1)	(388)	471	(823)	(352)
Total interest income	<u>\$ 7,192</u>	<u>\$(19,614)</u>	<u>\$(12,422)</u>	<u>\$ 7,838</u>	<u>\$(48,483)</u>	<u>\$(40,645)</u>
Interest incurred on:						
Savings and interest bearing						
demand deposits	\$ 137	\$ (1,663)	\$ (1,526)	\$ 928	\$ (2,528)	\$ (1,600)
Time deposits:						
Domestic	(1,644)	(2,737)	(4,381)	(1,077)	(7,411)	(8,488)
Foreign	(2,019)	(2,129)	(4,148)	(332)	(6,591)	(6,923)
Securities sold under repurchase						
agreements	(6,948)	(1,526)	(8,474)	(1,912)	(41)	(1,953)
Other borrowings	1,003	(411)	592	162	192	354
Junior subordinated deferrable						
interest debentures	—	(1,930)	(1,930)	(337)	(791)	(1,128)
Total interest expense	<u>\$(9,471)</u>	<u>\$(10,396)</u>	<u>\$(19,867)</u>	<u>\$ (2,568)</u>	<u>\$(17,170)</u>	<u>\$(19,738)</u>
Net interest income	<u>\$16,663</u>	<u>\$ (9,218)</u>	<u>\$ 7,445</u>	<u>\$ 10,406</u>	<u>\$(31,313)</u>	<u>\$(20,907)</u>

(Note 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 the strategy to manage interest rate risk, the Company strives 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 the Company's 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 employed by the Company to supplement gap analysis include simulation analysis to quantify interest rate risk exposure. The gap analysis prepared by management is reviewed by the Investment Committee of the Company twice a year. The Investment Committee is comprised of certain senior managers of the various Company bank subsidiaries along with consultants. Management currently believes that the Company is properly positioned for interest rate changes; however, if management determines at any time that the Company is not properly positioned, it will strive to adjust the interest rate sensitive assets and liabilities in order to manage the effect of interest rate changes.

The Company has 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, 2013, in rising rate scenarios of 150, 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% and 20%, respectively. At December 31, 2013, the income simulations show that a rate shift of 150, 300 and 400 basis points in interest rates up will vary projected net interest income for the coming 12 month period by (2.01)%, (1.98)% and (1.46)%, 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. The Company believes that it is 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,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis	\$68,823	\$71,768	\$118,505	\$108,023	\$68,314
Accruing loans contractually past due ninety days or more as to interest or principal payments . . .	7,197	14,769	14,268	19,347	11,986

The allowance for probable loan losses increased 20.6% to \$70,161,000 at December 31, 2013 from \$58,193,000 at December 31, 2012. The allowance was 1.3% of total loans, net of unearned income at December 31, 2013 and 1.2% at December 31, 2012. The provision for probable loan losses charged to expense decreased \$4,991,000 to \$22,968,000 for the year ended December 31, 2013 from \$27,959,000 for the same period in 2012 primarily due to the continued workout of impaired loans previously identified by the Company. The Company's provision for probable loan losses decreased for the year ended December 31, 2013 compared to the year ended December 31, 2012, mainly due to four commercial real estate relationships charged off in 2012 when the Company determined that further collection of the loan was not anticipated based on the borrowers' financial condition. The Company's provision for probable loan losses decreased for the year ended December 31, 2010 compared to the year ended December 31, 2009 mainly due to the decrease in the required reserves for impaired loans analyzed on an individual basis. The impaired loans have been measured based on the fair value of collateral. The majority of these loans show a fair value greater than the carrying value. Although the Texas and Oklahoma economies are performing better and appear to be recovering faster than other parts of the country, the long term weak economic environment may continue to reveal new problems within these markets. Loans accounted for as "troubled debt restructuring," which are included in impaired loans, were not significant and totaled \$20,358,000 and \$29,395,000 as of December 31, 2013 and December 31, 2012, respectively. See Note 1 to the Consolidated Financial Statements.

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:

	December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis	\$—	\$ —	\$—	\$ 7	\$ 24
Accruing loans contractually past due ninety days or more as to interest or principal payments	—	264	20	501	103

The gross income that would have been recorded during 2013, 2012 and 2011 on non-accrual loans in accordance with their original contract terms was \$4,088,000, \$2,549,000 and \$4,114,000 on domestic loans and \$0, \$0, and \$0 on foreign loans, respectively. The amount of interest income on such loans that was recognized in 2013, 2012 and 2011 was \$0, \$0, and \$31,000 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 deem 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 bank subsidiary 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 \$1,906,602,000 and \$1,650,410,000 at December 31, 2013 and 2012, 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:

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	(Dollars in Thousands)				
Loans, net of unearned discounts, outstanding at December 31	<u>\$5,199,235</u>	<u>\$4,775,004</u>	<u>\$5,053,475</u>	<u>\$5,410,003</u>	<u>\$5,667,262</u>
Average loans outstanding during the year (Note 1)	<u>\$4,978,833</u>	<u>\$4,932,728</u>	<u>\$5,261,601</u>	<u>\$5,542,230</u>	<u>\$5,748,789</u>
Balance of allowance at January 1 . . .	\$ 58,193	\$ 84,192	\$ 84,482	\$ 95,393	\$ 73,461
Provision charged to expense	22,968	27,959	17,318	22,812	58,833
Loans charged off:					
Domestic:					
Commercial, financial and agricultural	(12,342)	(48,445)	(18,085)	(7,702)	(14,565)
Real estate—mortgage	(1,252)	(1,417)	(2,109)	(2,973)	(2,500)
Real estate—construction	(278)	(7,617)	(1,467)	(22,186)	(17,953)
Consumer	(561)	(756)	(1,067)	(2,152)	(2,690)
Foreign	(22)	(111)	(171)	(227)	(831)
Total loans charged off:	<u>(14,455)</u>	<u>(58,346)</u>	<u>(22,899)</u>	<u>(35,240)</u>	<u>(38,539)</u>
Recoveries credited to allowance:					
Domestic:					
Commercial, financial and agricultural	2,842	3,767	4,422	626	519
Real estate—mortgage	359	208	328	517	128
Real estate—construction	87	229	171	16	19
Consumer	162	184	211	256	937
Foreign	5	—	159	102	35
Total recoveries	<u>3,455</u>	<u>4,388</u>	<u>5,291</u>	<u>1,517</u>	<u>1,638</u>
Net loans charged off	<u>(11,000)</u>	<u>(53,958)</u>	<u>(17,608)</u>	<u>(33,723)</u>	<u>(36,901)</u>
Balance of allowance at December 31 .	<u>\$ 70,161</u>	<u>\$ 58,193</u>	<u>\$ 84,192</u>	<u>\$ 84,482</u>	<u>\$ 95,393</u>
Ratio of net loans charged-off during the year to average loans outstanding during the year (Note 1)	<u>.22%</u>	<u>1.09%</u>	<u>.33%</u>	<u>.61%</u>	<u>.64%</u>
Ratio of allowance to loans, net of unearned discounts, outstanding at December 31	<u>1.35%</u>	<u>1.22%</u>	<u>1.67%</u>	<u>1.56%</u>	<u>1.68%</u>

(Note 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,									
	2013		2012		2011		2010		2009	
	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	47,676	55.7%	\$34,206	52.8%	\$51,847	50.6%	\$38,439	48.5%	\$47,676	47.8%
Real estate—Mortgage	8,061	16.3	8,838	17.6	9,322	17.7	12,670	17.5	16,825	16.8
Real estate—Construction . .	12,541	23.2	12,720	24.0	19,940	25.2	26,695	27.2	27,918	27.9
Consumer	750	1.3	1,289	1.6	1,724	1.9	6,241	2.3	2,581	2.6
Foreign	1,133	3.5	1,140	4.0	1,359	4.6	437	4.5	393	4.9
	<u>\$70,161</u>	<u>100.0%</u>	<u>\$58,193</u>	<u>100.0%</u>	<u>\$84,192</u>	<u>100.0%</u>	<u>\$84,482</u>	<u>100.0%</u>	<u>\$95,393</u>	<u>100.0%</u>

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

The bank subsidiaries 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 indicate so. Generally, unsecured consumer loans are charged off when 90 days past due. The increase in charge-offs for the year ended December 31, 2012 compared to the year ended December 31, 2011 was largely due to the charge-off of a \$22 million deficiency note on a large credit, which deficiency note was secured with a pool of assets of family trusts of the original creditors. Due to the complexities and delays in liquidating the pool of assets securing the note, the Company made the decision to charge off the loan.

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. The Company’s 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.” The reserve allocated to all categories increased by approximately \$12.0 million from 2012 to 2013. The increase can be attributed to a specific reserve of \$12.0 million on a previously identified impaired commercial loan that further deteriorated during 2013. The reserve allocated to all categories of loans decreased approximately \$26.0 million from 2011 to 2012. The decrease in the reserve is mainly due to the continued workout of the impaired loans previously identified by the Company. The reserve allocated to all categories decreased \$10.9 million from 2009 to 2010. The decrease in the reserve from 2009 to 2010 is mainly due to a decrease in the required reserves for impaired loans analyzed on an individual basis. The impaired loans have been measured based on the fair value of collateral. The majority of these loans show a fair value, after considering selling costs, greater than the carrying value. Please refer to Note 4—Allowance for Probable Loan Losses in the accompanying Notes to the consolidated Financial Statements.

While management of the Company 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 the Company's management that the allowance for probable loan losses at December 31, 2013 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, the Company's 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, 2013	Year Ended December 31, 2012	Percent Increase (Decrease) 2013 vs. 2012	Year Ended December 31, 2011	Percent Increase (Decrease) 2012 vs. 2011
(Dollars in Thousands)					
Service charges on deposit accounts	\$ 97,087	\$ 93,128	4.3%	\$ 97,968	(4.9)%
Other service charges, commissions and fees					
Banking	41,075	38,523	6.6	50,686	(24.0)
Non-banking	7,116	6,998	1.7	7,304	(4.2)
Investment securities transactions, net	9,601	38,446	(75.0)	17,285	122.4
Other investments, net	22,383	13,339	67.8	16,041	(16.8)
Other income	12,343	10,157	21.5	12,209	(16.8)
Total non-interest income	<u>\$189,605</u>	<u>\$200,591</u>	<u>(5.5)%</u>	<u>\$201,493</u>	<u>(.4)%</u>

Total non-interest income decreased 5.5% for the year ended December 31, 2013 when compared to the same period of 2012. Investment securities transactions decreased for the year ended December 31, 2013 compared to the same period of 2012 due to securities sales that occurred in 2012 as a result of the Company re-positioning a portion of the investment portfolio. Other investments income for the year ended December 31, 2013 was positively impacted by the sale of assets in a partnership where the holding company held an equity position, resulting in income of \$5.5 million. Banking service charges, commissions and fees decreased 24% for the twelve months ended December 31, 2012 compared to the same period of 2011 primarily due to the impact of regulatory changes related to interchange fee income and overdraft programs.

Non-Interest Expense

	Year Ended December 31, 2013	Year Ended December 31, 2012	Percent Increase (Decrease) 2013 vs. 2012	Year Ended December 31, 2011	Percent Increase (Decrease) 2012 vs. 2011
	(Dollars in Thousands)				
Employee compensation and benefits	\$119,845	\$118,041	1.5%	\$126,004	(6.3)%
Occupancy	31,766	34,608	(8.2)	38,722	(10.6)
Depreciation of bank premises and equipment	26,017	26,756	(2.8)	34,935	(23.4)
Professional fees	13,146	14,369	(8.5)	12,998	10.5
Deposit insurance assessments	6,737	7,709	(12.6)	9,047	(14.8)
Net expense, other real estate owned	6,896	8,929	(22.8)	14,817	(39.7)
Amortization of identified intangible assets	4,633	4,651	(.4)	5,293	(12.1)
Advertising	7,034	7,017	.2	5,807	20.8
Early termination fee—securities sold under repurchase agreements	12,303	31,550	(61.0)	—	100.0
Impairment charges (Total other-than-temporary impairment charges, \$(431) less loss of \$1,805, \$(916) less gain of \$(123), and \$(1,003) less loss of \$26, included in other comprehensive (loss) income)	1,374	1,039	32.2	977	6.3
Other	62,881	60,703	3.6	68,174	(11.0)
Total non-interest expense	<u>\$292,632</u>	<u>\$315,372</u>	<u>(7.2)%</u>	<u>\$316,774</u>	<u>(.4)%</u>

Non-interest expense for the year ended December 31, 2013 decreased by 7.2% compared to the same period of 2012. Non-interest expense for the twelve months ended December 31, 2013 and 2012 was negatively impacted by charges of \$12.3 million and \$31.6 million, respectively, recorded by the Company's lead bank subsidiary. The lead bank subsidiary terminated portions of its long-term repurchase agreements outstanding in order to help manage its long-term funding costs. Non-interest expense for 2011 was negatively impacted by a valuation allowance taken for a foreclosed real estate project, included in "net expense, other real estate owned," in the table above. After evaluation of the carrying value of the foreclosed real estate, the Company determined that the property required a valuation allowance. The Company recorded other-than-temporary impairment charges of \$1.4 million, \$1 million, and \$977 thousand on non-agency mortgage-backed securities, representing the credit related impairment on the securities in during 2013, 2012 and 2011, respectively. During the fourth quarter of 2011, the Company also recognized charges of \$5.36 million, before tax, related to the closing of fifty-five (55) in-store branches by December 31, 2011. The charges are included in "Depreciation of bank premises and equipment" and "Other" in the table above.

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, 2013, 2012 and 2011:

	December 31,		
	2013	2012	2011
	(Dollars in Thousands)		
Residential mortgage-backed securities			
Available for sale	\$5,027,701	\$5,265,204	\$4,969,263
Obligations of states and political subdivisions			
Available for sale	248,410	238,675	224,761
Equity securities			
Available for sale	28,468	21,136	19,891
Other securities			
Held to maturity	2,400	2,400	2,450
Total	<u>\$5,306,979</u>	<u>\$5,527,415</u>	<u>\$5,216,365</u>

The following tables set forth the contractual maturities of investment securities, based on amortized cost, at December 31, 2013 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	\$ 22	8.0%	\$19,887	5.03%	\$638,363	2.63%	\$4,437,893	2.71%
Obligations of states and political subdivisions	—	—	—	—	704	6.24	247,650	5.45
Equity securities	325	—	—	—	—	—	27,750	2.07
Other securities	—	—	—	—	—	—	—	—
Total	<u>\$347</u>	<u>.50%</u>	<u>\$19,887</u>	<u>5.03%</u>	<u>\$639,067</u>	<u>2.64%</u>	<u>\$4,713,293</u>	<u>2.85%</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	<u>\$125</u>	<u>1.43%</u>	<u>\$2,275</u>	<u>1.36%</u>	<u>\$—</u>	<u>—%</u>	<u>\$—</u>	<u>%</u>
Total	<u>\$125</u>	<u>1.43%</u>	<u>\$2,275</u>	<u>1.36%</u>	<u>\$—</u>	<u>—%</u>	<u>\$—</u>	<u>—%</u>

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, the Company believes 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, 2013, 2012, 2011, 2010 and 2009 are shown in the following table:

	December 31,				
	2013	2012	2011	2010	2009
	(Dollars in Thousands)				
Commercial, financial and agricultural	\$2,894,779	\$2,525,380	\$2,560,102	\$2,615,878	\$2,703,379
Real estate—mortgage	847,692	838,467	895,870	948,982	954,010
Real estate—construction	1,208,508	1,147,669	1,273,389	1,473,471	1,583,057
Consumer	66,414	74,514	94,109	126,047	146,331
Foreign	181,842	188,974	230,005	245,625	280,485
Loans, net of unearned discount . . .	<u>\$5,199,235</u>	<u>\$4,775,004</u>	<u>\$5,053,475</u>	<u>\$5,410,003</u>	<u>\$5,667,262</u>

The following table shows the amounts of loans (excluding real estate mortgages and consumer loans) outstanding as of December 31, 2013, 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	\$ 780,975	\$1,837,848	\$275,956	\$2,894,779
Real estate—construction	530,378	638,562	39,568	1,208,508
Foreign	124,578	41,200	16,064	181,842
Total	<u>\$1,435,931</u>	<u>\$2,517,610</u>	<u>\$331,588</u>	<u>\$4,285,131</u>

	Interest sensitivity	
	Fixed Rate	Variable Rate
	(Dollars in Thousands)	
Due after one but within five years	\$210,378	\$2,307,232
Due after five years	64,160	267,428
Total	<u>\$274,538</u>	<u>\$2,574,660</u>

International Operations

On December 31, 2013, the Company had \$181,842,000 (1.5% of total assets) in loans outstanding to borrowers domiciled in foreign countries, which included primarily borrowers domiciled in Mexico. The loan policies of the Company's bank subsidiaries 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, 2013 and 2012 is presented below.

	For the year ended December 31,			
	2013		2012	
	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	\$122,314	\$ 506	\$131,775	\$ 551
Secured by United States real estate	27,817	319	24,005	236
Secured by other United States collateral (securities, gold, silver, etc.)	1,003	12	1,352	18
Unsecured	1,163	6	654	6
Other (principally Mexico real estate)	29,545	290	31,188	329
	<u>\$181,842</u>	<u>\$1,133</u>	<u>\$188,974</u>	<u>\$1,140</u>

The transactions for the years ended December 31, 2013, 2012 and 2011, in that portion of the allowance for probable loan losses related to foreign debt were as follows:

	2013	2012	2011
	(Dollars in Thousands)		
Balance at January 1,	\$1,140	\$1,359	\$ 437
Charge-offs	(22)	(111)	(171)
Recoveries	5	—	159
Net charge-offs	(17)	(111)	(12)
Charge (credit) to expense	10	(108)	934
Balance at December 31	<u>\$1,133</u>	<u>\$1,140</u>	<u>\$1,359</u>

Deposits

	2013 Average Balance	2012 Average Balance
	(Dollars in Thousands)	
Deposits:		
Demand—non-interest bearing		
Domestic	\$2,097,318	\$1,832,870
Foreign	497,409	239,669
Total demand non-interest bearing	<u>2,594,727</u>	<u>2,072,539</u>
Savings and interest bearing demand		
Domestic	2,358,990	2,289,706
Foreign	520,125	516,951
Total savings and interest bearing demand	<u>2,879,115</u>	<u>2,806,657</u>
Time certificates of deposit		
\$100,000 or more:		
Domestic	899,847	1,037,528
Foreign	968,962	1,234,984
Less than \$100,000:		
Domestic	565,403	636,062
Foreign	337,610	373,235
Total time, certificates of deposit	<u>2,771,822</u>	<u>3,281,809</u>
Total deposits	<u>\$8,245,664</u>	<u>\$8,161,005</u>

	2013	2012	2011
	(Dollars in Thousands)		
Interest expense:			
Savings and interest bearing demand			
Domestic	\$ 3,182	\$ 4,487	\$ 6,549
Foreign	580	801	1,234
Total savings and interest bearing demand	<u>3,762</u>	<u>5,288</u>	<u>7,783</u>
Time, certificates of deposit			
\$100,000 or more			
Domestic	5,761	8,263	10,299
Foreign	5,590	9,148	11,512
Less than \$100,000			
Domestic	3,065	4,945	7,468
Foreign	1,028	1,617	2,277
Total time, certificates of deposit	<u>15,444</u>	<u>23,973</u>	<u>31,556</u>
Total interest expense on deposits	<u>\$19,206</u>	<u>\$29,261</u>	<u>\$39,339</u>

Scheduled maturities of time deposits in amounts of \$100,000 or more at December 31, 2013, were as follows:

Due within 3 months or less	\$ 673,126
Due after 3 months and within 6 months	441,749
Due after 6 months and within 12 months	494,928
Due after 12 months	185,837
	<u>\$1,795,640</u>

The Company offers a variety of deposit accounts having a wide range of interest rates and terms. The Company relies primarily on its high quality customer service, sales programs, customer referrals and advertising to attract and retain these deposits. Deposits provide the primary source of funding for the Company's 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, 2013 were \$8,243,425,000, a decrease of .5% from \$8,287,213,000 at December 31, 2012.

Return on Equity and Assets

Certain key ratios for the Company for the years ended December 31, 2013, 2012 and 2011 follows (Note 1):

	Years ended December 31,		
	2013	2012	2011
Percentage of net income to:			
Average shareholders' equity	8.95%	7.17%	8.71%
Average total assets	1.07	.91	1.08
Percentage of average shareholders' equity to average total assets	11.93	12.68	12.42
Percentage of cash dividends per share to net income per share	22.87	28.78	22.49

(Note 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 the Company's bank subsidiaries 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. The Company's bank subsidiaries derive their liquidity largely from deposits of individuals and business entities. Deposits from persons and entities domiciled in Mexico comprise a stable portion of the deposit base of the Company's bank subsidiaries. Historically, the Mexico based deposits of the Company's bank subsidiaries have been a stable source of funding. Such deposits comprised approximately 28%, 28%, and 29% of the Company's bank subsidiaries' total deposits at each of the years ended December 31, 2013, 2012 and 2011, respectively. Other important funding sources for the Company's bank subsidiaries have been borrowings from the Federal Home Loan Bank ("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. Primary liquidity of the Company and its subsidiaries has been maintained by means of increased investment in shorter-term securities, certificates of deposit and repurchase agreements. As in the past, the Company 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 anticipate fluctuations in interest rates over reasonable periods of time.

Asset/Liability Management

The Company's fund management policy has as its primary focus the measurement and management of the 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, 2013, 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 on the following page, the Company is liability-sensitive during the early time periods and is asset-sensitive in the longer periods. 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, 2013	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	\$ 552,691	\$ 1,158,451	\$3,347,427	\$ 248,410	\$ 5,306,979
Loans, net of non-accruals	3,900,925	243,071	300,286	692,130	5,136,412
Total earning assets	\$ 4,453,616	\$ 1,401,522	\$3,647,713	\$ 940,540	\$10,443,391
Cumulative earning assets	\$ 4,453,616	\$ 5,855,138	\$9,502,851	\$10,443,391	
Rate sensitive liabilities					
Time deposits	\$ 1,066,670	\$ 1,301,276	\$ 283,301	\$ 56	\$ 2,651,303
Other interest bearing deposits	2,925,612	—	—	—	2,925,612
Securities sold under repurchase agreements	331,860	14,505	611,016	—	957,381
Other borrowed funds	1,215,000	—	—	8,950	1,223,950
Junior subordinated deferrable interest debentures	190,726	—	—	—	190,726
Total interest bearing liabilities	\$ 5,729,868	\$ 1,315,781	\$ 894,317	\$ 9,006	\$ 7,948,972
Cumulative sensitive liabilities	\$ 5,729,868	\$ 7,045,649	\$7,939,966	\$ 7,948,972	
Repricing gap	\$(1,276,252)	\$ 85,741	\$2,753,396	\$ 931,534	\$ 2,494,419
Cumulative repricing gap	(1,276,252)	(1,190,511)	1,562,885	2,494,419	
Ratio of interest-sensitive assets to liabilities	.78	1.07	4.08	104.43	1.31
Ratio of cumulative, interest- sensitive assets to liabilities	.78	.83	1.20	1.31	

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. The Company and many other institutions rely primarily upon income simulation analysis in measuring and managing exposure to interest rate risk.

The Company has 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, 2013, in rising rate scenarios of 150, 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% and 20%, respectively. At

December 31, 2013, the income simulations show that a rate shift of 150, 300 and 400 basis points in interest rates up will vary projected net interest income for the coming 12 month period by (2.01)%, (1.98)% and (1.46)%, 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. The Company believes that it is properly positioned for a potential interest rate increase or decrease.

All the measurements of risk described above are made based upon the Company's business mix and interest rate exposures at the particular point in time. The exposure changes continuously as a result of the Company's ongoing business and its risk management initiatives. While management believes these measures provide a meaningful representation of the Company's 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.

Principal sources of liquidity and funding for the Company are dividends from subsidiaries and borrowed funds, with such funds being used to finance the Company's cash flow requirements. The Company closely monitors the dividend restrictions and availability from the bank subsidiaries as disclosed in Note 20 to the Consolidated Financial Statements. At December 31, 2013, the aggregate amount legally available to be distributed to the Company from bank subsidiaries as dividends was approximately \$584,000,000, assuming that each bank subsidiary continues to be classified as "well-capitalized" under the applicable regulations. The restricted capital (capital and surplus) of the bank subsidiaries was approximately \$927,033,000 as of December 31, 2013. The undivided profits of the bank subsidiaries were approximately \$920,060,000 as of December 31, 2013. Additionally, as a result of the Company's participation in the TARP Capital Purchase Program, the Company was restricted in the payment of dividends and was not allowed without the Treasury Department's consent, to declare or pay any dividend on the Company Common Stock other than a regular semi-annual cash dividend of not more than \$.33 per share, as adjusted for any stock dividend or stock split. The restriction ceased to exist on December 23, 2011 and the Company exited the TARP program when it finalized the repayment of all the TARP funds on November 28, 2012.

At December 31, 2013, the Company has outstanding \$1,223,950,000 in other borrowed funds and \$190,726,000 in junior subordinated deferrable interest debentures. In addition to borrowed funds and dividends, the Company has a number of other available alternatives to finance the growth of its existing banks as well as future growth and expansion.

Capital

The Company maintains an adequate level of capital as a margin of safety for its depositors and shareholders. At December 31, 2013, shareholders' equity was \$1,424,408,000 compared to \$1,435,708,000 at December 31, 2012, a decrease of \$11,300,000 or .8%. Shareholders' equity decreased due to the payment of cash dividends to shareholders and accumulated other comprehensive loss. The accumulated other comprehensive 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. The Company's 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 11.61% at December 31, 2013 and 10.86% at December 31, 2012. The core deposit intangibles and goodwill of \$285,718,000 as of December 31, 2013, are deducted from the sum of core capital elements when determining the capital ratios of the Company.

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 6% and a Tier 1 leverage ratio of 5%. The Company had risk-weighted Tier 1 capital ratios of 19.33% and 19.65% and risk weighted total capital ratios of 20.36% and 20.60% as of December 31, 2013 and 2012, respectively, which are well above the minimum regulatory requirements and exceed the well-capitalized ratios (see Note 20 to Notes to Consolidated Financial Statements).

Junior Subordinated Deferrable Interest Debentures

The Company has formed eight statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. The eight statutory business trusts formed by the Company (the "Trusts") have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the "Debentures") issued by the Company. As of December 31, 2013 and December 31, 2012, the principal amount of debentures outstanding totaled \$190,726,000. As a result of the participation in the TARP Capital Purchase Program, the Company was not permitted, without the consent of the Treasury Department, to redeem any of the Debentures. This restriction ceased to exist on December 23, 2011. The Company completed the repayment of the TARP funds on November 28, 2012. One half of the Trust I securities were redeemed on June 8, 2011 and the remaining one half of the Trust I securities were redeemed on July 1, 2011, with the consent of the Treasury Department.

The Debentures are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the respective indentures) of the Company, 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. The Company has fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. The Company has 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 VI, VII, 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 of the Company 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, 2013 and December 31, 2012, the total \$190,726,000 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, 2013:

	Junior Subordinated Deferrable Interest Debentures (in thousands)	Repricing Frequency	Interest Rate	Interest Rate Index	Maturity Date	Optional Redemption Date(1)
Trust VI	\$ 25,774	Quarterly	3.69%	LIBOR + 3.45	November 2032	February 2008
Trust VII	10,310	Quarterly	3.49%	LIBOR + 3.25	April 2033	April 2008
Trust VIII	25,774	Quarterly	3.29%	LIBOR + 3.05	October 2033	October 2008
Trust IX	41,238	Quarterly	1.87%	LIBOR + 1.62	October 2036	October 2011
Trust X	34,021	Quarterly	1.89%	LIBOR + 1.65	February 2037	February 2012
Trust XI	32,990	Quarterly	1.87%	LIBOR + 1.62	July 2037	July 2012
Trust XII	20,619	Quarterly	1.69%	LIBOR + 1.45	September 2037	September 2012
	<u>\$190,726</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 of the Company (other than deposit liabilities) as of December 31, 2013:

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	\$ 957,381	\$ 246,365	\$11,016	\$700,000	\$ —
Federal Home Loan Bank borrowings . . .	1,223,950	1,215,193	407	436	7,914
Junior subordinated deferrable interest debentures	190,726	—	—	—	190,726
Operating leases	10,787	4,330	4,908	1,322	227
Total Contractual Cash Obligations	<u>\$2,382,844</u>	<u>\$1,465,888</u>	<u>\$16,331</u>	<u>\$701,758</u>	<u>\$198,867</u>

The following table presents contractual commercial commitments of the Company (other than deposit liabilities) as of December 31, 2013:

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	\$ 108,683	\$ 87,384	\$ 21,289	\$ 10	\$ —
Commercial Letters of Credit	21,434	21,434	—	—	—
Credit Card Lines	61,120	61,120	—	—	—
Other Commercial Commitments	1,715,365	948,473	536,149	137,536	93,207
Total Commercial Commitments	<u>\$1,906,602</u>	<u>\$1,118,411</u>	<u>\$557,438</u>	<u>\$137,546</u>	<u>\$93,207</u>

Due to the nature of the Company's commercial commitments, including unfunded loan commitments and lines of credit, the amounts presented above do not necessarily reflect the amounts the Company anticipates funding in the periods presented above.

Critical Accounting Policies

The Company has established various accounting policies which govern the application of accounting principles in the preparation of the Company's 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.

The Company considers its Allowance for Probable Loan Losses as a policy critical to the sound operations of the bank subsidiaries. The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the bank subsidiaries. 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 bank subsidiary 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 the Company's 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 the Company's internal classified report. Additionally, the Company's credit department reviews the majority of the Company's 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, the Company 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.

The Company's 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 the Company's 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 the Company's 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 some future loss could be sustained by the Company 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 the Company's loans evaluated as impaired under ASC 310-10 are measured using the fair value of collateral method. In limited cases, the Company 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 the Company's 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 served by the Company, (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.

The Company's management continually reviews the allowance for loan losses of the bank subsidiaries 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 in the Company's allowance for loan loss. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, the Company's 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 the Company's consolidated financial statements.

Preferred Stock, Common Stock and Dividends

The Company had issued and outstanding 67,208,261 shares of \$1.00 par value Common Stock held by approximately 2,251 holders of record at February 19, 2014. The book value of the Common Stock at December 31, 2013 was \$22.24 per share compared with \$22.24 per share at December 31, 2012. On November 28, 2012, the Company completed the repurchase of all the 216,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, par value \$0.01 per share, having a liquidation preference of \$1,000 per share that it had issued to the Treasury Department under TARP. The Company repaid all of the \$216 million of TARP funds during the second half of 2012. Under the TARP program, the Company also issued to the Treasury Department a warrant to purchase 1,326,238 shares of the Company's 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. As of February 19, 2014, the Warrant is still outstanding.

The 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 the Company's Common Stock during 2013 and 2012, as quoted on the NASDAQ National Market for each of the quarters in the two year period ended December 31, 2013. 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 the Company's Common Stock was \$21.42 per share at February 19, 2014.

		<u>High</u>	<u>Low</u>
2013:	First quarter	\$21.00	\$18.26
	Second quarter	22.93	17.95
	Third quarter	25.85	20.85
	Fourth quarter	27.20	21.34
		<u>High</u>	<u>Low</u>
2012:	First quarter	\$21.89	\$18.32
	Second quarter	21.49	17.57
	Third quarter	20.40	17.45
	Fourth quarter	19.47	16.92

The Company paid cash dividends to the common shareholders of \$.20 per share on April 20, 2013 to all holders of record on April 1, 2013 and \$.23 per share on October 15, 2013 to all holders of record on September 30, 2013, or \$28,894,000 in the aggregate during 2013. The Company paid cash dividends to the common shareholders of \$.20 per share on April 20, 2012 to all holders of record on April 2, 2013 and \$.20 per share on October 15, 2012 to all holders of record on September 28, 2012, or \$26,894,000 in the aggregate during 2012.

Additionally, as a result of the Company's previous participation in the TARP Capital Purchase Program until November 28, 2012, the Company was restricted in the payment of dividends and was not allowed, without the Treasury Department's consent, to declare or pay any dividend on the Company Common Stock other than a regular semi-annual cash dividend of not more than \$.33 per share, as adjusted for any stock dividend or stock split. The restrictions ceased to exist on December 23, 2011. While the IBC Board is inclined to continue to declare regular semi-annual cash dividends, there can be no assurance as to future dividends because they are dependent upon the Company's future earnings, capital requirements, financial condition, acquisition opportunities and general business conditions at the time.

In addition, the Company has not issued common stock dividends during the last five-year period ending December 31, 2013.

The Company's principal source of funds to pay cash dividends on its Common Stock is cash dividends from its bank subsidiaries. For a discussion of the limitations, please see Note 20 of Notes to Consolidated Financial Statements.

Stock Repurchase Program

In April 2009, following receipt of the Treasury Department's consent, 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 twelve months and on February 28, 2013, the Board of Directors extended the repurchase program and again authorized the repurchase of up to \$40 million of common stock during the twelve month period commencing on April 9, 2013, which repurchase cap the Board is inclined to increase over time. 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. As of February 19, 2014, a total of 7,843,293 shares had been repurchased under all programs at a cost of \$237,536,000.

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, 2013.

	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, 2013	—	—	—	\$40,000,000
November 1—November 30, 2013	—	—	—	40,000,000
December 1—December 31, 2013	—	—	—	40,000,000
Total	—	\$—	—	

(1) The repurchase program was extended on February 28, 2013 and allows for the repurchase of up to an additional \$40,000,000 of treasury stock through April 9, 2014.

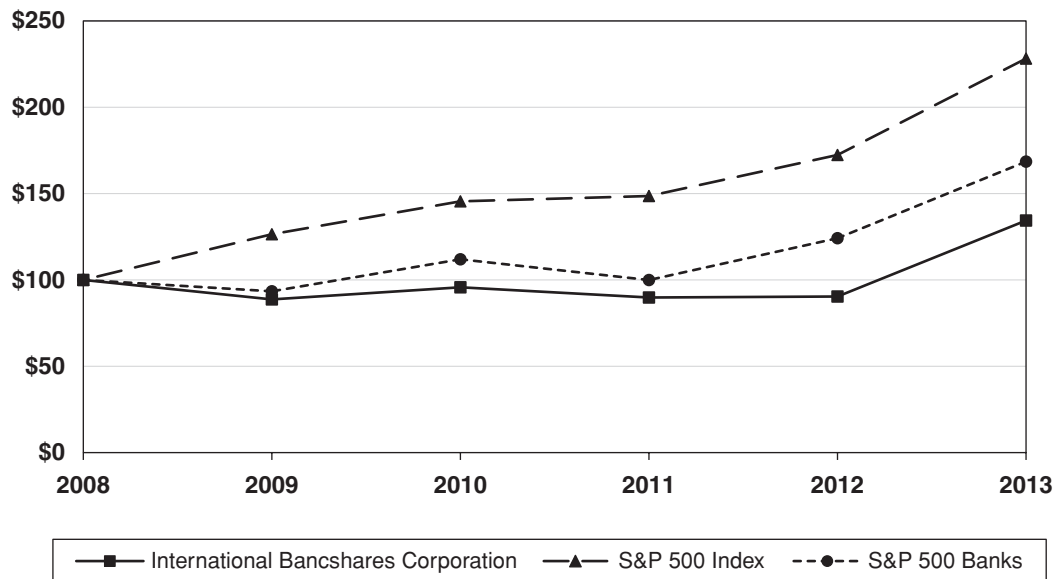
Equity Compensation Plan Information

The following table sets forth information as of December 31, 2013, with respect to the Company's 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	515,143	\$15.98	749,000
Total	515,143	\$15.98	749,000

Stock Performance

COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN



Total Return To Shareholders (Includes reinvestment of dividends)

Company / Index	Base Period 2008	INDEXED RETURNS December 31,				
		2009	2010	2011	2012	2013
International Bancshares Corporation	100	88.72	95.73	89.82	90.39	134.40
S&P 500 Index	100	126.46	145.51	148.59	172.37	228.19
S&P 500 Banks	100	93.41	111.94	99.94	124.16	168.52

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
International Bancshares Corporation:

We have audited the accompanying consolidated statements of condition of International Bancshares Corporation and subsidiaries as of December 31, 2013 and 2012, and 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, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of International Bancshares Corporation and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), International Bancshares Corporation and subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 1992, and our report dated February 24, 2014 expressed an unqualified opinion on the effectiveness of International Bancshares Corporation and subsidiaries' internal control over financial reporting.

/s/ McGladrey LLP

Dallas, Texas
February 24, 2014

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition

December 31, 2013 and 2012

(Dollars in Thousands, Except Per Share Amounts)

	<u>2013</u>	<u>2012</u>
Assets		
Cash and due from banks	\$ 274,785	\$ 283,100
Investment securities:		
Held to maturity (Market value of \$2,400 on December 31, 2013 and \$2,400 on December 31, 2012)	2,400	2,400
Available for sale (Amortized cost of \$5,372,594 on December 31, 2013 and \$5,423,189 on December 31, 2012)	5,304,579	5,525,015
Total investment securities	5,306,979	5,527,415
Loans	5,199,235	4,775,004
Less allowance for probable loan losses	(70,161)	(58,193)
Net loans	5,129,074	4,716,811
Bank premises and equipment, net	504,842	481,287
Accrued interest receivable	30,654	31,034
Other investments	388,563	372,739
Identified intangible assets, net	3,186	7,819
Goodwill	282,532	282,532
Other assets	158,862	179,936
Total assets	<u>\$12,079,477</u>	<u>\$11,882,673</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Continued)

December 31, 2013 and 2012

(Dollars in Thousands, Except Per Share Amounts)

	<u>2013</u>	<u>2012</u>
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand—non-interest bearing	\$ 2,666,510	\$ 2,465,750
Savings and interest bearing demand	2,925,612	2,867,151
Time	<u>2,651,303</u>	<u>2,954,312</u>
Total deposits	8,243,425	8,287,213
Securities sold under repurchase agreements	957,381	1,129,679
Other borrowed funds	1,223,950	749,027
Junior subordinated deferrable interest debentures	190,726	190,726
Other liabilities	<u>39,587</u>	<u>90,320</u>
Total liabilities	<u>10,655,069</u>	<u>10,446,965</u>
Shareholders' equity:		
Common shares of \$1.00 par value. Authorized 275,000,000 shares; issued 95,743,592 shares on December 31, 2013 and 95,724,517 shares on December 31, 2012	95,744	95,725
Surplus	163,947	163,287
Retained earnings	1,467,000	1,369,543
Accumulated other comprehensive (loss) income (including \$(5,646) on December 31, 2013 and \$(6,811) on December 31, 2012 of comprehensive loss related to other-than-temporary impairment for non-credit related issues)	<u>(43,774)</u>	<u>65,662</u>
	1,682,917	1,694,217
Less cost of shares in treasury, 28,537,180 shares on December 31, 2013 and December 31, 2012	<u>(258,509)</u>	<u>(258,509)</u>
Total shareholders' equity	<u>1,424,408</u>	<u>1,435,708</u>
Total liabilities and shareholders' equity	<u>\$12,079,477</u>	<u>\$11,882,673</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2013, 2012 and 2011

(Dollars in Thousands, Except Per Share Amounts)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Interest income:			
Loans, including fees	\$263,027	\$268,588	\$292,514
Investment securities:			
Taxable	87,198	94,885	113,650
Tax-exempt	12,877	11,663	10,091
Other interest income	115	503	1,869
Total interest income	<u>363,217</u>	<u>375,639</u>	<u>418,124</u>
Interest expense:			
Savings and interest bearing demand deposits	3,762	5,288	7,783
Time deposits	15,444	23,973	31,556
Securities sold under repurchase agreements	29,171	37,645	42,263
Other borrowings	1,590	998	1,623
Junior subordinated deferrable interest debentures	4,665	6,595	11,073
Total interest expense	<u>54,632</u>	<u>74,499</u>	<u>94,298</u>
Net interest income	<u>308,585</u>	<u>301,140</u>	<u>323,826</u>
Provision for probable loan losses	22,968	27,959	17,318
Net interest income after provision for probable loan losses	<u>285,617</u>	<u>273,181</u>	<u>306,508</u>
Non-interest income:			
Service charges on deposit accounts	97,087	93,128	97,968
Other service charges, commissions and fees			
Banking	41,075	38,523	50,686
Non-banking	7,116	6,998	7,304
Investment securities transactions, net	9,601	38,446	17,285
Other investments, net	22,383	13,339	16,041
Other income	12,343	10,157	12,209
Total non-interest income	<u>189,605</u>	<u>200,591</u>	<u>201,493</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Continued)

Years ended December 31, 2013, 2012 and 2011

(Dollars in Thousands, Except Per Share Amounts)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Non-interest expense:			
Employee compensation and benefits	\$ 119,845	\$ 118,041	\$ 126,004
Occupancy	31,766	34,608	38,722
Depreciation of bank premises and equipment	26,017	26,756	34,935
Professional fees	13,146	14,369	12,998
Deposit insurance assessments	6,737	7,709	9,047
Net expense, other real estate owned	6,896	8,929	14,817
Amortization of identified intangible assets	4,633	4,651	5,293
Advertising	7,034	7,017	5,807
Early termination fee—securities sold under repurchase agreements	12,303	31,550	—
Impairment charges (Total other-than-temporary impairment charges, \$(431) less loss of \$1,805, \$(916) less gain of \$(123), and \$(1,003) less loss of \$26, included in other comprehensive (loss) income)	1,374	1,039	977
Other	62,881	60,703	68,174
Total non-interest expense	<u>292,632</u>	<u>315,372</u>	<u>316,774</u>
Income before income taxes	182,590	158,400	191,227
Provision for income taxes	56,239	50,565	64,078
Net income	\$ 126,351	\$ 107,835	\$ 127,149
Preferred stock dividends and discount accretion	—	14,362	13,280
Net income available to common shareholders	<u>\$ 126,351</u>	<u>\$ 93,473</u>	<u>\$ 113,869</u>
Basic earnings per common share:			
Weighted average number of shares outstanding	67,195,180	67,236,681	67,506,554
Net income	<u>\$ 1.88</u>	<u>\$ 1.39</u>	<u>\$ 1.69</u>
Fully diluted earnings per common share:			
Weighted average number of shares outstanding	67,314,859	67,313,963	67,569,468
Net income	<u>\$ 1.88</u>	<u>\$ 1.39</u>	<u>\$ 1.69</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Years ended December 31, 2013, 2012, and 2011

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net income	\$ 126,351	\$107,835	\$127,149
Other comprehensive income, net of tax:			
Net unrealized holding (losses) gains on securities available for sale arising during period (net of tax effects of \$(56,048), \$2,701, and \$35,960)	(104,088)	5,018	66,782
Reclassification adjustment for gains on securities available for sale included in net income (net of tax effects of \$(3,360), \$(13,456), and \$(6,050))	(6,241)	(24,990)	(11,235)
Reclassification adjustment for impairment charges on available for sale securities included in net income (net of tax effects of \$481, \$364, and \$342)	893	675	635
	<u>(109,436)</u>	<u>(19,297)</u>	<u>56,182</u>
Comprehensive income	<u>\$ 16,915</u>	<u>\$ 88,538</u>	<u>\$183,331</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Years ended December 31, 2013, 2012 and 2011

(in Thousands, except share and per share amounts)

	Preferred Stock	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2010 . . .	\$ 208,068	95,711	\$95,711	\$162,276	\$1,214,743	\$ 28,777	\$(250,358)	\$1,459,217
Net Income	—	—	—	—	127,149	—	—	127,149
Dividends:								
Cash (\$.38 per share)	—	—	—	—	(25,648)	—	—	(25,648)
Preferred stock (5%) including discount accretion	2,480	—	—	—	(13,280)	—	—	(10,800)
Purchase of treasury (425,655 shares)	—	—	—	—	—	—	(6,435)	(6,435)
Exercise of stock options	—	9	9	104	—	—	—	113
Stock compensation expense recognized in earnings	—	—	—	387	—	—	—	387
Other comprehensive income, net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustment . .	—	—	—	—	—	56,182	—	56,182
Balance at December 31, 2011 . . .	210,548	95,720	95,720	162,767	1,302,964	84,959	(256,793)	1,600,165
Net Income	—	—	—	—	107,835	—	—	107,835
Dividends:								
Cash (\$.40 per share)	—	—	—	—	(26,894)	—	—	(26,894)
Preferred stock (5%) including discount accretion	5,452	—	—	—	(14,362)	—	—	(8,910)
Redemption of Series A Preferred Shares (216,000 shares)	(216,000)	—	—	—	—	—	—	(216,000)
Purchase of treasury stock (95,466 shares)	—	—	—	—	—	—	(1,716)	(1,716)
Exercise of stock options	—	5	5	46	—	—	—	51
Stock compensation expense recognized in earnings	—	—	—	474	—	—	—	474
Other comprehensive income, net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustment . .	—	—	—	—	—	(19,297)	—	(19,297)
Balance at December 31, 2012 . . .	—	95,725	95,725	163,287	1,369,543	65,662	(258,509)	1,435,708
Net Income	—	—	—	—	126,351	—	—	126,351
Dividends:								
Cash (\$.43 per share)	—	—	—	—	(28,894)	—	—	(28,894)
Exercise of stock options	—	19	19	246	—	—	—	265
Stock compensation expense recognized in earnings	—	—	—	414	—	—	—	414
Other comprehensive loss, net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments . .	—	—	—	—	—	(109,436)	—	(109,436)
Balance at December 31, 2013 . . .	—	95,744	\$95,744	\$163,947	\$1,467,000	\$ (43,774)	\$(258,509)	\$1,424,408

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2013, 2012 and 2011

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating activities:			
Net income	\$ 126,351	\$ 107,835	\$ 127,149
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for probable loan losses	22,968	27,959	17,318
Specific reserve, other real estate owned	1,204	1,776	9,806
Accretion of time deposit discounts	—	—	(11)
Depreciation of bank premises and equipment	26,017	26,756	34,935
Gain on sale of bank premises and equipment	(2,089)	(538)	(361)
(Gain) loss on sale of other real estate owned	(460)	488	(738)
Accretion of investment securities discounts	(4,025)	(3,195)	(2,081)
Amortization of investment securities premiums	44,245	30,501	18,362
Investment securities transactions, net	(9,601)	(38,446)	(17,285)
Impairment charges on available for sale securities	1,374	1,039	977
Accretion of junior subordinated debenture discounts	—	—	9
Amortization of identified intangible assets	4,633	4,651	5,293
Stock based compensation expense	414	474	387
Earnings from affiliates and other investments	(18,806)	(9,892)	(11,633)
Deferred tax (benefit) expense	(1,819)	7,923	(2,299)
Decrease in accrued interest receivable	380	968	3,658
Decrease (increase) in other assets	20,612	(5,392)	2,303
(Decrease) increase in other liabilities	(2,272)	7,106	(4,966)
Net cash provided by operating activities	<u>209,126</u>	<u>160,013</u>	<u>180,823</u>
Investing activities:			
Proceeds from maturities of securities	1,200	1,125	1,425
Proceeds from sales and calls of available for sale securities	178,123	1,382,231	1,102,849
Purchases of available for sale securities	(1,384,254)	(3,081,034)	(2,231,330)
Principal collected on mortgage backed securities	1,223,532	1,294,197	999,419
Net (increase) decrease in loans	(444,919)	170,072	306,915
Purchases of other investments	(2,475)	(4,228)	(11,941)
Distributions (contributions) from other investments	5,457	(7,410)	33,320
Purchases of bank premises and equipment	(50,016)	(62,030)	(20,393)
Proceeds from sales of bank premises and equipment	2,533	7,575	1,719
Proceeds from sales of other real estate owned	23,170	38,766	25,324
Purchase of identified intangible asset	—	(280)	(174)
Net cash (used in) provided by investing activities	<u>(447,649)</u>	<u>(261,016)</u>	<u>207,133</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Continued)

Years ended December 31, 2013, 2012 and 2011

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Financing activities:			
Net increase in non-interest bearing demand deposits	\$ 200,760	\$ 538,732	\$ 287,942
Net increase in savings and interest bearing demand deposits . . .	58,461	159,458	184,851
Net decrease in time deposits	(303,009)	(357,069)	(126,248)
Net decrease in securities sold under repurchase agreements . . .	(172,298)	(218,950)	(84,641)
Other borrowed funds, net	474,923	254,866	(532,619)
Repayment of long-term debt	—	—	(10,400)
Purchase of treasury stock	—	(1,716)	(6,435)
Redemption of Series A preferred shares	—	(216,000)	—
Proceeds from stock transactions	265	51	113
Payments of cash dividends—common	(28,894)	(26,894)	(25,648)
Payments of cash dividends—preferred	—	(10,260)	(10,800)
Net cash provided by (used in) financing activities	<u>230,208</u>	<u>122,218</u>	<u>(323,885)</u>
(Decrease) increase in cash and cash equivalents	(8,315)	21,215	64,071
Cash and cash equivalents at beginning of year	<u>283,100</u>	<u>261,885</u>	<u>197,814</u>
Cash and cash equivalents at end of year	<u>\$ 274,785</u>	<u>\$ 283,100</u>	<u>\$ 261,885</u>
Supplemental cash flow information:			
Interest paid	\$ 56,818	\$ 77,431	\$ 97,699
Income taxes paid	60,532	36,303	60,922
Non-cash investing and financing activities:			
Purchases of available-for-sale securities not yet settled	—	—	72,538
Net transfers from loans to other real estate owned	9,688	54,441	32,005
Accrued dividends, preferred shares	—	—	1,350

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

The accounting and reporting policies of International Bancshares Corporation (“Corporation”) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the “Company”) conform to accounting principles generally accepted in the United States of America 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

The consolidated financial statements include the accounts of the Corporation and its wholly-owned bank subsidiaries, International Bank of Commerce, Laredo (“IBC”), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville, and the Corporation’s wholly-owned non-bank subsidiaries, IBC Subsidiary Corporation, IBC Life Insurance Company, IBC Trading Company, Premier Tierra Holdings, Inc. and IBC Capital Corporation. All significant inter-company balances and transactions have been eliminated in consolidation.

The Company, through its subsidiaries, is 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. The primary markets of the Company are South, Central, and Southeast Texas and the state of Oklahoma. Each bank subsidiary is very active in facilitating international trade along the United States border with Mexico and elsewhere. Although the Company’s loan portfolio is diversified, the ability of the Company’s debtors to honor their contracts is primarily dependent upon the economic conditions in the Company’s trade area. In addition, the investment portfolio is directly impacted by fluctuations in market interest rates. The Company and its bank subsidiaries are subject to the regulations of certain Federal agencies as well as the Texas 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.

The Company owns two insurance-related subsidiaries, IBC Life Insurance Company and IBC Insurance Agency, Inc., a wholly owned subsidiary of IBC, the bank subsidiary. Neither of the insurance-related subsidiaries conducts underwriting activities. The IBC Life Insurance Company is in the business of reinsuring credit life and credit accident and health insurance. The business is assumed from an unaffiliated insurer and the only business written is generated by the bank subsidiaries of the Company. The risk assumed on each of the policies is not significant to the consolidated financial statements.

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

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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (Continued)

Investment Securities

The Company classifies debt and equity 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 until realized. The Company did not maintain any trading securities during the three year period ended December 31, 2013.

Mortgage-backed securities held at December 31, 2013 and 2012 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 (“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, the Company believes 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 (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to hold and the determination of whether the Company will more likely than not be required to sell the security prior to a recovery in fair value. If the Company determines that (1) it intends to sell the security or (2) it is more likely than not that it 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 the Company’s amortized cost in the security. If the Company determines that it (1) does not intend to sell the security and (2) it 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 (1) the amount of impairment related to credit loss and (2) 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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (Continued)

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 the Company's bank subsidiaries' allowances for probable loan losses. Such agencies may require the Company's bank subsidiaries to make additions or reductions to their U.S. generally accepted accounting principles ("GAAP") allowances based on their judgments of information available to them at the time of their examination.

The bank subsidiaries 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 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 amortized over the life of the loan using the interest method. The Company originates 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 of the Company's impaired loans are measured at the fair value of the collateral. In limited cases the Company may use other methods to determine the level of impairment of a loan if such loan is not collateral dependent.

Non-Accrual Loans

The non-accrual loan policy of the Company's bank subsidiaries 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (Continued)

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 bank subsidiary 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.

Other Real Estate Owned

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. Other real estate owned totaled \$85,879,000 and \$100,106,000 at December 31, 2013 and 2012, respectively. Other real estate owned is included in other assets.

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.

Other Investments

Other investments include equity investments in non-financial companies, bank owned life insurance, 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.

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. The Company files a consolidated federal income tax return with its 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (Continued)

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.

The Company evaluates uncertain tax positions at the end of each reporting period. The Company 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, 2013 and 2012, respectively, after evaluating all uncertain tax positions, the Company has recorded no liability for unrecognized tax benefits at the end of the reporting period. The Company 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, 2013, 2012 and 2011, the Company recognized no interest expense or penalties related to uncertain tax positions.

The Company files consolidated tax returns in the U.S. Federal jurisdiction and various state jurisdictions. The Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2010.

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-Sholes-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 the Company's 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 the Company's 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, 2013, after completing goodwill testing, the Company has 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (Continued)

exchanged either on its own or in combination with a related contract, asset, or liability. The Company's identified intangible assets relate to core deposits and contract rights. As of December 31, 2013, the Company has determined that no impairment of identified intangibles exists. Identified 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, the Company considers all short-term investments with a maturity at date of purchase of three months or less to be cash equivalents. Also, the Company reports transactions related to deposits and loans to customers on a net basis.

Accounting for Transfers and Servicing of Financial Assets

The Company accounts 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, the Company recognizes the financial and servicing assets it controls and liabilities it has incurred, derecognizes financial assets when control has been surrendered and derecognizes liabilities when extinguished. The Company has retained mortgage servicing rights in connection with the sale of mortgage loans. Because the Company 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

The Company operates as one segment. The operating information used by the Company's chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated financial statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (Continued)

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.

New Accounting Standards

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-02 to ASC 220, "Comprehensive Income." The update amends existing literature to require an entity to provide information about the amounts reclassified out of other comprehensive income by component, and it also requires enhanced disclosure and cross reference on items reclassified out of accumulated other comprehensive income during the reporting period. The update is effective for reporting periods beginning after December 15, 2012. The adoption of the update to existing standards did not have a significant impact to the Company's consolidated financial statements.

In July 2013, the Financial Accounting Standards Board issued Accounting Standards Update No. 2013-11 to ASC 740, "Income Taxes." The update amends existing literature to eliminate diversity in practice in the presentation of unrecognized tax benefits in instances where a net operating loss carryforward, a similar tax loss or a tax credit carryforward also exist. The update clarifies how the unrecognized tax benefit should be presented in those situations where other tax losses or tax credit carryforwards exist. The update does not change the currently required disclosures for unrecognized tax benefits under current ASC 740 guidance. The update is effective for fiscal years and interim periods within those years beginning after December 15, 2013. The adoption of the update to existing standards is not expected to have a significant impact to the Company's consolidated financial statements.

In January 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-04 to ASC 310-40, "Receivables—Troubled Debt Restructurings by Creditors." The update amends existing literature to eliminate diversity in practice by clarifying and defining when an in substance repossession or foreclosure occurs. The terms "in substance a repossession or foreclosure" and "physical possession" are not currently defined in the accounting literature, resulting in diversity in practice when a creditor derecognizes a loan receivable and recognizes the real estate property collateralizing the loan receivable as an asset. Additionally, the update requires interim and annual disclosures of both the amount of foreclosed residential real estate property and the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure. The update is effective for annual periods and the interim periods within those annual periods beginning after December 15, 2014. The adoption of the update to existing standards is not expected to have a significant impact to the Company's consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(2) Investment Securities

The amortized cost and estimated fair value by type of investment security at December 31, 2013 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	<u>\$2,400</u>	<u>\$—</u>	<u>\$—</u>	<u>\$2,400</u>	<u>\$2,400</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 . .	\$5,096,165	\$56,110	\$(124,574)	\$5,027,701	\$5,027,701
Obligations of states and political subdivisions	248,354	8,063	(8,007)	248,410	248,410
Equity securities	28,075	931	(538)	28,468	28,468
Total investment securities	<u>\$5,372,594</u>	<u>\$65,104</u>	<u>\$(133,119)</u>	<u>\$5,304,579</u>	<u>\$5,304,579</u>

(1) Included in the carrying value of residential mortgage-backed securities are \$1,799,807 of mortgage-backed securities issued by Ginnie Mae, \$3,200,042 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and \$27,852 issued by non-government entities

The amortized cost and estimated fair value of investment securities at December 31, 2013, 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	\$ 125	\$ 125	\$ —	\$ —
Due after one year through five years	2,275	2,275	—	—
Due after five years through ten years	—	—	704	749
Due after ten years	—	—	247,650	247,662
Residential mortgage-backed securities	—	—	5,096,165	5,027,701
Equity securities	—	—	28,075	28,468
Total investment securities	<u>\$2,400</u>	<u>\$2,400</u>	<u>\$5,372,594</u>	<u>\$5,304,579</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(2) Investment Securities (Continued)

The amortized cost and estimated fair value by type of investment security at December 31, 2012 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	<u>\$2,400</u>	<u>\$—</u>	<u>\$—</u>	<u>\$2,400</u>	<u>\$2,400</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 . . .	\$5,186,652	\$ 94,585	\$(16,033)	\$5,265,204	\$5,265,204
Obligations of states and political subdivisions	216,962	23,504	(1,791)	238,675	238,675
Equity securities	19,575	1,581	(20)	21,136	21,136
Total investment securities	<u>\$5,423,189</u>	<u>\$119,670</u>	<u>\$(17,844)</u>	<u>\$5,525,015</u>	<u>\$5,525,015</u>

(1) Included in the carrying value of residential mortgage-backed securities are \$2,035,742 of mortgage-backed securities issued by Ginnie Mae, \$3,196,602 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and \$32,860 issued by non-government entities

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, the Company believes 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 \$2,250,755,000 and \$2,264,525,000, respectively, at December 31, 2013.

Proceeds from the sale and call of securities available-for-sale were \$178,123,000, \$1,382,231,000 and \$1,102,849,000 during 2013, 2012 and 2011, respectively, which amounts included \$177,623,000, \$1,338,723,000 and \$1,095,815,000 of mortgage-backed securities. Gross gains of \$9,601,000, \$38,447,000 and \$17,318,000 and gross losses of \$0, \$1,000 and \$33,000 were realized on the sales in 2013, 2012 and 2011, respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(2) Investment Securities (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, 2013 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	\$2,459,565	\$ (98,022)	\$420,262	\$(26,552)	\$2,879,827	\$(124,574)
Obligations of states and political subdivisions	55,327	(3,025)	14,292	(4,982)	69,619	(8,007)
Equity securities	19,462	(538)	—	—	19,462	(538)
	<u>\$2,534,354</u>	<u>\$(101,585)</u>	<u>\$434,554</u>	<u>\$(31,534)</u>	<u>\$2,968,908</u>	<u>\$(133,119)</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, 2012 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	\$738,492	\$(5,476)	\$32,860	\$(10,557)	\$771,352	\$(16,033)
Obligations of states and political subdivisions	5,117	(114)	10,437	(1,677)	15,554	(1,791)
Equity securities	—	—	56	(20)	56	(20)
	<u>\$743,609</u>	<u>\$(5,590)</u>	<u>\$43,353</u>	<u>\$(12,254)</u>	<u>\$786,962</u>	<u>\$(17,844)</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, the Company believes 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. The Company has no intent to sell and will more than likely not be required to sell before a market price recovery or maturity of the securities; therefore, it is the conclusion of the Company that the investments in residential mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae are not considered

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(2) Investment Securities (Continued)

other-than-temporarily impaired. In addition, the Company has a small investment in non-agency residential mortgage-backed securities that have strong credit backgrounds and include additional credit enhancements to protect the Company from losses arising from high foreclosure rates. These securities have additional market volatility beyond economically induced interest rate events. It is the conclusion of the Company that the investments in non-agency residential mortgage-backed securities are other-than-temporarily impaired due to both credit and other than credit issues. An impairment charge of \$1,374,000 (\$893,100, after tax), was recorded in 2013 on the non-agency residential mortgage backed securities. Impairment charges of \$1,039,000 (\$675,000, after tax) and \$977,000 (\$635,000, after tax) were recorded in 2012 and 2011, respectively on the non-agency residential mortgage backed securities. The impairment charges represent the credit related impairment on the securities.

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. It is the belief of the Company that the entity issuing the debt will honor its interest payment schedule, as well as the full debt at maturity. The securities are purchased by the Company for their economic value. The decrease in fair value is primarily due to market interest rates and not other factors, and because the Company has no intent to sell and will more than likely not be required to sell before a market price recovery or maturity of the securities, it is the conclusion of the Company that the investments are not considered other-than-temporarily impaired.

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investments recognized in earnings for the twelve months ended December 31, 2013 (in Thousands):

Balance at December 31, 2012	\$10,432
Impairment charges recognized during period	<u>1,374</u>
Balance at December 31, 2013	<u>\$11,806</u>

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investments recognized in earnings for the twelve months ended December 31, 2012 (in Thousands):

Balance at December 31, 2011	\$ 9,393
Impairment charges recognized during period	<u>1,039</u>
Balance at December 31, 2012	<u>\$10,432</u>

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investments recognized in earnings for the twelve months ended December 31, 2011 (in Thousands):

Balance at December 31, 2010	\$8,416
Impairment charges recognized during period	<u>977</u>
Balance at December 31, 2011	<u>\$9,393</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)

(3) Loans

A summary of loans, by loan type at December 31, 2013 and 2012 is as follows:

	December 31,	
	2013	2012
	(Dollars in thousands)	
Commercial, financial and agricultural	\$2,894,779	\$2,525,380
Real estate-mortgage	847,692	838,467
Real estate—construction	1,208,508	1,147,669
Consumer	66,414	74,514
Foreign	181,842	188,974
Total loans	<u>\$5,199,235</u>	<u>\$4,775,004</u>

(4) Allowance for Probable Loan Losses

The allowance for probable loan losses primarily consists of the aggregate loan loss allowances of the bank subsidiaries. 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 bank subsidiary 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 the Company's 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. All segments of the loan portfolio continue to be impacted by the prolonged economic downturn. Loans secured by real estate could be impacted negatively by the continued economic environment and resulting decrease in collateral values. Consumer loans may be impacted by continued and prolonged unemployment rates.

The Company's management continually reviews the allowance for loan losses of the bank subsidiaries using the amounts determined from the allowances established on specific impaired loans, the allowance established on quantitative historical loss percentages, and the allowance based on qualitative data to establish an appropriate amount to maintain in the Company's allowance for loan losses. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, the Company's 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 the Company's 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 the Company's internal classified report. Additionally, the Company's credit department reviews the majority of the Company's loans for proper internal classification purposes regardless of whether they are past due and segregates any loans with potential problems for further

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

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, the Company 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.

While the Texas and Oklahoma economies are performing better than other parts of the country, Texas and Oklahoma are not completely immune to the problems associated with the U.S. economy. The increase in income and capital gains taxes on certain individuals, the increase in payroll taxes, and the unprecedented debt and deficit of the United States not yet resolved, adds uncertainty to the possibility of robust economic growth and may create a slowdown in the economy. Thus, the risk of loss associated with all segments of the loan portfolio in these markets continues to be impacted by the prolonged economic weakness. The downturn in the economy and other risk factors are minimized by the underwriting standards of the bank subsidiaries. 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 that the bank subsidiaries invest.

Commercial and industrial loans are mostly secured by the collateral pledged by the borrower that are 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)

(4) Allowance for Probable Loan Losses (Continued)

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

	December 31, 2013								
	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, . . .	\$ 11,632	\$12,720	\$21,880	\$694	\$4,390	\$4,448	\$1,289	\$1,140	\$ 58,193
Losses charge to allowance . .	(11,737)	(278)	(600)	(5)	(632)	(620)	(561)	(22)	(14,455)
Recoveries credited to allowance	2,690	87	152	—	61	298	162	5	3,455
Net losses charged to allowance	(9,047)	(191)	(448)	(5)	(571)	(322)	(399)	(17)	(11,000)
Provision (credit) charged to operations	19,848	12	3,035	87	(7)	123	(140)	10	22,968
Balance at December 31, . . .	<u>\$ 22,433</u>	<u>\$12,541</u>	<u>\$24,467</u>	<u>\$776</u>	<u>\$3,812</u>	<u>\$4,249</u>	<u>\$ 750</u>	<u>\$1,133</u>	<u>\$ 70,161</u>
	December 31, 2012								
	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, . . .	\$ 26,617	\$19,940	\$ 24,227	\$1,003	\$4,562	\$ 4,760	\$1,724	\$1,359	\$ 84,192
Losses charge to allowance . .	(34,721)	(7,617)	(13,724)	—	(227)	(1,190)	(756)	(111)	(58,346)
Recoveries credited to allowance	3,547	229	220	—	13	195	184	—	4,388
Net losses charged to allowance	(31,174)	(7,388)	(13,504)	—	(214)	(995)	(572)	(111)	(53,958)
Provision (credit) charged to operations	16,189	168	11,157	(309)	42	683	137	(108)	27,959
Balance at December 31, . . .	<u>\$ 11,632</u>	<u>\$12,720</u>	<u>\$ 21,880</u>	<u>\$ 694</u>	<u>\$4,390</u>	<u>\$ 4,448</u>	<u>\$1,289</u>	<u>\$1,140</u>	<u>\$ 58,193</u>

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 Company's allowance for probable loan losses increased for the year ended December 31, 2013 mainly due to the addition of a specific reserve of approximately \$12,000,000 on a previously identified impaired commercial loan that further deteriorated during 2013. The Company's net charge off experience decreased from December 31, 2013 compared to December 31, 2012 mainly due to four commercial real estate relationships charged off in 2012. The relationships were charged off as a result of the Company's assessment that no further collection of the loan was probable based on the borrowers' financial condition.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

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, 2013			
	Loans individually evaluated for impairment		Loans collectively evaluated for impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$34,183	\$12,234	\$1,008,459	\$10,199
Commercial real estate: other construction & land development	13,976	852	1,194,532	11,689
Commercial real estate: farmland & commercial	16,038	2,916	1,734,001	21,551
Commercial real estate: multifamily	295	—	101,803	776
Residential: first lien	6,153	—	432,309	3,812
Residential: junior lien	3,206	—	406,024	4,249
Consumer	1,606	—	64,808	750
Foreign	436	—	181,406	1,133
Total	<u>\$75,893</u>	<u>\$16,002</u>	<u>\$5,123,342</u>	<u>\$54,159</u>

	December 31, 2012			
	Loans individually evaluated for impairment		Loans collectively evaluated for impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$32,768	\$1,477	\$ 736,342	\$10,155
Commercial real estate: other construction & land development	28,660	539	1,119,009	12,181
Commercial real estate: farmland & commercial	13,945	2,730	1,659,377	19,150
Commercial real estate: multifamily	353	—	82,595	694
Residential: first lien	3,656	—	453,075	4,390
Residential: junior lien	1,850	—	379,886	4,448
Consumer	1,326	—	73,188	1,289
Foreign	447	—	188,527	1,140
Total	<u>\$83,005</u>	<u>\$4,746</u>	<u>\$4,691,999</u>	<u>\$53,447</u>

Loans accounted for on a non-accrual basis at December 31, 2013, 2012 and 2011 amounted to \$62,823,000, \$71,768,000 and \$118,505,000, respectively. The effect of such non-accrual loans reduced interest income by \$4,088,000, \$2,549,000 and \$4,114,000 for the years ended December 31, 2013, 2012 and 2011, 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

due 90 days or more as to principal or interest payments at December 31, 2013, 2012 and 2011 amounted to \$7,197,000, \$15,033,000 and \$14,288,000, respectively.

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

	December 31,	
	2013	2012
	(Dollars in Thousands)	
Domestic		
Commercial	\$34,110	\$31,929
Commercial real estate: other construction & land development	11,726	26,410
Commercial real estate: farmland & commercial	13,775	11,681
Commercial real estate: multifamily	295	353
Residential: first lien	1,266	1,175
Residential: junior lien	1,576	175
Consumer	75	45
Total non-accrual loans	<u>\$62,823</u>	<u>\$71,768</u>

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. The Company has identified these loans through its normal loan review procedures. 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 of the Company's impaired loans are measured at the fair value of the collateral. In limited cases the Company 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 the Company's impaired loans by loan class for the year ended December 31, 2013:

	December 31, 2013				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)				
Loans with Related Allowance					
Domestic					
Commercial	\$17,178	\$17,177	\$12,234	\$18,019	\$ 38
Commercial real estate: other construction & land development	6,818	6,825	852	6,058	—
Commercial real estate: farmland & commercial	7,259	10,697	2,916	7,167	92
Total impaired loans with related allowance	<u>\$31,255</u>	<u>\$34,699</u>	<u>\$16,002</u>	<u>\$31,244</u>	<u>\$130</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

	December 31, 2013			
	<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	\$17,005	\$17,023	\$16,778	\$ 2
Commercial real estate: other construction & land development	7,158	7,187	18,164	74
Commercial real estate: farmland & commercial	8,779	9,949	7,313	—
Commercial real estate: multifamily	295	295	322	—
Residential: first lien	6,153	6,258	4,860	179
Residential: junior lien	3,206	3,226	2,347	99
Consumer	1,606	1,612	1,380	1
Foreign	436	436	452	19
Total impaired loans with no related allowance	<u>\$44,638</u>	<u>\$45,986</u>	<u>\$51,616</u>	<u>\$374</u>

The following tables detail key information regarding the Company's impaired loans by loan class for the year ended December 31, 2012:

	December 31, 2012				
	<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	\$ 1,633	\$ 1,679	\$1,477	\$21,126	\$ 39
Commercial real estate: other construction & land development	3,671	3,671	539	6,608	—
Commercial real estate: farmland & commercial	6,678	9,923	2,730	7,342	92
Total impaired loans with related allowance	<u>\$11,982</u>	<u>\$15,273</u>	<u>\$4,746</u>	<u>\$35,076</u>	<u>\$131</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

	December 31, 2012			
	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Recognized
	(Dollars in Thousands)			
Loans with No Related Allowance				
Domestic				
Commercial	\$31,135	\$31,170	\$ 2,996	\$ 4
Commercial real estate: other construction & land development	24,989	25,160	39,449	141
Commercial real estate: farmland & commercial	7,267	9,340	16,536	8
Commercial real estate: multifamily	353	353	381	—
Residential: first lien	3,656	3,984	2,876	60
Residential: junior lien	1,850	1,944	1,939	104
Consumer	1,326	1,330	1,193	—
Foreign	447	447	166	6
Total impaired loans with no related allowance	<u>\$71,023</u>	<u>\$73,728</u>	<u>\$65,536</u>	<u>\$323</u>

Impaired loans with no related allowance decreased for December 31, 2013 when compared to December 31, 2012 due to a few previously identified impaired loans being paid off, recording large principal paydowns, or foreclosed upon and included in other real estate owned during 2013.

A portion of the impaired loans have adequate collateral and credit enhancements not requiring a related allowance for loan loss. The level of impaired loans is reflective of the economic weakness that has been created by the financial crisis and the subsequent economic downturn. Management is confident the Company's loss exposure regarding these credits will be significantly reduced due to the Company's 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. The Company has no direct exposure to sub-prime loans in its loan portfolio, but the sub-prime crisis has affected the credit markets on a national level, and as a result, the Company has experienced an increasing amount of impaired loans; however, management's decision to place loans in this category does not necessarily mean that the Company will experience significant losses from these loans or significant increases in impaired loans from these levels.

Management of the Company 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 collectable 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. It is also important to note that even though the economic conditions in Texas and Oklahoma are weakened, we believe these markets are improving and better positioned to recover than many other areas of the country. Loans accounted for as "troubled debt restructuring," which are included in impaired loans, were not significant and totaled \$20,358,000 and \$29,395,000 as of December 31, 2013 and December 31, 2012, respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

The bank subsidiaries 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 of the Company 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 the Company’s management that the allowance for probable loan losses at December 31, 2013 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, 2013						
	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	\$ 4,240	\$ 538	\$36,066	\$2,051	\$40,844	\$1,001,798	\$1,042,642
Commercial real estate: other construction & land development	1,042	—	9,942	62	10,984	1,197,524	1,208,508
Commercial real estate: farmland & commercial	6,216	520	6,990	417	13,726	1,736,313	1,750,039
Commercial real estate: multifamily	39	142	295	—	476	101,622	102,098
Residential: first lien	4,758	3,046	4,541	3,518	12,345	426,117	438,462
Residential: junior lien	606	198	1,900	368	2,704	406,526	409,230
Consumer	1,523	469	803	781	2,795	63,619	66,414
Foreign	1,467	417	—	—	1,884	179,958	181,842
Total past due loans	<u>\$19,891</u>	<u>\$5,330</u>	<u>\$60,537</u>	<u>\$7,197</u>	<u>\$85,758</u>	<u>\$5,113,477</u>	<u>\$5,199,235</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

	December 31, 2012						
	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	\$ 4,393	\$ 471	\$ 3,386	\$ 2,689	\$ 8,250	\$ 760,860	\$ 769,110
Commercial real estate: other construction & land development	1,107	2,300	24,225	497	27,632	1,120,037	1,147,669
Commercial real estate: farmland & commercial . . .	3,127	21,272	2,310	929	26,709	1,646,613	1,673,322
Commercial real estate: multifamily	685	—	353	—	1,038	81,910	82,948
Residential: first lien	4,305	2,510	10,645	9,657	17,460	439,271	456,731
Residential: junior lien	2,035	410	259	115	2,704	379,032	381,736
Consumer	1,598	404	915	882	2,917	71,597	74,514
Foreign	2,257	1,005	264	264	3,526	185,448	188,974
Total past due loans	<u>\$19,507</u>	<u>\$28,372</u>	<u>\$42,357</u>	<u>\$15,033</u>	<u>\$90,236</u>	<u>\$4,684,768</u>	<u>\$4,775,004</u>

The Company's 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 the Company's 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 the Company's 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 some future loss could be sustained by the Company 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 the Company's loans evaluated as impaired under ASC 310-10 are measured using the fair value of collateral method. In limited cases, the Company 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 the Company's 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(4) Allowance for Probable Loan Losses (Continued)

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 by the Company, (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:

December 31, 2013					
	Pass	Special Review	Watch List—Pass	Watch List—Substandard	Watch List—Impaired
	(Dollars in Thousands)				
Domestic					
Commercial	\$ 955,522	\$ 2,270	\$ 4,389	\$46,278	\$34,183
Commercial real estate: other construction & land development . . .	1,167,295	14,247	9,318	3,672	13,976
Commercial real estate: farmland & commercial	1,635,179	56,438	21,912	20,472	16,038
Commercial real estate: multifamily . . .	100,948	—	—	855	295
Residential: first lien	432,067	122	—	120	6,153
Residential: junior lien	405,731	—	—	293	3,206
Consumer	64,808	—	—	—	1,606
Foreign	180,837	—	—	569	436
Total	<u>\$4,942,387</u>	<u>\$73,077</u>	<u>\$35,619</u>	<u>\$72,259</u>	<u>\$75,893</u>
December 31, 2012					
	Pass	Special Review	Watch List—Pass	Watch List—Substandard	Watch List—Impaired
	(Dollars in Thousands)				
Domestic					
Commercial	\$ 675,263	\$ 4,278	\$16,535	\$40,266	\$32,768
Commercial real estate: other construction & land development . . .	1,038,749	55,079	2,614	22,567	28,660
Commercial real estate: farmland & commercial	1,486,572	109,144	46,316	17,345	13,945
Commercial real estate: multifamily . . .	82,542	—	53	—	353
Residential: first lien	446,218	519	—	6,338	3,656
Residential: junior lien	378,000	77	309	1,500	1,850
Consumer	73,188	—	—	—	1,326
Foreign	188,499	—	28	—	447
Total	<u>\$4,369,031</u>	<u>\$169,097</u>	<u>\$65,855</u>	<u>\$88,016</u>	<u>\$83,005</u>

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, 2013 and 2012 were as follows:

	Estimated useful lives	2013	2012
		(Dollars in Thousands)	
Bank buildings and improvements	5 – 40 years	\$ 470,386	\$ 433,942
Furniture, equipment and vehicles	1 – 20 years	260,932	258,222
Land		128,805	128,695
Real estate held for future expansion:			
Land, building, furniture, fixture and equipment	7 – 27 years	511	562
Less: accumulated depreciation		(355,792)	(340,134)
Bank premises and equipment, net		<u>\$ 504,842</u>	<u>\$ 481,287</u>

(6) Goodwill and Other Intangible Assets

The majority of the Company's identified intangibles are in the form of amortizable core deposit premium, with the exception of \$809,000, which represents identified intangibles in the acquisition of the rights to the insurance agency contracts of InsCorp, Inc., acquired in 2008. Information on the Company's identified intangible assets follows:

	Carrying Amount	Accumulated Amortization	Net
	(Dollars in Thousands)		
December 31, 2013:			
Core deposit premium	\$58,675	\$56,298	\$2,377
Identified intangible (contract rights)	<u>2,022</u>	<u>1,213</u>	<u>809</u>
Total identified intangibles	<u>\$60,697</u>	<u>\$57,511</u>	<u>\$3,186</u>
December 31, 2012:			
Core deposit premium	\$58,675	\$51,974	\$6,701
Identified intangible (contract rights)	<u>2,022</u>	<u>904</u>	<u>1,118</u>
Total identified intangibles	<u>\$60,697</u>	<u>\$52,878</u>	<u>\$7,819</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(6) Goodwill and Other Intangible Assets (Continued)

Amortization expense of intangible assets for the years ended December 31, 2013, 2012 and 2011, was \$4,633,000, \$4,651,000 and \$5,293,000, respectively. Estimated amortization expense for each of the five succeeding fiscal years, and thereafter, is as follows:

Fiscal year ending December 31:

	Total (in thousands)
2014	\$2,389
2015	452
2016	295
2017	25
2018	25
Thereafter	—
Total	<u>\$3,186</u>

There were no changes in the carrying amount of goodwill for the years ended December 31, 2013 and 2012.

(7) Deposits

Deposits as of December 31, 2013 and 2012 and related interest expense for the years ended December 31, 2013, 2012 and 2011 were as follows:

	2013 (Dollars in Thousands)	2012
Deposits:		
Demand—non-interest bearing		
Domestic	\$2,175,694	\$2,002,920
Foreign	490,816	462,830
Total demand non-interest bearing	<u>2,666,510</u>	<u>2,465,750</u>
Savings and interest bearing demand		
Domestic	2,364,905	2,350,872
Foreign	560,707	516,279
Total savings and interest bearing demand	<u>2,925,612</u>	<u>2,867,151</u>
Time, certificates of deposit \$100,000 or more		
Domestic	856,700	973,824
Foreign	938,940	1,025,089
Less than \$100,000		
Domestic	531,503	601,766
Foreign	324,160	353,633
Total time, certificates of deposit	<u>2,651,303</u>	<u>2,954,312</u>
Total deposits	<u>\$8,243,425</u>	<u>\$8,287,213</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(7) Deposits (Continued)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
	(Dollars in Thousands)		
Interest expense:			
Savings and interest bearing demand			
Domestic	3,182	\$ 4,487	\$ 6,549
Foreign	<u>580</u>	<u>801</u>	<u>1,234</u>
Total savings and interest bearing demand	<u>3,762</u>	<u>5,288</u>	<u>7,783</u>
Time, certificates of deposit \$100,000 or more			
Domestic	5,761	8,263	10,299
Foreign	<u>5,590</u>	<u>9,148</u>	<u>11,512</u>
Less than \$100,000			
Domestic	3,065	4,945	7,468
Foreign	<u>1,028</u>	<u>1,617</u>	<u>2,277</u>
Total time, certificates of deposit	<u>15,444</u>	<u>23,973</u>	<u>31,556</u>
Total interest expense on deposits	<u>\$19,206</u>	<u>\$29,261</u>	<u>\$39,339</u>

Scheduled maturities of time deposits as of December 31, 2013 were as follows:

	Total
	(in thousands)
2014	\$2,370,338
2015	187,430
2016	63,018
2017	28,521
2018	1,940
Thereafter	<u>56</u>
Total	<u>\$2,651,303</u>

Scheduled maturities of time deposits in amounts of \$100,000 or more at December 31, 2013, were as follows:

Due within 3 months or less	\$ 673,126
Due after 3 months and within 6 months	441,749
Due after 6 months and within 12 months	494,928
Due after 12 months	<u>185,837</u>
	<u>\$1,795,640</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(8) Securities Sold Under Repurchase Agreements

The Company's bank subsidiaries have entered into repurchase agreements with an investment banking firm and individual customers of the bank subsidiaries. The purchasers have agreed to resell to the bank subsidiaries identical securities upon the maturities of the agreements. Securities sold under repurchase agreements were mortgage-backed book entry securities and averaged \$1,041,186,000 and \$1,276,831,000 during 2013 and 2012, respectively, and the maximum amount outstanding at any month end during 2013 and 2012 was \$1,119,531,000 and \$1,412,744,000, respectively.

Further information related to repurchase agreements at December 31, 2013 and 2012 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, 2013 term:				
Overnight agreements	\$ 332,042	\$ 341,238	\$ 209,899	.17%
1 to 29 days	27,954	28,288	18,666	.40
30 to 90 days	8,106	8,263	3,295	.43
Over 90 days	945,535	940,209	725,521	3.78
Total	<u>\$1,313,637</u>	<u>\$1,317,998</u>	<u>\$ 957,381</u>	2.91%
December 31, 2012 term:				
Overnight agreements	\$ 340,711	\$ 350,933	\$ 263,992	.28%
1 to 29 days	10,378	10,910	6,992	1.10
30 to 90 days	33,619	35,097	22,078	1.05
Over 90 days	1,033,957	1,062,897	836,617	3.73
Total	<u>\$1,418,665</u>	<u>\$1,459,837</u>	<u>\$1,129,679</u>	2.85%

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 at the market price offered at the time of funding. These borrowings are secured by mortgage-backed investment securities and a portion of the Company's loan portfolio. The increase in other borrowed funds is a result of purchases of available-for-sale securities.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(9) Other Borrowed Funds (Continued)

Further information regarding the Company's other borrowed funds at December 31, 2013 and 2012 is set forth in the following table:

	December 31,	
	2013	2012
	(Dollars in Thousands)	
Federal Home Loan Bank advances—short-term		
Balance at year end	\$1,215,000	\$ 742,500
Rate on balance outstanding at year end	.17%	.15%
Average daily balance	\$ 833,868	\$ 412,919
Average rate	.16%	.19%
Maximum amount outstanding at any month end	\$1,280,500	\$1,005,500
Federal Home Loan Bank advances—long-term(1)		
Balance at year end	\$ 8,950	\$ 6,527
Rate on balance outstanding at year end	3.53%	3.51%
Average daily balance	\$ 7,289	\$ 6,590
Average rate	3.53%	3.51%
Maximum amount outstanding at any month end	\$ 8,993	\$ 6,650

- (1) The amortization of the long-term advances is approximately \$207,000 per year for each of the next five years and the final maturity date is October 2, 2028.

(10) Junior Subordinated Deferrable Interest Debentures

The Company has formed eight statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. The eight statutory business trusts formed by the Company (the "Trusts") have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (the "Debentures") issued by the Company. As of December 31, 2013 and December 31, 2012, the principal amount of debentures outstanding totaled \$190,726,000. As a result of the Company's participation in the TARP Capital Purchase Program, the Company was not permitted, without the consent of the Treasury Department, to redeem any of the Debentures. This restriction ceased to exist on December 23, 2011 and the Company exited the TARP Capital Purchase Program on November 28, 2012. One half of the Trust I securities were redeemed on June 8, 2011 and the remaining one half of the Trust I securities were redeemed on July 1, 2011 with the consent of the Treasury Department.

The Debentures are subordinated and junior in right of payment to all present and future senior indebtedness (as defined in the respective indentures) of the Company, 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. The Company has fully and unconditionally guaranteed the obligations of each of the Trusts with respect to the Capital and Common Securities. The Company has 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 VI, VII, VIII, IX, X, XI and XII. If interest payments on any of the Debentures are deferred, distributions on both the Capital and Common

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(10) Junior Subordinated Deferrable Interest Debentures (Continued)

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 of the Company 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, 2013 and 2012, the total \$190,726,000 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, 2013:

	Junior Subordinated Deferrable Interest Debentures (in thousands)	Repricing Frequency	Interest Rate	Interest Rate Index(1)	Maturity Date	Optional Redemption Date(1)
Trust VI	\$ 25,774	Quarterly	3.69%	LIBOR + 3.45	November 2032	February 2008
Trust VII	10,310	Quarterly	3.49%	LIBOR + 3.25	April 2033	April 2008
Trust VIII	25,774	Quarterly	3.29%	LIBOR + 3.05	October 2033	October 2008
Trust IX	41,238	Quarterly	1.87%	LIBOR + 1.62	October 2036	October 2011
Trust X	34,021	Quarterly	1.89%	LIBOR + 1.65	February 2037	February 2012
Trust XI	32,990	Quarterly	1.87%	LIBOR + 1.62	July 2037	July 2012
Trust XII	20,619	Quarterly	1.69%	LIBOR + 1.45	September 2037	September 2012
	<u>\$190,726</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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(11) Earnings per Share (“EPS”) (Continued)

potential common shares outstanding during the reporting period. The calculation of the basic EPS and the diluted EPS for the years ended December 31, 2013, 2012, and 2011 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, 2013:			
Basic EPS			
Net income available to common shareholders .	\$126,351	67,195,180	\$1.88
Potential dilutive common shares	—	119,679	
Diluted EPS	<u>\$126,351</u>	<u>67,314,859</u>	\$1.88
December 31, 2012:			
Basic EPS			
Net income available to common shareholders .	\$ 93,473	67,236,681	\$1.39
Potential dilutive common shares	—	77,282	
Diluted EPS	<u>\$ 93,473</u>	<u>67,313,963</u>	\$1.39
December 31, 2011:			
Basic EPS			
Net income available to common shareholders .	\$113,869	67,506,554	\$1.69
Potential dilutive common shares	—	62,914	
Diluted EPS	<u>\$113,869</u>	<u>67,569,468</u>	\$1.69

(12) Employees’ Profit Sharing Plan

The Company has a deferred profit sharing plan for full-time employees with a minimum of one year of continuous employment. The Company’s annual contribution to the plan is based on a percentage, as determined by the 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 \$3,500,000, \$3,400,000 and \$3,900,000 were charged to income for the years ended December 31, 2013, 2012, and 2011, respectively.

(13) International Operations

The Company provides international banking services for its customers through its bank subsidiaries. Neither the Company nor its bank subsidiaries have facilities located outside the United States. International operations are distinguished from domestic operations based upon the domicile of the customer.

Because the resources employed by the Company 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)

(13) International Operations (Continued)

A summary of assets attributable to international operations at December 31, 2013 and 2012 are as follows:

	2013	2012
	(Dollars in Thousands)	
Loans:		
Commercial	\$142,145	\$148,770
Others	39,697	40,204
	181,842	188,974
Less allowance for probable loan losses	(1,133)	(1,140)
Net loans	\$180,709	\$187,834
Accrued interest receivable	\$ 617	\$ 902

At December 31, 2013, the Company had \$130,116,000 in outstanding standby and commercial letters of credit to facilitate trade activities. The letters of credit are issued primarily in conjunction with credit facilities, which are available to various Mexican banks doing business with the Company.

Revenues directly attributable to international operations were \$6,085,000, \$7,714,000 and \$9,870,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

(14) Income Taxes

The Company files 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:

	2013	2012	2011
	(Dollars in Thousands)		
Current			
U.S.	\$59,583	\$40,375	\$61,279
State	(1,530)	2,234	5,083
Foreign	3	33	15
Total current taxes	58,056	42,642	66,377
Deferred			
U.S.	(1,692)	7,928	(2,296)
State	(125)	(5)	(3)
Total deferred taxes	(1,817)	7,923	(2,299)
Total income taxes	\$56,239	\$50,565	\$64,078

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(14) Income Taxes (Continued)

Total income tax expense differs from the amount computed by applying the U.S. Federal income tax rate of 35% for 2013, 2012 and 2011 to income before income taxes. The reasons for the differences for the years ended December 31 are as follows:

	2013	2012	2011
	(Dollars in Thousands)		
Computed expected tax expense	\$64,183	\$55,634	\$66,941
Change in taxes resulting from:			
Tax-exempt interest income	(4,828)	(4,381)	(3,682)
State tax, net of federal income taxes and tax credit	(110)	1,446	3,302
Tax refunds	(966)	—	—
Other investment income	(2,656)	(2,691)	(3,083)
Other	616	557	600
Actual tax expense	<u>\$56,239</u>	<u>\$50,565</u>	<u>\$64,078</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, 2013 and 2012 are reflected below:

	2013	2012
	(Dollars in Thousands)	
Deferred tax assets:		
Loans receivable, principally due to the allowance for		
probable loan losses	\$ 25,365	\$ 24,323
Other real estate owned	3,878	3,919
Impairment charges on available-for-sale securities	5,327	3,611
Accrued expenses	399	137
Net unrealized gains on available for sale investment		
securities	24,235	—
Other	4,816	5,549
Total deferred tax assets	<u>64,020</u>	<u>37,539</u>
Deferred tax liabilities:		
Bank premises and equipment, principally due to differences		
on depreciation	(20,729)	(21,529)
Net unrealized gains on available for sale investment		
securities	—	(36,156)
Identified intangible assets and goodwill	(18,051)	(18,133)
Other	(11,476)	(10,182)
Total deferred tax liabilities	<u>(50,256)</u>	<u>(86,000)</u>
Net deferred tax asset (liability)	<u>\$ 13,764</u>	<u>\$(48,461)</u>

The net deferred tax asset (liability) of \$13,764,000 at December 31, 2013 and \$(48,461,000) at December 31, 2012 is included in other assets or liabilities, respectively in the consolidated statements of condition.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(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, 2013, 749,000 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 the Company’s stock. The Company uses 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.

	2013	2012
Expected Life (Years)	7.63	7.63
Dividend yield	2.33%	2.33%
Interest rate	2.86%	1.58%
Volatility	47.28%	47.30%

A summary of option activity under the stock option plans for the twelve months ended December 31, 2013 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, 2012	794,877	\$19.03		
Plus: Options granted	8,500	21.33		
Less:				
Options exercised	19,075	13.83		
Options expired	235,607	26.51		
Options forfeited	33,552	16.94		
Options outstanding at December 31, 2013	515,143	15.98	4.16	5,375
Options fully vested and exercisable at December 31, 2013	228,001	18.37	2.67	1,851

Stock-based compensation expense included in the consolidated statements of income for the years ended December 31, 2013, 2012 and 2011 was approximately \$414,000, \$474,000 and \$387,000, respectively. As of December 31, 2013, there was approximately \$808,000 of total unrecognized stock-based compensation cost related to non-vested options granted under the Company plans that will be recognized over a weighted average period of 1.78 years.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(15) Stock Options (Continued)

Other information pertaining to option activity during the twelve month period ending December 31, 2013, 2012 and 2011 is as follows:

	Twelve Months Ended December 31,		
	2013	2012	2011
Weighted average grant date fair value of stock options granted	\$ 9.05	\$ 8.71	\$ 5.51
Total fair value of stock options vested	\$480,000	\$524,000	\$661,000
Total intrinsic value of stock options exercised	\$171,000	\$ 41,000	\$ 27,000

(16) Long Term Restricted Stock Units

As a participant in the Troubled Asset Relief Program Capital Purchase Program (the “CPP”) until November 28, 2012, the Company was subject to certain compensation restrictions, which included a prohibition on the payment or accrual of any bonuses (including equity-based incentive compensation) to certain officers and employees except for awards of CPP-compliant long-term restricted stock and stock units.

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

The Plan authorizes the Company to issue Restricted Stock Units (“RSUs”) to officers, employees, consultants and advisors of the Company and its subsidiaries. The Plan provides that RSUs shall be issued by a committee of the Board appointed by the Board from time to time consisting of at least two (2) members of the Board, each of whom is both a non-employee director and an outside director. On December 18, 2009, 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.

Dennis E. Nixon, the Company’s President, Chairman of the Board and a director of the Company, was awarded CPP-compliant RSU’s granted as of December 19, 2012, December 16, 2011, December 15, 2010 and December 18, 2009 of \$425,000, \$400,000, \$400,000 and \$250,000 for his performance in 2012, 2011, 2010 and 2009, respectively. In order to meet the requirements of a CPP-compliant RSU, Mr. Nixon’s RSUs do not exceed one-third of his total annual compensation in the respective year. Mr. Nixon’s 2009 and 2010 RSU’s vested and were paid in December 2012 in the respective cash amounts of \$262,842 and \$358,782. The 2011 RSU vested and was paid in December 2013 in the cash amount of \$591,344. The 2012 RSU remains outstanding and will vest in December 2014.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(17) Commitments, Contingent Liabilities and Other Matters

The Company leases portions of its banking premises and equipment under operating leases. Total rental expense for the years ended December 31, 2013, 2012 and 2011 were \$7,300,000, \$8,300,000 and \$12,200,000, respectively. Future minimum lease payments due under non-cancellable operating leases at December 31, 2013 were as follows:

Fiscal year ending:

	Total (in thousands)
2014	\$ 4,330
2015	2,874
2016	2,034
2017	917
2018	405
Thereafter	227
Total	<u>\$10,787</u>

It is expected that certain leases will be renewed, as these leases expire. Aggregate future minimum rentals to be received under non-cancellable sub-leases greater than one year at December 31, 2013 were \$66,500,000.

Cash of approximately \$96,087,000 and \$84,070,000 at December 31, 2013 and 2012, respectively, was maintained to satisfy regulatory reserve requirements.

The Company is involved in various legal proceedings that are in various stages of litigation. Some of these actions allege “lender liability” claims on a variety of theories and claim substantial actual and punitive damages. The Company has determined, based on discussions with its 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 the consolidated statements of condition and related statements of income, comprehensive income, shareholders’ equity and cash flows of the Company. 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 subsidiaries of the Company make loans to directors and executive officers of the Corporation, 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 \$51,554,000 and \$51,102,000 at December 31, 2013 and 2012, respectively.

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

In the normal course of business, the bank subsidiaries are party to financial instruments with off-statement of condition risk to meet the financing needs of their customers. These financial instruments

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 (Continued)

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 bank subsidiaries have in particular classes of financial instruments. At December 31, 2013, the following financial amounts of instruments, whose contract amounts represent credit risks, were outstanding:

Commitments to extend credit	\$1,715,365,000
Credit card lines	61,120,000
Standby letters of credit	108,683,000
Commercial letters of credit	21,434,000

The Company enters 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, the Company is 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, 2013, the maximum potential amount of future payments is \$108,683,000. At December 31, 2013, the fair value of these guarantees is not significant. Unsecured letters of credit totaled \$42,503,000 and \$28,383,000 at December 31, 2013 and 2012, respectively.

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

The bank subsidiaries' 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 bank subsidiaries use the same credit policies in making commitments and conditional obligations as they do for on-statement of condition instruments. The bank subsidiaries 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 bank subsidiaries 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 bank subsidiaries 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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(20) Capital Requirements

On December 23, 2008, as part of the Troubled Asset Relief Program Capital Purchase Program (the “TARP Capital Purchase Program”) of the United States Department of the Treasury (“Treasury”), the Company issued to the Treasury, in exchange for aggregate consideration of \$216 million, (i) 216,000 shares of the Company’s fixed-rate cumulative perpetual preferred stock, Series A, par value \$.01 per share (the “Senior Preferred Stock”), having a liquidation preference of \$1,000 per share and (ii) a warrant to purchase 1,326,238 shares of the Company’s common stock at a price per share of \$24.43 and with a term of ten years (the “Warrant”). The Senior Preferred Stock paid a coupon rate of 5% of the first five years and 9% per year thereafter.

On November 28, 2012, the Company completed the repurchase of all of the 216,000 shares of the Senior Preferred Stock held by Treasury. The Company commenced the \$216 million repayment during the third quarter of 2012 and completed the final payment in the fourth quarter of 2012. The Company paid a total of \$41,520,139 in preferred stock dividends to the U.S. Treasury from December of 2008 to November 28, 2012. On June 12, 2013, the U.S. Treasury sold the Warrant to a third party. As of February 19, 2014, the Warrant is still outstanding.

Bank regulatory agencies limit the amount of dividends, which the bank subsidiaries can pay the Corporation, through IBC Subsidiary Corporation, without obtaining prior approval from such agencies. At December 31, 2013, the subsidiary banks could pay dividends of up to \$584,000,000 to the Corporation without prior regulatory approval and without adversely affecting their “well-capitalized” status. In addition to legal requirements, regulatory authorities also consider the adequacy of the bank subsidiaries’ total capital in relation to their deposits and other factors. These capital adequacy considerations also limit amounts available for payment of dividends. The Company historically has not allowed any subsidiary bank to pay dividends in such a manner as to impair its capital adequacy.

The Company and the bank subsidiaries 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 the Company’s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company’s assets, liabilities, and certain off-statement of condition items as calculated under regulatory accounting practices. The Company’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company 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, 2013, that the Company and each of the bank subsidiaries met all capital adequacy requirements to which they are subject.

As of December 31, 2013, the most recent notification from the Federal Deposit Insurance Corporation categorized all the bank subsidiaries as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as “well-capitalized,” the Company and the bank subsidiaries 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 the categorization of the Company or any of the bank subsidiaries as well-capitalized.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(20) Capital Requirements (Continued)

The Company's and the bank subsidiaries' actual capital amounts and ratios for 2013 are 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, 2013:						
Total Capital (to Risk Weighted Assets):						
Consolidated	\$1,442,837	20.36%	\$566,870	8.00%	N/A	N/A
International Bank of Commerce, Laredo	1,035,189	16.96	488,303	8.00	\$610,378	10.00%
International Bank of Commerce, Brownsville . .	143,879	27.63	41,652	8.00	52,065	10.00
International Bank of Commerce, Zapata	57,675	32.65	14,130	8.00	17,663	10.00
Commerce Bank	64,585	36.45	14,175	8.00	17,719	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$1,369,657	19.33%	\$283,435	4.00%	N/A	N/A
International Bank of Commerce, Laredo	969,731	15.89	244,151	4.00	\$366,227	6.00%
International Bank of Commerce, Brownsville . .	138,467	26.60	20,826	4.00	31,239	6.00
International Bank of Commerce, Zapata	56,459	31.96	7,065	4.00	10,598	6.00
Commerce Bank	63,491	35.83	7,087	4.00	10,631	6.00
Tier 1 Capital (to Average Assets):						
Consolidated	\$1,369,657	11.61%	\$472,044	4.00%	\$ N/A	N/A
International Bank of Commerce, Laredo	969,731	10.09	384,497	4.00	480,622	5.00%
International Bank of Commerce, Brownsville . .	138,467	13.33	41,553	4.00	51,942	5.00
International Bank of Commerce, Zapata	56,459	10.64	21,219	4.00	26,523	5.00
Commerce Bank	63,491	11.88	21,372	4.00	26,715	5.00

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(20) Capital Requirements (Continued)

The Company's and the bank subsidiaries' actual capital amounts and ratios for 2012 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, 2012:						
Total Capital (to Risk Weighted Assets):						
Consolidated	\$1,328,089	20.60%	\$515,695	8.00%	N/A	N/A
International Bank of Commerce, Laredo	945,384	17.19	440,038	8.00	\$550,048	10.00%
International Bank of Commerce, Brownsville . . .	128,788	27.36	37,659	8.00	47,074	10.00
International Bank of Commerce, Zapata	54,542	33.14	13,166	8.00	16,458	10.00
Commerce Bank	60,982	34.52	14,131	8.00	17,664	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$1,266,799	19.65%	\$257,848	4.00%	N/A	N/A
International Bank of Commerce, Laredo	892,888	16.23	220,019	4.00	\$330,029	6.00%
International Bank of Commerce, Brownsville . . .	123,361	26.21	18,830	4.00	28,245	6.00
International Bank of Commerce, Zapata	52,967	32.18	6,583	4.00	9,875	6.00
Commerce Bank	59,200	33.52	7,065	4.00	10,598	6.00
Tier 1 Capital (to Average Assets):						
Consolidated	\$1,266,799	10.86%	\$466,624	4.00%	\$ N/A	N/A
International Bank of Commerce, Laredo	892,888	9.26	385,621	4.00	482,026	5.00%
International Bank of Commerce, Brownsville . . .	123,361	13.79	35,787	4.00	44,734	5.00
International Bank of Commerce, Zapata	52,967	10.64	19,918	4.00	24,897	5.00
Commerce Bank	59,200	11.27	21,004	4.00	26,255	5.00

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(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, 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 assets and liabilities reported on the consolidated statements of condition at their fair value as of December 31, 2013 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, 2013	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>				
<i>Assets:</i>				
<i>Available for sale securities</i>				
Residential mortgage-backed securities	\$5,027,701	\$ —	\$4,999,849	\$27,852
States and political subdivisions	248,410	—	248,410	—
Other	28,468	28,468	—	—
	<u>\$5,304,579</u>	<u>\$28,468</u>	<u>\$5,248,259</u>	<u>\$27,852</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(21) Fair Value (Continued)

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value as of December 31, 2012 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, 2012	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>				
<i>Assets:</i>				
<i>Available for sale securities</i>				
Residential mortgage-backed securities	\$5,265,204	\$ —	\$5,232,344	\$32,860
States and political subdivisions	238,675	—	238,675	—
Other	21,136	21,136	—	—
	<u>\$5,525,015</u>	<u>\$21,136</u>	<u>\$5,471,019</u>	<u>\$32,860</u>

Investment securities available-for-sale are classified within level 2 and level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within level 1. For investments classified as level 2 in the fair value hierarchy, the Company obtains fair value measurements for investment securities 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. Investment securities classified as level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in inactive markets and markets that have experienced significant decreases in volume and level of activity, as evidenced by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company used a discounted cash flow model to determine fair value. Inputs in the model included both historical performance and expected future performance based on information currently available.

Assumptions used in the discounted cash flow model as of December 31, 2013 and December 31, 2012 were applied separately to those portions of the bond where the underlying residential mortgage loans had been performing under original contract terms for at least the prior 24 months and those where the underlying residential mortgages had not been meeting the original contractual obligation for the same period. Unobservable inputs included in the model are estimates on future principal prepayment rates, and default and loss severity rates. For that portion of the bond where the underlying residential mortgage had been meeting the original contract terms for at least 24 months, the Company used the following estimates in the model: (i) a voluntary prepayment rate of 7%, (ii) a 1% default rate, (iii) a loss severity rate of 25%, and (iv) a discount rate of 13%. The assumptions used in the model for the rest of the bond included the

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(21) Fair Value (Continued)

following estimates: (i) a voluntary prepayment rate of 2%, (ii) a default rate of 4.5%, (iii) a loss severity rate that started at 60% for the first year (2012) then declines by 5% for the following five years (2013, 2014, 2015, 2016 and 2017) and remains at 25% thereafter (2018 and beyond), and (iv) a discount rate of 13%. The estimates used in the model to determine fair value are based on observable historical data of the underlying collateral. The model anticipates that the housing market will gradually improve and that the underlying collateral will eventually all perform in accordance with the original contract terms on the bond. Should the number of loans in the underlying collateral that default and go into foreclosure or the severity of the losses in the underlying collateral significantly change, the results of the model would be impacted. The Company will continue to evaluate the actual historical performance of the underlying collateral and will modify the assumptions used in the model as necessary.

The following table presents a reconciliation of activity for such mortgage-backed securities on a net basis (Dollars in thousands):

Balance at December 31, 2012	\$32,860
Principal paydowns	(5,440)
Total unrealized gains (losses) included in:	
Other comprehensive income	1,806
Impairment realized in earnings	(1,374)
Balance at December 31, 2013	<u>\$27,852</u>

Certain assets and liabilities 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 assets measured at fair value on a non-recurring basis as of and for the period ended December 31, 2013 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, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision During Period	
<i>Measured on a non-recurring basis:</i>						
<i>Assets:</i>						
Impaired loans	\$28,391	\$—	\$—	\$28,391	\$13,229	
Other real estate owned	16,329	—	—	16,329	1,204	

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(21) Fair Value (Continued)

The following table represents assets measured at fair value on a non-recurring basis as of and for the year ended December 31, 2012 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, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision During Period
<i>Measured on a non-recurring basis:</i>					
Assets:					
Impaired loans	\$11,981	\$—	\$—	\$11,981	\$295
Other real estate owned	18,749	—	—	18,749	—

The Company's 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. 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 the Company's 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. 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. As part of the weekly credit quality meetings and the determination of the loan loss provision, obsolete appraisals are identified. Appraisals are considered for each type of impaired collateral dependent loan and new or updated appraisals may be obtained as warranted after evaluation of any material deterioration in the performance of the project or changes in project specifications, the economic conditions for the geographic area where the property is located, a change in the use of the property, differences between the current property conditions and the conditions assumed in prior appraisals or evaluations, or, if it's an income producing property, changes in the cash flow on the property. 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. Impaired loans are remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for probable loan losses based upon the fair value of the underlying collateral. As of December 31, 2013, the Company had \$64,585,000 of impaired commercial collateral dependent loans, of which \$50,346,000 had an appraisal or evaluation performed within the immediately preceding twelve months. As of December 31, 2012, the Company had \$73,646,000 of impaired commercial collateral dependent loans, of which \$48,856,000 had an appraisal or evaluation performed within the immediately preceding twelve months.

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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(21) Fair Value (Continued)

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, 2013 and the twelve months ended December 31, 2012, respectively the Company recorded \$402,000 and \$10,450,000 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, 2013 and twelve months ended December 31, 2012, respectively, the Company recorded \$1,204,000 and \$0 in adjustments to fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for the Company's financial instruments at December 31, 2013 and December 31, 2012 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 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.

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, 2013, and December 31, 2012, the carrying amount of fixed rate performing loans was \$1,243,252,000 and \$1,189,585,000, respectively, and the estimated fair value was \$1,196,916,000 and \$1,126,228,000, respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(21) Fair Value (Continued)

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, 2013 and December 31, 2012. 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, 2013 and December 31, 2012, the carrying amount of time deposits was \$2,651,303,000 and \$2,954,312,000, respectively, and the estimated fair value was \$2,649,452,000 and \$2,962,190,000, 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, 2013 and December 31, 2012. The fair value of the long-term instruments is based on established market spreads using option adjusted spreads methodology. Long-term repurchase agreements are within level 3 of the fair value hierarchy. At December 31, 2013 and December 31, 2012, the carrying amount of long-term repurchase agreements was \$710,000,000 and \$800,000,000 respectively, and the estimated fair value was \$792,215,500 and \$932,007,000, respectively.

Junior Subordinated Deferrable Interest Debentures

The Company currently has 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, 2013 and December 31, 2012.

Other Borrowed Funds

The company currently has 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, 2013 and December 31, 2012. The fair value of the long-term borrowings is based on established market spreads for similar types of borrowings. The long-term borrowings are included in Level 2 of the fair value hierarchy. At December 31, 2013 and December 31, 2012, the carrying amount of the long-term FHLB borrowings was \$8,950,000 and \$6,527,000, respectively, and the estimated fair value was \$8,950,000 and \$7,073,000, respectively.

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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(21) Fair Value (Continued)

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 the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's 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, 2013 and 2012

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash	\$ 8,106	\$ 1,539
Other investments	62,381	63,044
Notes receivable	313	409
Investment in subsidiaries	1,556,932	1,573,679
Other assets	197	617
Total assets	<u>\$1,627,929</u>	<u>\$1,639,288</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Junior subordinated deferrable interest debentures	\$ 190,726	\$ 190,726
Due to IBC Trading	21	21
Other liabilities	12,774	12,833
Total liabilities	<u>203,521</u>	<u>203,580</u>
Shareholders' equity:		
Common shares	95,744	95,725
Surplus	163,947	163,287
Retained earnings	1,467,000	1,369,543
Accumulated other comprehensive (loss) income	(43,774)	65,662
	1,682,917	1,694,217
Less cost of shares in treasury	(258,509)	(258,509)
Total shareholders' equity	<u>1,424,408</u>	<u>1,435,708</u>
Total liabilities and shareholders' equity	<u>\$1,627,929</u>	<u>\$1,639,288</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, 2013, 2012 and 2011
(Dollars in Thousands)**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Income:			
Dividends from subsidiaries	\$ 30,000	\$ 229,250	\$ 54,800
Interest income on notes receivable	18	27	19
Interest income on other investments	12,301	6,759	7,517
Other interest income	—	18	69
Other	<u>26</u>	<u>686</u>	<u>41</u>
Total income	42,345	236,740	62,446
Expenses:			
Interest expense (Debentures)	4,665	6,595	11,073
Other	<u>1,889</u>	<u>3,867</u>	<u>6,543</u>
Total expenses	<u>6,554</u>	<u>10,462</u>	<u>17,616</u>
Income before federal income taxes and equity in undistributed net income of subsidiaries	35,791	226,278	44,830
Income tax expense (benefit)	<u>2,529</u>	<u>(738)</u>	<u>(3,513)</u>
Income before equity in undistributed net income of subsidiaries	33,262	227,016	48,343
Equity in undistributed (distributed) net income of subsidiaries	<u>93,089</u>	<u>(119,181)</u>	<u>78,806</u>
Net income	<u>126,351</u>	<u>107,835</u>	<u>127,149</u>
Preferred stock dividends and discount accretion	<u>—</u>	<u>14,362</u>	<u>13,280</u>
Net income available to common shareholders	<u><u>\$126,351</u></u>	<u><u>\$ 93,473</u></u>	<u><u>\$113,869</u></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, 2013, 2012 and 2011

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating activities:			
Net income	\$126,351	\$ 107,835	\$127,149
Adjustments to reconcile net income to net cash provided by operating activities:			
Accretion of junior subordinated interest deferrable debentures	—	—	9
Investment securities transactions, net	—	—	2
Impairment charges on available for sale securities	754	—	—
Stock compensation expense	414	474	387
(Decrease) increase in other liabilities	(969)	6,711	(3,234)
Equity in (undistributed) distributed net income of subsidiaries	<u>(93,089)</u>	<u>119,181</u>	<u>(78,806)</u>
Net cash provided by operating activities	<u>33,461</u>	<u>234,201</u>	<u>45,507</u>
Investing activities:			
Principal collected on mortgage-backed securities	1,207	1,985	1,355
Net decrease (increase) in notes receivable	96	86	(245)
Decrease (increase) in other assets and other investments	<u>432</u>	<u>6,418</u>	<u>(4,193)</u>
Net cash provided by (used in) investing activities	<u>1,735</u>	<u>8,489</u>	<u>(3,083)</u>
Financing activities:			
Repayment of trust preferred securities	—	—	(10,400)
Redemption of preferred shares	—	(216,000)	—
Proceeds from stock transactions	265	51	113
Payments of cash dividends—common	(28,894)	(26,894)	(25,648)
Payments of cash dividends—preferred	—	(10,260)	(10,800)
Purchase of treasury stock	<u>—</u>	<u>(1,716)</u>	<u>(6,435)</u>
Net cash used in financing activities	<u>(28,629)</u>	<u>(254,819)</u>	<u>(53,170)</u>
Increase (decrease) in cash	6,567	(12,129)	(10,746)
Cash at beginning of year	<u>1,539</u>	<u>13,668</u>	<u>24,414</u>
Cash at end of year	<u>\$ 8,106</u>	<u>\$ 1,539</u>	<u>\$ 13,668</u>

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

	<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
2013				
Interest income	\$98,133	\$91,650	\$86,324	\$87,110
Interest expense	<u>13,447</u>	<u>13,007</u>	<u>13,700</u>	<u>14,478</u>
Net interest income	84,686	78,643	72,624	72,632
Provision for probable loan losses	5,407	5,800	4,342	7,419
Non-interest income	45,167	44,481	46,705	53,252
Non-interest expense	<u>67,830</u>	<u>70,227</u>	<u>73,714</u>	<u>80,861</u>
Income before income taxes	56,616	47,097	41,273	37,604
Income taxes	<u>17,673</u>	<u>15,271</u>	<u>13,760</u>	<u>9,535</u>
Net income available to common shareholders	<u>\$38,943</u>	<u>\$31,826</u>	<u>\$27,513</u>	<u>\$28,069</u>
Per common share:				
Basic				
Net income	<u>\$.58</u>	<u>\$.47</u>	<u>\$.41</u>	<u>\$.42</u>
Diluted				
Net income	<u>\$.58</u>	<u>\$.47</u>	<u>\$.41</u>	<u>\$.42</u>

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

	<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
2012				
Interest income	\$92,399	\$ 93,775	\$93,683	\$95,782
Interest expense	<u>16,374</u>	<u>17,420</u>	<u>20,040</u>	<u>20,665</u>
Net interest income	76,025	76,355	73,643	75,117
Provision for probable loan losses	11,218	5,349	6,107	5,285
Non-interest income	42,588	74,007	40,819	43,177
Non-interest expense	<u>68,694</u>	<u>106,444</u>	<u>72,091</u>	<u>68,143</u>
Income before income taxes	38,701	38,569	36,264	44,866
Income taxes	<u>12,981</u>	<u>12,691</u>	<u>11,714</u>	<u>13,179</u>
Net income	<u>25,720</u>	<u>25,878</u>	<u>24,550</u>	<u>31,687</u>
Preferred stock dividends and discount accretion	<u>3,819</u>	<u>3,845</u>	<u>3,355</u>	<u>3,343</u>
Net income available to common shareholders	<u>\$21,901</u>	<u>\$ 22,033</u>	<u>\$21,195</u>	<u>\$28,344</u>
Per common share:				
Basic				
Net income	<u>\$.32</u>	<u>\$.33</u>	<u>\$.32</u>	<u>\$.42</u>
Diluted				
Net income	<u>\$.32</u>	<u>\$.33</u>	<u>\$.31</u>	<u>\$.42</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES
Condensed Average Statements of Condition
(Dollars in Thousands, Except Per Share Amounts)
(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, 2013, 2012, and 2011:

	2013			2012			2011		
	Average Balance	Interest	Average Rate/Cost	Average Balance	Interest	Average Rate/Cost	Average Balance	Interest	Average Rate/Cost
	(Dollars in Thousands)								
<i>Assets</i>									
Interest earning assets:									
Loan, net of unearned discounts:									
Domestic	\$ 4,802,120	\$256,942	5.35%	\$ 4,730,903	\$260,874	5.51%	\$ 5,022,584	\$282,644	5.63%
Foreign	176,713	6,085	3.44	201,825	7,714	3.82	239,017	9,870	4.13
Investment securities:									
Taxable	5,051,736	87,198	1.73	4,877,210	94,885	1.95	4,731,408	113,650	2.40
Tax-exempt	232,266	12,877	5.54	210,320	11,663	5.55	190,933	10,091	5.29
Other	45,578	115	.25	200,109	503	.25	120,777	1,869	1.55
Total interest-earning assets .	10,308,413	363,217	3.52%	10,220,367	375,639	3.68%	10,304,719	418,124	4.06%
Non-interest earning assets:									
Cash and due from banks	270,619			410,726			319,466		
Bank premises and equipment, net	470,183			441,981			456,840		
Other assets	844,360			861,145			751,654		
Less allowance for probable loan losses	(66,001)			(77,103)			(83,919)		
Total	<u>\$11,827,574</u>			<u>\$11,857,116</u>			<u>\$11,748,760</u>		
<i>Liabilities and Shareholders' Equity</i>									
<i>Equity</i>									
Interest bearing liabilities:									
Savings and interest bearing demand deposits	\$ 2,879,115	\$ 3,762	.13%	\$ 2,806,657	5,288	.19%	\$ 2,625,958	\$ 7,783	.30%
Time deposits:									
Domestic	1,465,250	8,826	.60	1,673,590	13,208	.79	1,730,016	17,767	1.03
Foreign	1,306,572	6,618	.51	1,608,219	10,765	.67	1,646,619	13,789	.84
Securities sold under repurchase agreements	1,041,192	29,171	2.80	1,276,841	37,645	2.95	1,415,775	42,263	2.99
Other borrowings	841,158	1,590	.19	419,509	998	.24	740,281	1,623	.22
Junior subordinated interest deferrable debentures	190,726	4,665	2.45	190,726	6,595	3.46	195,540	11,073	5.66
Total interest bearing liabilities	7,724,013	54,632	.71%	7,975,542	74,499	.93%	8,354,189	94,298	1.13%
Non-interest bearing liabilities:									
Demand Deposits	2,594,727			2,072,539			1,817,781		
Other liabilities	97,237			305,214			117,295		
Shareholders' equity	1,411,597			1,503,821			1,459,495		
Total	<u>\$11,827,574</u>			<u>\$11,857,116</u>			<u>\$11,748,760</u>		
Net interest income . . .		<u>\$308,585</u>			<u>\$301,140</u>			<u>\$323,826</u>	
Net yield on interest earning assets			2.99%			2.95%			3.14%

**INTERNATIONAL BANCSHARES CORPORATION
OFFICERS AND DIRECTORS**

OFFICERS

DENNIS E. NIXON
Chairman of the Board and President

R. DAVID GUERRA
Vice President

EDWARD J. FARIAS
Vice President

IMELDA NAVARRO
Treasurer

WILLIAM J. CUELLAR
Auditor

MARISA V. SANTOS
Secretary

HILDA V. TORRES
Assistant Secretary

DIRECTORS

DENNIS E. NIXON
President, International Bank of Commerce

IRVING GREENBLUM
International Investments/Real Estate

R. DAVID GUERRA
President
International Bank of Commerce
Branch in McAllen, TX

DOUG HOWLAND
Owner
Construction & Construction Materials Company
Investments

IMELDA NAVARRO
Senior Executive Vice President
International Bank of Commerce

PEGGY NEWMAN
Investments

LARRY NORTON
President
Norton Stores, Inc.

LEONARDO SALINAS
Investments

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

List of Subsidiaries
Subsidiaries of International Bancshares Corporation

<u>Name</u>	<u>State of Incorporation or Organization</u>	<u>Business</u>	<u>% of Ownership</u>
		Bank Holding	
IBC Subsidiary Corporation	Delaware	Company	100%
IBC Life Insurance Company	Texas	Credit Life Insurance	100%
IBC Trading Company	Texas	Export Trading	100%
IBC Capital Corporation	Texas	Investments	100%
Premier Tierra Holdings, Inc.	Texas	Liquidating Subsidiary	100%

Subsidiaries of IBC Subsidiary Corporation

<u>Name</u>	<u>State of Incorporation or Organization</u>	<u>Business</u>	<u>% of Ownership</u>
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%
Gulfstar Merchant Banking I, Ltd. . . .	Texas	Investment and 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 24, 2014, 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, 2013.

/s/ McGladrey LLP

Dallas, Texas

February 24, 2014

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 24, 2014

By: /s/ DENNIS E. NIXON

Dennis E. Nixon
President (Chief Executive Officer)

Certification

I, Imelda Navarro, 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 24, 2014

By: /s/ IMELDA NAVARRO

Imelda Navarro
Treasurer (Chief 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, 2013 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 24, 2014

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, 2013 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Imelda Navarro, 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:

- (3) 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
- (4) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ IMELDA NAVARRO

Imelda Navarro
Treasurer

Date: February 24, 2014

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.