

**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, 2016

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, 2016 was \$1,720,588,000.00 based on the closing sales price per share of the Registrant's common stock on such date as reported by NASDAQ.

As of February 22, 2017, there were 65,989,631 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, 2016 (in Parts I and II) and (b) Proxy Statement relating to the Company's 2017 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 funding sources in the future could adversely impact the Company’s growth strategy, prospects and performance.
- Changes in consumer spending, borrowing and saving 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 (“CFPB”) as a regulator of financial institutions, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance, employment, environmental and immigration laws and regulations and the risk of litigation that may follow.
- Changes in our liquidity position.
- 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.
- Changes in estimates of future reserve requirements based upon periodic review thereof under relevant regulatory and accounting requirements.

- 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, lower oil prices 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, including the restrictions of arbitration clauses by the CFPB related to the CFPB study on the use of such clauses.
- 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 failures or breaches of our network security, as well as other cyber security risks, could subject us to increased operating costs, litigation and other liabilities.
- Acts of war or terrorism.
- Natural disasters.
- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale 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 legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews and the ability to obtain required regulatory approvals.
- The effect of final rules amending Regulation E that prohibit financial institutions from charging consumer fees for paying overdrafts on ATM and one-time debit card transactions, 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 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 increase in required capital levels related to the implementation of capital and liquidity rules of the federal banking agencies that address or are impacted by the Basel III capital and liquidity standards.
- The enhanced due diligence burden imposed on banks related to the banks' inability to rely on credit ratings under Dodd-Frank, 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. As of December 31, 2016, 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, 2016 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 are principally 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 four 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"); (iii) International Bank of Commerce, Zapata, a Texas state banking association which commenced operations in 1984, located in Zapata, Texas ("IBC-Zapata") and (iv) International Bank of Commerce, Oklahoma City, Oklahoma, an Oklahoma state banking corporation ("IBC-Oklahoma"). IBC-Oklahoma was formed as of January 1, 2017, as part of an internal corporate reorganization, whereby IBC assigned and transferred, certain assets and liabilities located in Oklahoma and Dallas, Texas to IBC-Oklahoma, and IBC-Oklahoma accepted and assumed such assets and liabilities. All five banks are wholly owned subsidiary banks of IBC Subsidiary Corporation, itself a wholly owned subsidiary of International Bancshares Corporation.

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 Trading Company, an export trading company which is currently inactive, (ii) IBC Subsidiary Corporation, a second-tier bank holding company incorporated in the State of Delaware, (iii) IBC Charitable and Community Development Corporation, a Texas non-profit corporation formed to conduct charitable and community development activities, (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, Risk Committee, Compensation Committee, and Nominating Committee. The Company's website will also include the Proxy Statement relating to the Company's 2017 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, IBC-Brownsville, and, as of January 1, 2017, IBC-Oklahoma, 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, safety deposit boxes, collections, 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 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, 2016, the Company and its subsidiaries employed approximately 2,861 persons full-time and 355 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. From time to time, the Company has increased its market share in its primary market area 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%, 27% and 27% of the bank subsidiaries’ total deposits for the three years ended December 31, 2016, 2015 and 2014, 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. Furthermore, Congress, state legislatures and applicable federal and state regulatory agencies are continually reviewing such statutes, regulations and policies. Any change in such laws or policies applicable to the Company and its subsidiaries could have a material effect on our business, financial condition or our results of operations. Recent political developments, including the change in the United States’ administration, have increased uncertainty to the implementation, scope and timing of regulatory reforms. With few exceptions, state and Federal banking laws have as their principal objective either the maintenance of the safety and soundness of the Federal deposit insurance system or the protection of consumers, rather than the specific protection of 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, have or 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. The FRB issued a final rule on February 18, 2014 (effective July 1, 2015), which is applicable to the Company, 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. Under the final rule, the risk committee must: (i) include at least one member having experience in identifying, assessing, and managing risk exposures of large, complex firms, and (ii) be chaired by an independent director. The risk committee must also have a written charter and it must meet at least quarterly.
- 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 October 27, 2014, the Federal Reserve issued a final rule, effective November 26, 2014, amending the stress test rules applicable to bank holding companies with more than \$10 billion but less than \$50 billion in total consolidated assets, like the Company. This final rule modifies the start date of the stress test cycles from October 1 of a calendar year to January 1 of the following calendar year. On March 25, 2015, the FRB

approved a final rule to modify its capital plan and stress testing rules, effective for the 2016 capital plan and stress testing cycle. 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. Effective January 1, 2015, the FDIC revised the dates for final data, as well as reporting dates and public dates. 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.
- 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. On October 29, 2016, the CFPB amended Regulation C to implement amendments to HMDA. The rule creates new requirements and modifies existing requirements, including the institutional and transactional coverage of Regulation C, reportable data requirements, and disclosure and reporting requirements. The final rule provides extensive guidance regarding compliance with both the existing and new requirements. Effective January 1, 2017, the CFPB amended Regulation C to implement amendments to HMDA which creates significant new data requirements and modifies existing requirements, including the institutional and transactional coverage of Regulation C, reportable data requirements, and disclosure and reporting requirements. The final rule provides guidance regarding compliance with both the existing and new requirements. The final rule will increase compliance for financial institutions that originate mortgage loans.
- 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. On June 4, 2012, the OCC adopted a final rule (effective January 1, 2013), that removes credit rating references in OCC regulations relating to investment securities and imposing certain new due diligence requirements. On November 15, 2012, the FDIC adopted the OCC final rule through release of FDIC FIL-48-2012. The Interagency Uniform Agreement on the Classification and Appraisal of Securities Held by Depository Institutions, issued in 2013 as FIL-51-2013, applies these changes to examiner classifications of securities.
- 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. On June 9, 2015, the agencies issued a final interagency policy statement establishing joint standards for assessing the diversity policies and practices of the entities they regulate. The final standards, which are generally similar to the proposed standards, provide a framework for regulated entities to create and strengthen their diversity policies and practices, including their organizational commitment to diversity, workforce and employment practices, procurement and business practices, and practices to promote transparency of organizational diversity and inclusion within the entities' U.S. operations. On June 9, 2015, the agencies issued a final rule (effective June 10, 2015) which regulated entities will need to adjust their existing policies and practices to conform.
- Require 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. On December 18, 2014, the Federal Reserve delayed implementation until July 2017 of the requirement for banks to unwind investments in private equity funds, hedge funds and specialty security projects. On April 6, 2015, the FRB (SR15-6) and the other federal bank regulatory agencies issued "Interagency Frequently Asked Questions (FAQs) on the Regulatory Capital." The FAQ topics include the definition of capital, high-volatility commercial real estate ("HVCRE") exposures, real estate and off-balance sheet exposures, equity exposures to investment funds, qualifying central counterparty, and credit valuation adjustment. On November 6, 2015, the FRB (SR15-13) and the other federal bank regulatory agencies issued "Deduction Methodology for Investments in Covered Funds," to clarify the interaction between the agencies' regulatory capital rule and the Volcker Rule with respect to the appropriate capital treatment for investments in certain private equity funds and hedge funds ("covered funds"). In particular, the guidance clarifies supervisory expectations on how a banking organization's regulatory capital deductions of investments in covered funds made pursuant to section 13 of the Bank Holding Company Act (also referred to as the Volcker Rule), and implementing regulations relate to deductions of these investments pursuant to the regulatory capital rule. Additionally, Congress has taken steps to pass legislation granting a two (2) year delay to the Volcker Rule's swaps push-out rule that eliminates federal subsidies for trading in certain derivatives, including collateralized loan obligations or securitized bundles of business loans. 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.

- Authorize 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. On February 18, 2014, the FRB published the final rule, which became effective June 1, 2014. Most of the proposed SIFI rules do not apply to the Company because the Company has total consolidated assets in an amount less than \$50 billion. Two aspects of the 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. On January 24, 2017, the FRB finalized a rule to reduce risks associated with globally systemic U.S. bank holding companies and intermediate holding companies of systematically important foreign banking organizations. The FRB final rule, among other things, establishes “total loss-absorbing capacity” standards for the globally systematic important banks (“GSIBs”). None of these recently finalized rules to reduce risks associated with GSIBs apply to the Company because the Company has total consolidated assets in an amount less than \$50 billion.

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, President Bush 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, 2015, none of the Warrant had been exercised. The Warrant expires on December 23, 2018. Adjustments to the Exercise Price of the Warrant will be made if the Company pays cash dividends in excess of 33 cents per semi-annual period or makes certain other shareholder distributions before 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.

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

OFFICE OF FOREIGN ASSETS CONTROL REGULATION. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. OFAC publishes lists of specially designated targets and countries. 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. The Company is also responsible for reporting blocked transactions after their occurrence. 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. As part of the Local Financial Corporation (“LFIN”) acquisition in 2004, the Company acquired a securities firm registered under the Exchange Act, IBC Investments, Inc. 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, 2016, the Company has made 39 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.

On September 8, 2016, the FRB published a report to Congress in which it recommended the repeal of the merchant banking authority granted to financial holding companies under the GLBA. Specifically, the FRB recommended that Congress repeal the statutory merchant banking authority and the grandfathering exemption under section 4(o) of the BHCA for certain companies that became financial holding companies after 1999. The FRB also noted in the report that it is currently considering regulatory measures that would limit what it termed “safety and soundness risks of merchant banking investments.” It is uncertain what, if any, action the FRB or Congress will take regarding the FRB’s report.

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, applies prospectively and does 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. These privacy provisions also have the effect of increasing the length of the waiting period, after privacy disclosures are provided to new customers, before information can be shared among different affiliated companies for the purpose of cross-selling products and services between those affiliated companies. On December 4, 2015, the Fixing America's Surface Transportation Act (the "FAST Act") was signed into law. Part of the FAST Act amended GLBA by providing financial institutions with an exception to the general requirement that those institutions deliver annual privacy notices.

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 joint notice of proposed rulemaking implementing this statutory requirement in the near future. 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 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 (2%) of insured deposits. It also implements a lower assessment rate schedule when the fund reaches 1.15 percent (1.15%) and, in lieu of dividends, provides for a lower rate schedule when the reserve ratio reaches 2 percent (2%) and 2.5 percent (2.5%). 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.

In October 2015, the FDIC proposed to impose a surcharge on the quarterly assessments of insured depository institutions with total consolidated assets of \$10 billion or more. This would result in increased costs for IBC and other bank subsidiaries of the Company. Because of the uncertainty as to the outcome of the FDIC’s proposals, we cannot provide any assurance as to the ultimate impact of any surcharges on the amount of deposit insurance expense reported in future periods. On March 15, 2016, the FDIC issued its final rule which imposes on banks with at least \$10 billion in assets, a surcharge of 4.5 cents per \$100 of their assessment base, after making certain adjustments. The FDIC expects the reserve ratio will likely reach 1.35 percent (1.35%) after approximately two years of payments of the surcharges.

The final rule became effective on July 1, 2016. If the reserve ratio reached 1.15 percent (1.15%) before that date, surcharges began July 1, 2016. If the reserve ratio did not reach 1.15 percent (1.15%) by that date, surcharges would begin the first quarter after the reserve ratio reaches 1.15 percent (1.15%).

FDIC deposit insurance expense for the Company totaled \$5,777,000, \$5,938,000 and \$6,082,000 in 2016, 2015 and 2014, respectively.

On February 26, 2016, the FDIC proposed potential new requirements for insured depository institutions with at least 2 million deposit accounts (currently, 37 mega and regional banks,) (“Covered Institutions”). The FDIC proposed new recordkeeping standards and deposit insurance calculation requirements for these Covered Institutions. The FDIC requested comment on whether and how these institutions should be required to enhance recordkeeping by maintaining substantially more accurate and complete data on each depositor’s ownership interest by right and capacity for all or a large subset of their deposit accounts and develop and maintain the capability to calculate the insured and uninsured amounts for each depositor by deposit insurance category for all (or a substantial subset of) deposit accounts at the end of any business day. The FDIC also requested comments regarding the increased compliance costs that Covered Institutions will incur in implementing a final rule.

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. The federal authorities’ risk-based capital guidelines in effect as of December 31, 2014 were based upon the 1988 capital accord (defined below as “BIS”). The capital guidelines effective as of December 31, 2014 utilize 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 was required to 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, 2016 was 13.91%. The guidelines also provide that bank holding companies experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Each of 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, 2016.

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 bank 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, 2016, the Company and each of the bank subsidiaries were classified as “well capitalized” under the applicable regulations. The new Basel III capital rules also revise the “prompt corrective action” regulations as discussed below under “Basel III Prompt Corrective Action.”

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 set capital requirements for operational risk, and refined the existing capital requirements for credit risk and market risk exposures. The United States federal banking agencies developed 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 applies 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.

The Basel III capital rules include the new components of "Accumulated Other Comprehensive Income (Loss)" that factors into the calculation of CET1 all net unrealized gains (losses) on available-for-sale securities. The definition also establishes the expectation that the majority of Common Equity Tier 1 should be voting shares. 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 Basel III capital rules establish calculations for risk-weighted assets using alternatives to credit ratings that would be based on either the weighted average of the underlying collateral or a formula based on subordination position and delinquencies or the use of a 1,250% risk-rating, which would be the default rating if requisite standards of a comprehensive understanding and levels of the due diligence are not met. Securitized structures such as private label

mortgage-backed securities may be risk weighted based on a gross-up approach considering underlying assets otherwise they default to the 1,250% risk weight.

On the quality of capital side, the final Basel III capital rule emphasized Common Equity Tier 1 capital, the most loss-absorbing form of capital, and implements strict eligibility criteria for regulatory capital instruments. The final rule also improved the methodology for calculating risk-weighted assets to enhance risk sensitivity. The 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. A key provision of the new Basel III rules permits all non-advanced approaches institutions, like the Company, to make a one-time irrevocable election to determine how most items reported in Accumulated Other Comprehensive Income ("AOCI") will be handled for regulatory capital purposes. The irrevocable election was made with the filing of the March 31, 2015 Call Report and consisted of an institution choosing to either opt-out or not opt-out of the requirement to include most components of AOCI in Common Equity Tier 1 capital. For institutions that opt-out, most AOCI items will not be included in the calculation of Common Equity Tier 1 capital. For institutions that do not opt-out, most AOCI items will be included in the calculation of Common Equity Tier 1 capital, which affects the institution's legal lending limit calculation. If a top-tier banking organization makes the AOCI opt-out election, all consolidated banking subsidiary organizations under it must make the same election. The Company made the AOCI opt-out election.

Under Basel III capital rules, the initial minimum capital ratios that became effective on January 1, 2015 are as follows:

- 4.5% CET1 to risk-weighted assets.
- 6.0% Tier 1 capital to risk-weighted assets.
- 8.0% Total capital to risk-weighted assets.
- 4.0% Tier 1 capital to average quarterly assets.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a four-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

The Basel III capital rules prescribe a standardized approach for risk weightings that expand the risk-weighting categories from the four BIS-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. Specific changes to the rules impacting the Company's determination of risk-weighted assets include, among other things:

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

In addition, the Basel III capital rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

On February 13, 2015, the FRB (SR 15-4) and other federal bank regulatory agencies made available an automated tool to assist financial institutions subject to the agencies' regulatory capital rules in calculating risk-based capital requirements for individual securitization exposures. Specifically, institutions that use the rules' Simplified Supervisory Formula Approach ("SSFA") to calculate risk-based capital requirements for securitization exposures may use the tool, at their discretion, to calculate capital requirements for such exposures.

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

A bank will be (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a CET1 capital ratio of 6.5% or greater, a Tier 1 risk-based capital ratio of 8.0% or greater (6.0% prior to January 1, 2015), and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by an such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a CET1 capital ratio of 4.5% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater (4.0% prior to January 1, 2015), and a leverage ratio of 4.0% or greater and is not "well capitalized", (iii) "undercapitalized" if the institution has a total risk-based capital ratio that is less than 8.0%, a CET1 capital ratio less than 4.5%, a Tier 1 risk-based capital ratio of less than 6.0% (4.0% prior to January 1, 2015) or a leverage ratio of less than 4.0%, (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a CET1 capital ratio less than 3%, a Tier 1 risk-based capital ratio of less than 4.0% (3.0% prior to January 1, 2015) or a leverage ratio of less than 3.0%, and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

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

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

As of December 31, 2016, each of its bank subsidiaries was “well capitalized” based on the aforementioned ratios pursuant to the Basel III capital rules.

LIQUIDITY REQUIREMENTS. Historically, regulation and monitoring of bank and bank holding company liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III final framework requires banks and bank holding companies to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward will be required by regulation. On January 7, 2013, Basel III liquidity coverage ratio was published and it uses international liquidity standards that serve 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. On September 3, 2014, the bank regulators issued the final version of the LCR. The final rule defines banks with between \$50 billion and \$250 billion in assets as “modified LCR companies” and they will be subjected to less rigorous requirements regarding the high-quality liquid assets calculations.

FASB CECL ACCOUNTING STANDARD. In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2016-13 to ASC 326, “Financial Instruments – Credit Losses.” The accounting standards update amends existing standards for credit losses on financial assets. The change in accounting standard requires that the expected credit losses on financial instruments held as of the end of the period be measured based on historical loss experience, current conditions and reasonable and supportable forecasts. The accounting standard update also amends the accounting for credit losses on available-for-sale debt securities and financial assets purchased with credit deterioration. The accounting standard change will be effective for the Company on January 1, 2020. The change in accounting standards could result in an increase in the Company’s reserve for probable loan losses and require the Company to book loan losses more quickly; however, the Company is still evaluating the impact of the change.

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, 2017. “Large institution” now means a bank with total assets of at least \$1.221 billion for December 31 of both of the prior two calendar years and “intermediate small institution” means an institution with assets of at least \$305 million and less than \$1.221 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. On July 15, 2016, the federal banking agencies issued revised “Interagency Questions and Answers Regarding Community Reinvestment” (“Questions and Answers”) to provide guidance to financial institutions and the public. These Questions and Answers consolidate and supersede all previously published “Interagency Questions and Answers Regarding Community Reinvestment” and were effective immediately.

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. Banking regulators take into account compliance with consumer protection laws when considering approval of a proposed transaction.

On July 22, 2016, the CFPB proposed major small dollar loan consumer protection regulations, including payday loans, vehicle title loans, and certain high-cost installment loans. Two categories of loans are covered. The first category includes loans with a term of 45 days or less or loans with multiple advances if each advance is required to be repaid within 45 days. The second category includes loans with terms greater than 45 days, provided that they have an all-in annual percentage rate higher than 36 percent; and, either are repaid directly from the consumer’s account or income or are secured by the consumer’s vehicle. The proposed rules focus on practices involving consumer’s ability to repay their loans and other practices related to withdrawing payments from consumers’ accounts. Several types of consumer credit would be excluded, including: loans extended solely to finance the purchase of a car or other consumer good in which the good secures the loan; home mortgages and other loans secured by real property or a dwelling if recorded or perfected; credit cards; student loans; non-recourse pawn loans; and overdraft services and lines of credit.

MILITARY LENDING ACT. On July 22, 2015, the Department of Defense issued final amendments to the rule that implements the federal Military Lending Act. The amended rule became effective October 3, 2015, but compliance for credit card accounts is not required until October 3, 2017. The Department of Defense expanded the definition of “consumer credit” to include a much broader range of credit products, including some credit products offered by depository institutions. The rule requires lenders to provide certain protections to borrowers who are covered under the rule. For instance, lenders must cap the Military Annual Percentage Rule for covered credit products provided to covered borrowers at 36%. Lenders must also provide certain disclosures and other protections to covered borrowers. Although a lender can use any method to determine a borrower’s military status, the lender can obtain a safe harbor by verifying the borrower’s military status either through the Department of Defense Manpower Data Center or by using a consumer credit report that contains military status.

ELECTRONIC BANKING AND CYBER SECURITY. 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. In 2014, in adherence to a presidential executive order, the National Institute of Standards and Technology (“NIST”) released a preliminary Framework for Approving Critical Infrastructure Cybersecurity. Banks will be expected to incorporate the NIST Cybersecurity Framework into their security frameworks which are also governed by FFIEC guidelines. On October 26, 2016, the federal banking agencies proposed enhanced cyber risk management standards for large interconnected entities and their service providers. The proposal establishes enhanced standards to increase the operational resilience of these entities and reduce the impact on the financial system in case of a cyber event experienced by one of these entities. The standards address cyber risk governance, cyber risk management, internal dependency management, external dependency management, incident response, cyber resilience and situational awareness. The enhanced standards would be implemented in a tiered manner, imposing more stringent standards on the systems of those entities that are critical to the functioning of the financial sector.

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. Dodd-Frank Act changes became effective on July 21, 2012. However, to date, the FRB has not issued any guidance nor has it amended Regulation W, although it is expected to do so in the near future.

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 one-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.

COMMERCIAL REAL ESTATE LENDING. In 2006, the federal bank regulators issued interagency guidance titled “Concentration in Commercial Real Estate Lending: Sound Risk Management Practices.” The guidance focuses on the risks of high levels of concentration in CRE lending and identified two supervisory concentration levels. The first was the concentration level where loans for construction, land and land development represent 100% or more of a bank institution’s total risk-based capital. The second was the CRE concentration where total non-owner occupied CRE loans represent 300 percent or more of the institution’s total risk-based capital and growth in total CRE lending has increased by 50 percent or more during the previous 36 months. The guidance states that the banking institutions exceeding the concentration levels should have in place enhanced credit risk controls, including stress-testing of CRE portfolios and that the concentration levels may result in further supervisory analysis.

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 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.

On November 3, 2014, the CFPB issued a final rule amending the 2013 mortgage rules by adopting an alternative definition of “small servicer” and amending the ability-to-repay rule exemption as applied to certain nonprofits, and also provides a limited, post-consummation cure mechanism for the points and fees limit for qualified mortgages. On December 15, 2014, the CFPB proposed amendments to certain mortgage rules issued in 2013 relating to force-placed insurance notices, policies and procedures, early intervention, and loss mitigation requirements under Regulation X’s servicing provisions; and periodic statement requirements under Regulation Z’s servicing provisions. The proposed rule also addresses compliance when a consumer is in bankruptcy and makes technical corrections to several other provisions. On January 20, 2015, the CFPB issued a new final rule amending the 2013 TILA-RESPA final rule extending the timing requirements for revised disclosures when consumers lock a rate or extend a rate lock after the Loan Estimate is provided and permitting certain language related to construction loans for transactions involving new construction. Finally, on July 21, 2015, the CFPB issued another new final rule amending the 2013 TILA-RESPA final rule to further extend the effective date until October 3, 2015. On August 15, 2016, the CFPB proposed making technical amendments regarding the integrated mortgage disclosure rules and guidance. These amendments include: creating tolerances for the total of payments; adjusting a partial exemption for certain non-bearing subordinate lien transactions; providing a uniform rule for the application of integrated mortgage disclosure requirements to cooperating units; and providing guidance on sharing disclosures with various parties involved in the mortgage origination process.

On March 25, 2016, the CFPB requested comments on an interim final rule to expand the small creditors that are eligible under Regulation Z: to originate balloon-payment qualified mortgages; and for an exemption from the requirements to establish an escrow account for higher-priced mortgages. The affected rules are the January 2013 Escrows Final Rule, the 2013 Home Ownership and Equity Protection Act Final Rule, the January 2013 and May 2013 ability to repay Final Rule. The interim final rule became effective on March 31, 2016.

On March 3, 2016, the CFPB established an application process under which a person may request to have an area designated as rural for the purposes of Federal consumer financial laws. Previously, the CFPB designated rural areas for the purposes of certain Federal consumer financial laws relating to mortgage lending. The CFPB began to accept applications on March 31, 2016.

On October 19, 2016, the CFPB amended certain mortgage rules issued in 2013. This final rule clarifies, revises, or amends provisions regarding force-placed insurance notices, policies and procedures, early intervention, and loss mitigation requirements under Regulation X’s servicing provisions; and prompt crediting and periodic statement requirements under Regulation Z’s servicing provisions. The final rule also addresses compliance when a consumer is in bankruptcy and makes technical corrections to several other provisions. Concurrently, the CFPB issued an interpretive rule relating to compliance with certain mortgage servicing rules.

In October 2016, the CFPB also issued a final rule amending the mortgage servicing rules. The CFPB issued this interpretive rule under the Fair Debt Collection Practices Act (“FDCPA”) to clarify the interaction of the FDCPA and mortgage servicing rules. This interpretive rule constitutes an advisory opinion under FDCPA section 813(e) and provides a safe harbor from liability for actions done or omitted in good faith in conformity with the opinion.

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

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 to pay dividends is restricted under Texas and Oklahoma law. A Texas bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. An Oklahoma bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Oklahoma Department of Banking. The FDIC has the right to prohibit the payment of dividends by a bank where the payment is deemed to be an unsafe and unsound banking practice. At December 31, 2016, there was an aggregate of approximately \$819,500,000 available for the payment of dividends to the Company by IBC, Commerce Bank, IBC-Zapata and IBC-Brownsville under the capital

rules applicable as of December 31, 2016, assuming that each of such banks continues to be classified as “well capitalized.” Further, the Company could expend the entire \$819,500,000 and continue to be classified as “well capitalized” under the capital rules applicable as of December 31, 2016. Note 20 of Notes to Consolidated Financial Statements of the Company in the 2016 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 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, including increasing the Company's cost of doing business, affecting the Company's compensation structure, or limiting or expanding permissible activities. 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. The same uncertainty exists with respect to regulations authorized or required under the Dodd-Frank Act but that have not yet been proposed or finalized. There is also the possibility that the Dodd-Frank Act may be revised by Congress in the future because certain bills have been introduced into Congress that would amend certain provisions of Dodd-Frank.

On January 20, 2017, the White House issued a memorandum to all executive departments and agency heads imposing "...a temporary moratorium on new agency regulations that are not compelled by Congress or public safety." Agencies are prohibited from sending any new regulations to the Office of the Federal Register ("OFR") until a new agency head reviews and approves the regulation. Regulations already submitted to the OFR but not yet published in the Federal Register must be withdrawn, and regulations already published in the Federal Register but not yet in effect must have their effective date postponed for 60 days. "Guidance documents," or agency policies and interpretations of statutory or regulatory issues, are also subject to the regulatory freeze. The memorandum identifies regulations subject to statutory or judicial deadlines, and regulations that "affect critical health, safety, financial or national security matters," as determined by the Office of Management and Budget ("OMB") Director as exceptions. It is not clear, though, whether the announced freeze on federal regulations applies, and certain "independent regulatory agency," such as the CFPB, the OCC, the FRB, the FDIC, and the SEC may be excluded from that moratorium.

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, 2016.

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 effect 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, 2016. 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 IRS rule 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, including as a result of a cyber-attack, 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, including cybersecurity risks. Our products and services involve the gathering, storage and transition of sensitive information regarding our customers and their accounts. 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. Cyber-security attacks, 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. As a financial institution we are also subject to and examined for compliance with an array of data protection laws, regulations and guidance, as well as our own internal privacy and information security policies and programs. If our information systems or infrastructure experience a significant disruption or breach, it could lead to unauthorized access to personal or confidential information of our customers in our possession and unauthorized access to our proprietary information, methodologies and business secrets. In addition, if our partners, vendors or other market participants experience a disruption or breach, it could lead to unauthorized transactions on Company or Company customer accounts or unauthorized access to personal or confidential information maintained by those entities. A disruption or breach such as these could result in significant legal, financial and non-financial exposure, regulatory intervention, remediation costs, damage to our reputation and loss of confidence in the security of our systems, products and services that could adversely affect our business.

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.

There are restrictions on the Company's ability to both receive and pay dividends.

Holders of the Company's common stock only receive dividends as the Company's Board of Directors may declare out of legally available funds. Although the Company has historically declared cash dividends on its common stock, it is not required to do so and there can be no assurance that the Company will pay dividends in the future.

The Company is a financial holding company engaged in the business of managing, controlling and operating its subsidiaries, including its subsidiary banks. The Company receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company's common stock. Various federal and state laws and regulations limit the amount of dividends that the Company's subsidiaries may pay to the Company. The inability to receive dividends from the Company's subsidiaries could have a material adverse effect on the Company's business, financial condition and results of operations.

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, 2016. 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 associated with lending activities.

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

The Company may be adversely affected by declining crude oil prices.

Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. Energy production and related industries represent a large part of the economies in some of the Company's primary markets. Furthermore, a prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in

particular, the economies of energy-dominant states such as Texas and Oklahoma. Accordingly, a prolonged period of low oil prices could have a material adverse effect on the Company's business, financial condition and results of operation.

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, a decline in oil prices, 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. If economic conditions in the Company's primary market areas continue to weaken or worsen due to the recent decline in oil prices or other factors or fail to improve or to continue 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 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 study of such matters that were published during the fourth 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, 2016, we had approximately \$160 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.

The exercise of warrants in connection with our participation in the CPP could negatively impact the market price for our common stock.

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 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 66 of the 2016 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 2016 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	74	Chairman of the Board of the Company since 1992, President of the Company since 1979, Chief Executive Officer and Director of IBC	1979
R. David Guerra	64	Vice President of the Company since 1986, President of IBC McAllen Branch and Director of IBC	1986
Imelda Navarro	59	Treasurer of the Company since 1982, President of IBC and Director of IBC	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 24 through 27 of Registrant's 2016 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 2016 Annual Report is incorporated herein by reference.

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

The information set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" located on pages 2 through 27 of Registrant's 2016 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 21 of Registrant's 2016 Annual Report is incorporated herein by reference.

Item 8. *Financial Statements and Supplementary Data*

The consolidated financial statements located on pages 29 through 81 of Registrant's 2016 Annual Report are incorporated herein by reference.

The condensed quarterly income statements located on pages 82 and 83 of Registrant's 2016 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, 2016 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, 2016, 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 in 2013. Based on the assessment, management determined that the Company maintained effective internal control over financial reporting as of December 31, 2016, based on those criteria.

RSM US LLP, the independent registered public accounting firm that audited the 2016 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, 2016. Their report, which expresses an unqualified opinion, on the effectiveness of the Company's internal control over financial reporting as of December 31, 2016 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, 2016, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. 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, 2015, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of condition of International Bancshares Corporation and subsidiaries as of December 31, 2016 and 2015, 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, 2016 and our report dated February 27, 2017 expressed an unqualified opinion.

/s/ RSM US LLP

Dallas, TX
February 27, 2017

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 2017 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 2017 Annual Meeting of Shareholders entitled "EXECUTIVE COMPENSATION," and (ii) that portion entitled "Compensation Committee and Stock Option Plan Committee Interlocks and Insider Participation" in the portion entitled "MEETINGS AND COMMITTEES OF THE BOARD OF DIRECTORS."

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

There are incorporated in this Item 12 by reference those portions of the Company's definitive proxy statement relating to the Company's 2017 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 2017 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 2017 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 2016 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, 2016 and 2015

Statements of Income for the years ended December 31, 2016, 2015 and 2014

Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014

Statements of Shareholders' Equity for the years ended December 31, 2016, 2015 and 2014

Statements of Cash Flows for the years ended December 31, 2016, 2015 and 2014

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 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 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 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 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)* —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)(g)* —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.
- (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)*+ —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.
- (10e)*+ —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.
- (10f)*+ —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.

- (10g)*+ —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 2016 Annual Report
- (21) —List of Subsidiaries of International Bancshares Corporation as of February 27, 2017
- (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, 2016, 2015 and 2014 (ii) the Condensed Consolidated Balance Sheet as of December 31, 2016 and 2015, and (iii) the Condensed Consolidated Statement of Cash Flows for the years ended December 31, 2016, 2015 and 2014.

Item 16. *Form 10-K Summary*

None

SIGNATURES

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

INTERNATIONAL BANCSHARES CORPORATION
(Registrant)

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

Date: February 27, 2017

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

<u>Signatures</u>	<u>Title</u>	<u>Date</u>
<u>/s/ DENNIS E. NIXON</u> Dennis E. Nixon	President and Director (Principal Executive Officer)	February 27, 2017
<u>/s/ IMELDA NAVARRO</u> Imelda Navarro	Treasurer (Principal Financial Officer and Principal Accounting Officer)	February 27, 2017
<u>/s/ JAVIER DE ANDA</u> Javier de Anda	Director	February 27, 2017
<u>/s/ IRVING GREENBLUM</u> Irving Greenblum	Director	February 27, 2017
<u>/s/ R. DAVID GUERRA</u> R. David Guerra	Director	February 27, 2017
<u>/s/ DOUG HOWLAND</u> Doug Howland	Director	February 27, 2017
<u>/s/ PEGGY J. NEWMAN</u> Peggy J. Newman	Director	February 27, 2017
<u>/s/ LARRY NORTON</u> Larry Norton	Director	February 27, 2017
<u>/s/ ROBERTO RESENDEZ</u> Roberto Resendez	Director	February 27, 2017
<u>/s/ LEONARDO SALINAS</u> Leonardo Salinas	Director	February 27, 2017
<u>/s/ ANTONIO R. SANCHEZ, JR.</u> Antonio R. Sanchez, Jr.	Director	February 27, 2017

Exhibit Index

Exhibit 13—	International Bancshares Corporation 2016 Annual Report, Exhibit 13, page 1
Exhibit 21—	List of Subsidiaries of International Bancshares Corporation as of February 22, 2017
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
Exhibit 101—	Interactive Data File

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, 2016. 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,				
	2016	2015	2014	2013	2012
	(Dollars in Thousands, Except Per Share Data)				
STATEMENT OF CONDITION					
Assets	\$ 11,804,041	\$ 11,772,869	\$ 12,196,520	\$ 12,079,477	\$ 11,882,673
Investment securities available-for-sale	4,177,349	4,199,372	4,911,963	5,304,579	5,525,015
Net loans	5,900,027	5,883,926	5,614,417	5,129,074	4,716,811
Deposits	8,610,089	8,536,253	8,438,625	8,243,425	8,287,213
Other borrowed funds	733,375	505,750	1,073,944	1,223,950	749,027
Junior subordinated deferrable interest debentures	160,416	161,416	175,416	190,726	190,726
Shareholders' equity	1,724,667	1,665,503	1,580,658	1,424,408	1,435,708
INCOME STATEMENT					
Interest income	\$ 387,914	\$ 396,754	\$ 393,599	\$ 363,217	\$ 375,639
Interest expense	43,129	44,317	46,543	54,632	74,499
Net interest income	344,785	352,437	347,056	308,585	301,140
Provision for probable loan losses	19,859	24,405	14,423	22,968	27,959
Non-interest income	161,702	155,734	178,348	189,605	200,591
Non-interest expense	289,625	276,924	281,043	292,632	315,372
Income before income taxes	197,003	206,842	229,938	182,590	158,400
Income taxes	63,071	70,116	76,787	56,239	50,565
Net income	133,932	136,726	153,151	126,351	107,835
Preferred stock dividends and discount accretion	—	—	—	—	14,362
Net income available to common shareholders	\$ 133,932	\$ 136,726	\$ 153,151	\$ 126,351	\$ 93,473
Per common share:					
Basic	\$ 2.03	\$ 2.06	\$ 2.29	\$ 1.88	\$ 1.39
Diluted	\$ 2.02	\$ 2.05	\$ 2.28	\$ 1.88	\$ 1.39

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, 2016. The following discussion should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2016, 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, borrowing and saving 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 (“CFPB”) as a regulator of financial institutions, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance, employment, environmental and immigration laws and regulations and the risk of litigation that may follow.
- Changes in our liquidity position.
- 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, or the possible imposition of tariffs on imported goods.
- 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.
- Changes in estimates of future reserve requirements based upon periodic review thereof under relevant regulatory and accounting requirements.
- 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, lower oil prices 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, including the restrictions of arbitration clauses by the CFPB related to the CFPB proposal to restrict such clauses.
- 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 failures or breaches of our network security, as well as other cyber security risks, could subject us to increased operating costs, litigation and other liabilities.
- Acts of war or terrorism.
- Natural disasters.
- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale 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 legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews and the ability to obtain required regulatory approvals.
- The effect of final rules amending Regulation E that prohibit financial institutions from charging consumer fees for paying overdrafts on ATM and one-time debit card transactions, 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 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 increase in required capital levels related to the implementation of capital and liquidity rules of the federal banking agencies that address or are impacted by the Basel III capital and liquidity standards.
- The enhanced due diligence burden imposed on banks related to the banks' inability to rely on credit ratings under Dodd-Frank, 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 193 facilities and 307 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. The sales team of each of the Company's bank subsidiaries aim to match the right mix of products and services to each customer to best serve the customer's needs. That process entails spending time with customers to assess those needs and servicing the sales arising from those discussions on a long term basis. The bank subsidiaries have various compensation plans, including incentive based compensation, for fairly compensating employees. The bank subsidiaries also have a robust process in place to review sales that support the incentive based compensation plan to monitor the quality of the sales and identify any significant irregularities, a process that has been in place for many years.

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, 2016 was 7.70% as compared to 8.44% for the year ended December 31, 2015.

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, including congressional efforts to revamp or reform it, 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.

Results of Operations

Summary

Consolidated Statements of Condition Information

	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>Percent Increase (Decrease)</u>
	<u>(Dollars in Thousands)</u>		
Assets	\$ 11,804,041	\$ 11,772,869	0.3 %
Net loans	5,900,027	5,883,926	0.3
Deposits	8,610,089	8,536,253	0.9
Other borrowed funds	733,375	505,750	45.0
Junior subordinated deferrable interest debentures	160,416	161,416	(0.6)
Shareholders' equity	1,724,667	1,665,503	3.6

Consolidated Statements of Income Information

	<u>Year Ended December 31, 2016</u>	<u>Year Ended December 31, 2015</u>	<u>Percent Increase (Decrease) 2016 vs. 2015</u>	<u>Year Ended December 31, 2014</u>	<u>Percent Increase (Decrease) 2015 vs. 2014</u>
	<u>(Dollars in Thousands, Except Per Share Data)</u>				
Interest income	\$ 387,914	\$ 396,754	(2.2)%	\$ 393,599	0.8 %
Interest expense	43,129	44,317	(2.7)	46,543	(4.8)
Net interest income	344,785	352,437	(2.2)	347,056	1.6
Provision for probable loan losses	19,859	24,405	(18.6)	14,423	69.2
Non-interest income	161,702	155,734	3.8	178,348	(12.7)
Non-interest expense	289,625	276,924	4.6	281,043	(1.5)
Net income	133,932	136,726	(2.0)	153,151	(10.7)
Per common share:					
Basic	\$ 2.03	\$ 2.06	(1.5)%	\$ 2.29	(10.0)%
Diluted	2.02	2.05	(1.5)	2.28	(10.1)

Net Income

Net income for the year ended December 31, 2016 decreased by 2.0% compared to the same period in 2015. Net income for the year ended December 31, 2016 was negatively impacted by a small decrease in the net interest margin as a result of a decrease in interest income on available-for-sale securities and an increase in non-interest expense. The decrease in interest income on available-for-sale securities is due to a decrease in the average outstanding balance of such investments. The decrease in the balance is being driven primarily by the lack of available investments in the market that fit the Company's investment profile and investment goals. The increase in non-interest income can be attributed to an increase in income from other investments, which is being positively impacted by the sale of an investment by the merchant banking entities in which the Company holds an equity interest, the Company's share of revenue on a non-financial equity investment it holds accounted for under the equity method of accounting, and insurance proceeds from a policy the lead bank subsidiary had purchased to cover the cost of employee compensation and benefit programs, resulting in income of approximately \$5.0 million, after tax. The increase in non-interest expense can be attributed primarily to a charge of \$7.0 million, \$4.6 million after tax, to unwind a portion of a subsidiary bank's long-term repurchase agreements in order to improve the net interest margin in the long term. Also contributing to the increase is an increase of \$3.9 million, \$2.5 million after tax, in software and software maintenance costs arising from additional investments made by the Company in its network infrastructure. Net income for the year ended December 31, 2015 decreased by 10.7% compared to the same period in 2014. Net income for the year ended December 31, 2015 was negatively impacted by an increase in the provision for probable loan losses during the period as a result of an increase in the portion of the allowance for probable loan losses calculated based on actual historical loss experience in the commercial loan category of the Company's loan portfolio, resulting in an increase of 69.2% in the provision for

probable loan losses charged to expense. The decrease in non-interest income for the year ended December 31, 2015 compared to the same period of 2014 and can be primarily attributed to infrequent transactions that occurred in 2014 including the sale of an equity investment by a merchant banking company in which the Company holds a 50% interest, the sale of property originally held by the bank subsidiaries, the discount recorded in connection with the buyback of \$10.3 million of the outstanding capital securities issued by one of the statutory business trusts formed by the Company, a decrease in overdraft income due to a decrease in volume and gains on sales of investments of \$5.0 million, after tax.

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. Tax-exempt yields have not been adjusted to a tax-equivalent basis.

	For the years ended December 31,		
	2016 Average Rate/Cost	2015 Average Rate/Cost	2014 Average Rate/Cost
Assets			
Interest earning assets:			
Loan, net of unearned discounts:			
Domestic	5.06 %	5.14 %	5.19 %
Foreign	3.28	3.35	3.36
Investment securities:			
Taxable	1.97	2.00	2.08
Tax-exempt	4.08	4.11	4.57
Other	0.24	0.14	0.29
Total interest-earning assets	3.75 %	3.73 %	3.70 %
Liabilities			
Interest bearing liabilities:			
Savings and interest bearing demand deposits	0.15 %	0.12 %	0.12 %
Time deposits:			
Domestic	0.46	0.50	0.49
Foreign	0.41	0.42	0.44
Securities sold under repurchase agreements	2.75	2.72	2.75
Other borrowings	0.49	0.19	0.19
Junior subordinated deferrable interest debentures	2.85	2.40	2.35
Total interest bearing liabilities	0.62 %	0.60 %	0.60 %

The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net income and net interest margin. The yield on average interest-earning assets increased 0.5% from 3.73% in 2015 to 3.75% in 2016, and the rates paid on average interest-bearing liabilities increased 3.3% from 0.60% in 2015 to 0.62% in 2016. The yield on average interest-earning assets increased 0.8% from 3.70% in 2014 to 3.73% in 2015, and the rates paid on average interest-bearing liabilities remained the same in 2015 and 2014 at 0.60%. 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 2016, 2015 and 2014 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:

	2016 compared to 2015			2015 compared to 2014		
	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	\$ 6,111	\$ (4,966)	\$ 1,145	\$ 18,175	\$ (2,507)	\$ 15,668
Foreign	(490)	(118)	(608)	86	(17)	69
Investment securities:						
Taxable	(7,188)	(1,287)	(8,475)	(8,438)	(3,649)	(12,087)
Tax-exempt	(875)	(88)	(963)	809	(1,257)	(448)
Other	(24)	85	61	100	(147)	(47)
Total interest income	<u>\$ (2,466)</u>	<u>\$ (6,374)</u>	<u>\$ (8,840)</u>	<u>\$ 10,732</u>	<u>\$ (7,577)</u>	<u>\$ 3,155</u>
Interest incurred on:						
Savings and interest bearing demand deposits	\$ 64	\$ 905	\$ 969	\$ 65	\$ (69)	\$ (4)
Time deposits:						
Domestic	(544)	(502)	(1,046)	(394)	78	(316)
Foreign	(136)	(88)	(224)	(290)	(194)	(484)
Securities sold under repurchase agreements	(3,083)	182	(2,901)	(585)	(254)	(839)
Other borrowings	(432)	1,945	1,513	(414)	(4)	(418)
Junior subordinated deferrable interest debentures	(230)	731	501	(252)	87	(165)
Total interest expense	<u>\$ (4,361)</u>	<u>\$ 3,173</u>	<u>\$ (1,188)</u>	<u>\$ (1,870)</u>	<u>\$ (356)</u>	<u>\$ (2,226)</u>
Net interest income	<u>\$ 1,895</u>	<u>\$ (9,547)</u>	<u>\$ (7,652)</u>	<u>\$ 12,602</u>	<u>\$ (7,221)</u>	<u>\$ 5,381</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, 2016, 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, 2016, 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 1.00%, 3.92% and 6.01%, 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,				
	2016	2015	2014	2013	2012
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis	\$ 36,858	\$ 47,320	\$ 63,559	\$ 62,823	\$ 71,768
Accruing loans contractually past due ninety days or more as to interest or principal payments	5,215	11,174	9,988	7,197	14,769

The allowance for probable loan losses decreased 3.5% to \$64,661,000 at December 31, 2016 from \$66,988,000 at December 31, 2015. The allowance was 1.08% of total loans, net of unearned income at December 31, 2016 and 1.13% at December 31, 2015. The provision for probable loan losses charged to expense decreased \$4,546,000 to \$19,859,000 for the year ended December 31, 2016 from \$24,405,000 for the same period in 2015. The decrease in the provision for probable loan losses charged to expense for the year ended December 31, 2016 can be attributed to two large recoveries on loans that had been charged off in prior years of approximately \$10.4 million. The recoveries positively impacted the balance in the allowance for probable loan losses and resulted in decreased provision expense. The increase in the provision for probable loan losses charged to expense for the year ended December 31, 2015 can be attributed to an increase in the portion of the allowance for probable loan losses calculated based on actual historical loss experience in the commercial loan category of the Company's loan portfolio. The decrease in the allowance at December 31, 2014 compared to the same period in 2013 is due to a charge down in an impaired commercial relationship that is mainly secured by multiple pieces of transportation equipment, the value of which fluctuates due to market factors and the amount of use of the equipment. The provision for probable loan losses charged to expense decreased for the year ended December 31, 2014 compared to the same period in 2013 partially due to a specific reserve added in 2013 for the relationship that is mainly secured by multiple pieces of transportation equipment.

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

	December 31, 2016	December 31, 2015
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 10,710	\$ 2,419
Commercial real estate: other construction & land development	—	2,553
Commercial real estate: farmland & commercial	3,086	2,853
Residential: first lien	6,181	5,316
Residential: junior lien	812	929
Consumer	1,269	1,263
Foreign	360	386
Total troubled debt restructuring	<u>\$ 22,418</u>	<u>\$ 15,719</u>

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

	2016	2015	December 31, 2014	2013	2012
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis	\$ 387	\$ 365	\$ —	\$ —	\$ —
Accruing loans contractually past due ninety days or more as to interest or principal payments	11	442	—	—	264

The gross income that would have been recorded during 2016, 2015 and 2014 on non-accrual loans in accordance with their original contract terms was approximately \$2,438,000, \$3,279,000 and \$4,013,000 on domestic loans and approximately \$23,800, \$19,000, and \$0 on foreign loans, respectively. The amount of interest income on such loans that was recognized in 2016, 2015 and 2014 was approximately \$0, \$844,000, and \$29,000 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 approximately \$2,262,717,000 and \$1,781,959,000 at December 31, 2016 and 2015, 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:

	2016	2015	2014	2013	2012
	(Dollars in Thousands)				
Loans, net of unearned discounts, outstanding at December 31	\$ 5,964,688	\$ 5,950,914	\$ 5,679,245	\$ 5,199,235	\$ 4,775,004
Average loans outstanding during the year (Note 1)	\$ 5,949,048	\$ 5,844,842	\$ 5,491,841	\$ 4,978,833	\$ 4,932,728
Balance of allowance at January 1	\$ 66,988	\$ 64,828	\$ 70,161	\$ 58,193	\$ 84,192
Provision charged to expense	19,859	24,405	14,423	22,968	27,959
Loans charged off:					
Domestic:					
Commercial, financial and agricultural	(35,029)	(25,294)	(21,003)	(12,342)	(48,445)
Real estate—mortgage	(401)	(432)	(1,012)	(1,252)	(1,417)
Real estate—construction	(16)	(695)	(680)	(278)	(7,617)
Consumer	(414)	(704)	(719)	(561)	(756)
Foreign	(41)	—	(51)	(22)	(111)
Total loans charged off:	(35,901)	(27,125)	(23,465)	(14,455)	(58,346)
Recoveries credited to allowance:					
Domestic:					
Commercial, financial and agricultural	7,229	4,098	3,086	2,842	3,767
Real estate—mortgage	299	461	291	359	208
Real estate—construction	6,099	141	72	87	229
Consumer	69	170	210	162	184
Foreign	19	10	50	5	—
Total recoveries	13,715	4,880	3,709	3,455	4,388
Net loans charged off	(22,186)	(22,245)	(19,756)	(11,000)	(53,958)
Balance of allowance at December 31	\$ 64,661	\$ 66,988	\$ 64,828	\$ 70,161	\$ 58,193
Ratio of net loans charged-off during the year to average loans outstanding during the year (Note 1)	0.37 %	0.38 %	0.36 %	0.22 %	1.09 %
Ratio of allowance to loans, net of unearned discounts, outstanding at December 31	1.08 %	1.13 %	1.14 %	1.35 %	1.22 %

(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,									
	2016		2015		2014		2013		2012	
	<u>Allowance</u>	<u>Percent of total</u>	<u>Allowance</u>	<u>Percent of total</u>	<u>Allowance</u>	<u>Percent of total</u>	<u>Allowance</u>	<u>Percent of total</u>	<u>Allowance</u>	<u>Percent of total</u>
	(Dollars in Thousands)									
Commercial, Financial and Agricultural	\$ 32,928	50.2 %	\$ 35,379	52.1 %	\$ 41,881	54.7 %	\$ 47,676	55.7 %	\$ 34,206	52.8 %
Real estate—Mortgage	11,355	17.3	10,979	16.2	8,272	16.0	8,061	16.3	8,838	17.6
Real estate—Construction	18,887	28.8	18,818	27.7	12,955	24.9	12,541	23.2	12,720	24.0
Consumer	607	0.9	659	1.0	660	1.1	750	1.3	1,289	1.6
Foreign	884	2.8	1,152	3.0	1,060	3.3	1,133	3.5	1,140	4.0
	<u>\$ 64,661</u>	<u>100.0 %</u>	<u>\$ 66,988</u>	<u>100.0 %</u>	<u>\$ 64,828</u>	<u>100.0 %</u>	<u>\$ 70,161</u>	<u>100.0 %</u>	<u>\$ 58,193</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, 2016 can be attributed to further deterioration in a previously identified and charged down relationship primarily secured by multiple pieces of transportation equipment. In March 2016, litigation against the management of the borrower was filed in the State of Nevada, resulting in a going concern issue with the borrower’s operations and the future use of the transportation equipment pledged as collateral on the relationship. As a result, management, in accordance with its credit review procedures, re-evaluated the collateral values on the equipment in light of the new circumstances and reduced the collateral values accordingly, resulting in a further charge-down of the relationship of approximately \$19.4 million, which is included in the losses charged to the allowance in the commercial category in the table detailing twelve months ended December 31, 2016 activity. The same relationship had been previously charged down in the years ended December 31, 2015 and 2014. Two large recoveries on loans charged off in prior years are included in the recoveries credited to the allowance in the table detailing activity for the year ended December 31, 2016. The recoveries occurred in the first and third quarters of 2016 in the amounts of \$4.4 million and \$6 million, respectively and are included in the Commercial and Commercial Real Estate: Other Construction and Land Development categories. The increase in charge-offs for the years ended December 31, 2015 and 2014 in the Commercial category can be attributed to a charge down of a relationship that is primarily secured by multiple pieces of transportation equipment. The relationship was charged down by \$13.5 million and \$8.5 million for the years ended December 31, 2015 and December 31, 2014, respectively.

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 loans individually evaluated for impairment at December 31, 2015 decreased approximately \$10.0 million, primarily as a result of a charge down in the above described relationship secured by multiple pieces of transportation equipment. The reserve allocated to loans collectively evaluated for impairment at December 31, 2015 increased approximately \$12.0 million and can be attributed to an increase in the

actual historical charge-off experience in the commercial loan category of the calculation. The reserve allocated by categories shows an overall decrease of \$5.3 million from December 31, 2013 to December 31, 2014 and a \$12.0 million increase from December 31, 2012 to December 31, 2013. The decrease for the year ended December 31, 2014 compared to the year ended December 31, 2013 is partially due to a charge down in the above-described relationship secured by multiple pieces of transportation equipment. A specific reserve on the relationship of \$12.0 million was recognized in 2013 and created the increase in the reserve for probable loan losses for December 31, 2013 compared to December 31, 2012. The decrease in the reserve is mainly due to the continued workout of the impaired loans previously identified by the Company. 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, 2016 was adequate to absorb probable losses from loans in the portfolio at that date. See Critical Accounting Policies on page 23. 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, 2016	Year Ended December 31, 2015	Percent Increase (Decrease) 2016 vs. 2015	Year Ended December 31, 2014	Percent Increase (Decrease) 2015 vs. 2014
	(Dollars in Thousands)				
Service charges on deposit accounts	\$ 73,581	\$ 78,825	(6.7)%	\$ 88,586	(11.0)%
Other service charges, commissions and fees					
Banking	46,267	44,971	2.9	44,435	1.2
Non-banking	7,006	7,223	(3.0)	7,463	(3.2)
Investment securities transactions, net	(2,626)	(3,682)	(28.7)	1,283	(387.0)
Other investments, net	23,827	16,969	40.4	22,023	(22.9)
Other income	13,647	11,428	19.4	14,558	(21.5)
Total non-interest income	<u>\$ 161,702</u>	<u>\$ 155,734</u>	<u>3.8 %</u>	<u>\$ 178,348</u>	<u>(12.7)%</u>

Total non-interest income for the year ended December 31, 2016 increased by 3.8% compared to the same period of 2015. The increase in non-interest income can be attributed to an increase in income from other investments, which is being positively impacted by the sale of an investment by the merchant banking entities in which the Company holds an equity interest, the Company's share of revenue on a non-financial equity investment it holds accounted for under the equity method of accounting and insurance proceeds from a policy the lead bank subsidiary had purchased to cover the cost of employee compensation and benefit programs, resulting in income of approximately \$7.8 million. Non-interest income was negatively impacted by a decrease in service charges on deposits for the year ended December 31, 2016 compared to the same period of 2015 and can be attributed to a decrease in the volume of overdraft charges on deposit accounts. Total non-interest income for the year ended December 31, 2015 decreased by 12.7% compared to the same period of 2014. The decrease in non-interest income occurred primarily in service charges on deposits, investment securities transactions, other investments and other income. The decrease in service charges on deposits can be attributed to a decrease in the volume of overdraft income on deposit accounts. The decrease in investment securities transactions can be attributed to the sale of investment securities in 2015 in connection with the repositioning of a portion of the Company's investment portfolio. The decrease in other investments can be attributed to infrequent transactions that occurred in the first quarter of 2014, namely, the sale of an equity investment by a merchant banking company in which the Company holds a 50%. The decrease in other income can be attributed to the sale of property originally held by the bank subsidiaries resulting in a net gain of approximately \$2.9 million and the discount recorded in connection with the buyback of \$15.3 million the outstanding capital securities issued by one of the statutory business trusts formed by the Company in the amount of approximately \$1.8 million in 2014.

Non-Interest Expense

	Year Ended December 31, 2016	Year Ended December 31, 2015	Percent Increase (Decrease) 2016 vs. 2015	Year Ended December 31, 2014	Percent Increase (Decrease) 2015 vs. 2014
	(Dollars in Thousands)				
Employee compensation and benefits	\$ 128,661	\$ 125,135	2.8 %	\$ 121,511	3.0 %
Occupancy	26,583	28,019	(5.1)	32,530	(13.9)
Depreciation of bank premises and equipment	24,738	25,009	(1.1)	24,013	4.1
Professional fees	13,672	12,278	11.4	10,925	12.4
Deposit insurance assessments	5,777	5,938	(2.7)	6,082	(2.4)
Net expense, other real estate owned	5,688	5,695	(0.1)	2,358	141.5
Amortization of identified intangible assets	128	644	(80.1)	2,389	(73.0)
Advertising	7,814	7,585	3.0	7,742	(2.0)
Early termination fee—securities sold under repurchase agreements	7,042	3,510	100.6	11,000	(68.1)
Software and software maintenance	15,087	11,225	34.4	9,824	14.3
Impairment charges (Total other-than-temporary impairment charges, \$793 net of \$1,147, \$371, net of \$1,325, and \$(366), net of \$(1,183), included in other comprehensive loss)	354	954	(62.9)	817	16.8
Other	54,081	50,932	6.2	51,852	(1.8)
Total non-interest expense	<u>\$ 289,625</u>	<u>\$ 276,924</u>	<u>4.6 %</u>	<u>\$ 281,043</u>	<u>(1.5)%</u>

Non-interest expense increased 4.6% for the year ended December 31, 2016 compared to the same period of 2015. Non-interest expense for the year ended December 31, 2015 decreased by 1.5% compared to the same period of 2014. Non-interest expense for the twelve months ended December 31, 2016, 2015 and 2014 was negatively impacted by charges of \$7.0 million, \$3.5 million, and \$11.0 million, respectively, recorded by the Company's lead bank subsidiary related to the termination of a portion of its long-term repurchase agreements outstanding in order to help manage its long-term funding costs. Non-interest expense for the year ended December 31, 2016 was negatively impacted by an increase of \$3.9 million in software and software maintenance costs arising from additional investments made by the Company in its network infrastructure. Net expense, other real estate owned increased 141.5% for the twelve months ended December 31, 2015 compared to the same period of 2014. The increase can be attributed to increased carrying costs and specific reserves established on properties to property reflect the fair value of the property.

Effects of Inflation

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

Financial Condition

Investment Securities

The following table sets forth the carrying value of investment securities as of December 31, 2016, 2015 and 2014:

	December 31,		
	2016	2015	2014
	(Dollars in Thousands)		
Residential mortgage-backed securities			
Available for sale	\$ 3,894,470	\$ 3,893,211	\$ 4,600,372
Obligations of states and political subdivisions			
Available for sale	254,972	277,704	282,276
Equity securities			
Available for sale	27,907	28,457	29,315
Other securities			
Held to maturity	2,400	2,400	2,400
Total	<u>\$ 4,179,749</u>	<u>\$ 4,201,772</u>	<u>\$ 4,914,363</u>

The following tables set forth the contractual maturities of investment securities, based on amortized cost, at December 31, 2016 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	\$ 9	7.30 %	\$ 21,346	4.63 %	771,018	3.12 %	\$ 3,153,771	2.51 %
Obligations of states and political subdivisions	—	—	—	—	1,218	4.76 %	243,404	4.61
Equity securities	28,075	2.44	—	—	—	—	—	—
Other securities	—	—	—	—	—	—	—	—
Total	<u>\$ 28,084</u>	<u>2.44 %</u>	<u>\$ 21,346</u>	<u>4.63 %</u>	<u>\$ 772,236</u>	<u>3.12 %</u>	<u>\$ 3,397,175</u>	<u>2.66 %</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	\$ 125	1.91 %	\$ 2,275	1.79 %	—	— %	—	— %
Total	<u>\$ 125</u>	<u>1.91 %</u>	<u>\$ 2,275</u>	<u>1.74 %</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, 2016, 2015, 2014, 2013 and 2012 are shown in the following table:

	December 31,				
	2016	2015	2014	2013	2012
	(Dollars in Thousands)				
Commercial, financial and agricultural	\$ 2,993,203	\$ 3,101,748	\$ 3,107,584	\$ 2,894,779	\$ 2,525,380
Real estate—mortgage	1,032,222	962,582	910,326	847,692	838,467
Real estate—construction	1,716,875	1,649,827	1,414,977	1,208,508	1,147,669
Consumer	55,168	57,744	61,137	66,414	74,514
Foreign	167,220	179,013	185,221	181,842	188,974
Loans, net of unearned discount	<u>\$ 5,964,688</u>	<u>\$ 5,950,914</u>	<u>\$ 5,679,245</u>	<u>\$ 5,199,235</u>	<u>\$ 4,775,004</u>

The following table shows the amounts of loans (excluding real estate mortgages and consumer loans) outstanding as of December 31, 2016, 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	\$ 987,705	\$ 1,763,368	\$ 242,130	\$ 2,993,203
Real estate—construction	764,377	824,007	128,491	1,716,875
Foreign	108,424	44,783	14,013	167,220
Total	<u>\$ 1,860,506</u>	<u>\$ 2,632,158</u>	<u>\$ 384,634</u>	<u>\$ 4,877,298</u>

	Interest sensitivity	
	Fixed Rate	Variable Rate
	(Dollars in Thousands)	
Due after one but within five years	\$ 261,833	\$ 2,370,325
Due after five years	32,272	352,362
Total	<u>\$ 294,105</u>	<u>\$ 2,722,687</u>

International Operations

On December 31, 2016, the Company had \$167,220,000 (1.4% 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, 2016 and 2015 is presented below.

	For the year ended December 31,			
	2016		2015	
	Amount of	Related	Amount of	Related
	Loans	Allowance for	Loans	Allowance for
		Probable Losses		Probable Losses
	(Dollars in Thousands)			
Secured by certificates of deposit in United States banks	\$ 110,036	\$ 351	\$ 117,379	\$ 477
Secured by United States real estate	30,561	218	29,261	297
Secured by other United States collateral (securities, gold, silver, etc.)	16,985	103	17,263	127
Unsecured	848	19	4,350	69
Other (principally Mexico real estate)	8,790	193	10,760	182
	<u>\$ 167,220</u>	<u>\$ 884</u>	<u>\$ 179,013</u>	<u>\$ 1,152</u>

The transactions for the years ended December 31, 2016, 2015 and 2014, in that portion of the allowance for probable loan losses related to foreign debt were as follows:

	2016	2015	2014
	(Dollars in Thousands)		
Balance at January 1,	\$ 1,152	\$ 1,060	\$ 1,133
Charge-offs	(41)	—	(51)
Recoveries	19	10	50
Net charge-offs	(22)	10	(1)
Charge (credit) to expense	(246)	82	(72)
Balance at December 31	<u>\$ 884</u>	<u>\$ 1,152</u>	<u>\$ 1,060</u>

Deposits

	2016 Average Balance	2015 Average Balance
	(Dollars in Thousands)	
Deposits:		
Demand—non-interest bearing		
Domestic	\$ 2,504,360	\$ 2,477,835
Foreign	644,230	581,692
Total demand non-interest bearing	3,148,590	3,059,527
Savings and interest bearing demand		
Domestic	2,504,369	2,498,294
Foreign	585,986	538,248
Total savings and interest bearing demand	3,090,355	3,036,542
Time certificates of deposit		
\$100,000 or more:		
Domestic	760,014	823,455
Foreign	843,145	862,209
Less than \$100,000:		
Domestic	409,142	454,693
Foreign	280,170	293,489
Total time, certificates of deposit	2,292,471	2,433,846
Total deposits	\$ 8,531,416	\$ 8,529,915

	2016	2015	2014
	(Dollars in Thousands)		
Interest expense:			
Savings and interest bearing demand			
Domestic	\$ 3,922	\$ 3,026	\$ 2,998
Foreign	640	567	599
Total savings and interest bearing demand	4,562	3,593	3,597
Time, certificates of deposit			
\$100,000 or more			
Domestic	3,881	4,693	4,615
Foreign	3,929	4,116	4,529
Less than \$100,000			
Domestic	1,447	1,680	2,074
Foreign	706	744	815
Total time, certificates of deposit	9,963	11,233	12,033
Total interest expense on deposits	\$ 14,525	\$ 14,826	\$ 15,630

Scheduled maturities of time deposits in amounts of \$100,000 or more at December 31, 2016, were as follows:

Due within 3 months or less	\$ 605,093
Due after 3 months and within 6 months	390,668
Due after 6 months and within 12 months	430,477
Due after 12 months	160,057
	<u>\$ 1,586,265</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, 2016 were \$8,610,089,000, an increase of 0.9% from \$8,536,253,000 at December 31, 2015. The increase in deposits is the result of the increased availability of deposits in the banking market. Even though the Company increased its deposits, the Company is still experiencing a substantial amount of competition for deposits at higher than market rates. As a result, the Company has attempted to maintain certain deposit relationships but has allowed certain deposits to leave as the result of aggressive pricing by competitors.

Return on Equity and Assets

Certain key ratios for the Company for the years ended December 31, 2016, 2015 and 2014 follows (Note 1):

	Years ended December 31,		
	2016	2015	2014
Percentage of net income to:			
Average shareholders' equity	7.70 %	8.44 %	10.24 %
Average total assets	1.12	1.13	1.26
Percentage of average shareholders' equity to average total assets	14.60	13.35	12.32
Percentage of cash dividends per share to net income per share	29.56	28.12	22.57

(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. 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%, 27%, and 27% of the Company's bank subsidiaries' total deposits at each of the years ended December 31, 2016, 2015 and 2014, respectively. Other important funding sources for the Company's bank subsidiaries during 2016 and 2015 were borrowings from the FHLB, securities sold under repurchase agreements and large certificates of deposit, requiring management to closely monitor its asset/liability mix in terms of both rate sensitivity and maturity distribution. The borrowings from FHLB are primarily short term in nature and are renewed at maturity. The Company's bank subsidiaries have had a long-standing relationship with the FHLB and keep open unused lines of credit in order to fund liquidity needs. In the event that the FHLB bank indebtedness is not renewed, the repayment of the outstanding indebtedness would more than likely be repaid through proceeds generated from the sales of unpledged available for sale securities. The Company maintains a sizable, high quality investment portfolio to provide significant liquidity. These securities can be sold or sold under agreements to repurchase, to provide immediate liquidity. As in the past, 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 anticipated 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, 2016, is illustrated in the following table. This information reflects the balances of assets and liabilities whose rates are subject to change. As indicated in the table below, 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, 2016	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	\$ 345,055	\$ 794,036	\$ 2,782,811	\$ 257,847	\$ 4,179,749
Loans, net of non-accruals	4,523,652	193,708	359,687	850,396	5,927,443
Total earning assets	\$ 4,868,707	\$ 987,744	\$ 3,142,498	\$ 1,108,243	\$ 10,107,192
Cumulative earning assets	\$ 4,868,707	\$ 5,856,451	\$ 8,998,949	\$ 10,107,192	
Rate sensitive liabilities					
Time deposits	\$ 935,068	\$ 1,086,586	\$ 226,558	\$ 98	\$ 2,248,310
Other interest bearing deposits	3,203,728	—	—	—	3,203,728
Securities sold under repurchase agreements	203,078	1,907	300,000	—	504,985
Other borrowed funds	733,375	—	—	—	733,375
Junior subordinated deferrable interest debentures	160,416	—	—	—	160,416
Total interest bearing liabilities	\$ 5,235,665	\$ 1,088,493	\$ 526,558	\$ 98	\$ 6,850,814
Cumulative sensitive liabilities	\$ 5,235,665	\$ 6,324,158	\$ 6,850,716	\$ 6,850,814	
Repricing gap	\$ (366,958)	\$ (100,749)	\$ 2,615,940	\$ 1,108,145	\$ 3,256,378
Cumulative repricing gap	(366,958)	(467,707)	2,148,233	3,256,378	
Ratio of interest-sensitive assets to liabilities	0.93	0.91	5.97	11,308.60	1.48
Ratio of cumulative, interest-sensitive assets to liabilities	0.93	0.93	1.31	1.48	

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, 2016, 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, 2016, 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 1.0%, 3.92% and 6.01%, 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, 2016, the aggregate amount legally available to be distributed to the Company from bank subsidiaries as dividends was approximately \$819,500,000, assuming that each bank subsidiary continues to be classified as "well-capitalized" under the applicable regulations in effect at December 31, 2016. The restricted capital (capital and surplus) of the bank subsidiaries was approximately \$959,844,000 as of December 31, 2016. The undivided profits of the bank subsidiaries were approximately \$1,779,344,000 as of December 31, 2016.

At December 31, 2016, the Company has outstanding \$733,375,000 in other borrowed funds and \$160,416,000 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, 2016, shareholders' equity was \$1,724,667,000 compared to \$1,665,503,000 at December 31, 2015, an increase of \$59,164,000, or 3.6%. Shareholders' equity increased primarily due to the retention of earnings, offset by the payment of cash dividends to shareholders and repurchases of the Company's common stock in the form of treasury stock. 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 13.91% at December 31, 2016 and 13.15% at December 31, 2015. The core deposit intangibles and goodwill of \$282,557,000 as of December 31, 2016, 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 8% and a Tier 1 leverage ratio of 5%. The Company had risk-weighted Tier 1 capital ratios of 18.68% and 18.69% and risk weighted total capital ratios of 19.47% and 19.54% as of December 31, 2016 and 2015, respectively, which are well above the minimum regulatory requirements and exceed the well-capitalized ratios (see Note 20 to Notes to Consolidated Financial Statements).

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

implementation of the BASEL III capital reforms and various Dodd-Frank Act related capital provisions. Consistent with the Basel international framework, the rules include a new minimum ratio of Common Equity Tier 1 (“CET1”) to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets. The capital conservation buffer began phasing-in on January 1, 2016 at .625% and will increase each year until January 1, 2019, when the Company will be required to have a 2.5% capital conservation buffer, effectively resulting in a minimum ratio of CET1 capital to risk-weighted assets of at least 7% upon full implementation. The rules also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. Regarding the quality of capital, the new rules emphasize CET1 capital and implements strict eligibility criteria for regulatory capital instruments. The new rules also improve the methodology for calculating risk-weighted assets to enhance risk sensitivity. The new rules are subject to a four year phase in period for mandatory compliance and the Company was required to begin to phase in the new rules beginning on January 1, 2015. Management believes, as of December 31, 2016, that the Company and each of the bank subsidiaries will meet all capital adequacy requirements once the capital conservation is fully phased-in.

Junior Subordinated Deferrable Interest Debentures

The Company has formed six statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. The 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, 2016 and December 31, 2015, the principal amount of debentures outstanding totaled \$160,416,000 and \$161,416,000, respectively. On July 29, 2015, the Company bought back a portion of the Capital Securities of IB Capital Trusts X and XI from the holder of the securities for a price that reflected an approximate 24.5% discount from the redemption prices of the securities. The Company thereby retired \$13,000,000 of the total \$34,021,000 of related Junior Subordinated Deferrable Interest Debentures related to IB Capital Trust X and \$1,000,000 of the total \$27,990,000 of related Junior Subordinated Deferrable Interest Debentures related to IB Capital Trust XI. On November 1, 2016, the Company bought back a portion of the Capital Securities of IB Capital Trust XI from the holder of the securities for a price that reflected an approximate 24% discount from the redemption price of the securities. The Company thereby retired \$1,000,000 of the total \$26,990,000 of related Junior Subordinated Deferrable Interest Debentures related to IB Capital Trust XI. The discounts recorded in connection with the repurchases of the outstanding Capital Securities are included in other income on the consolidated financial statements.

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, 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, 2016 and December 31, 2015, the total \$160,416,000 and \$161,416,000, respectively of the Capital Securities outstanding qualified as Tier 1 capital.

The following table illustrates key information about each of the Debentures and their interest rates at December 31, 2016:

	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	4.36 %	LIBOR + 3.45	November 2032	February 2008
Trust VIII	25,774	Quarterly	3.93 %	LIBOR + 3.05	October 2033	October 2008
Trust IX	41,238	Quarterly	2.47 %	LIBOR + 1.62	October 2036	October 2011
Trust X	21,021	Quarterly	2.54 %	LIBOR + 1.65	February 2037	February 2012
Trust XI	25,990	Quarterly	2.47 %	LIBOR + 1.62	July 2037	July 2012
Trust XII	20,619	Quarterly	2.38 %	LIBOR + 1.45	September 2037	September 2012
	<u>\$ 160,416</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, 2016:

	Total	Payments due by Period (Dollars in Thousands)			
		Less than One Year	One to Three Years	Three to Five Years	After Five Years
Contractual Cash Obligations					
Securities sold under repurchase agreements	\$ 504,985	\$ 203,078	\$ 301,907	\$ —	\$ —
Federal Home Loan Bank borrowings	733,375	733,375	—	—	—
Junior subordinated deferrable interest debentures	160,416	—	—	—	160,416
Operating leases	12,848	3,078	5,498	4,184	88
Total Contractual Cash Obligations	<u>\$ 1,411,624</u>	<u>\$ 939,531</u>	<u>\$ 307,405</u>	<u>\$ 4,184</u>	<u>\$ 160,504</u>

The following table presents contractual commercial commitments of the Company (other than deposit liabilities) as of December 31, 2016:

	Total	Amount of Commitment Expiration Per Period (Dollars in Thousands)			
		Less than One Year	One to Three Years	Three to Five Years	After Five Years
Commercial Commitments					
Financial and Performance Standby Letters of Credit	\$ 88,504	\$ 82,834	\$ 5,486	\$ 184	\$ —
Commercial Letters of Credit	4,650	4,650	—	—	—
Credit Card Lines	18,531	18,531	—	—	—
Other Commercial Commitments	2,262,717	1,377,568	384,848	366,233	134,068
Total Commercial Commitments	<u>\$ 2,374,402</u>	<u>\$ 1,483,583</u>	<u>\$ 390,334</u>	<u>\$ 366,417</u>	<u>\$ 134,068</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 65,989,631 shares of \$1.00 par value Common Stock held by approximately 2,062 holders of record at February 22, 2017. The book value of the Common Stock at December 31, 2016 was \$27.53 per share compared with \$26.11 per share at December 31, 2015. In connection with the Company's participation in the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program") in 2008, the US Treasury received a warrant (the "Warrant") to purchase 1,326,238 shares of the Company's common stock (the "Warrant Shares") at \$24.43 per share. The term of the Warrant is ten years and was immediately exercisable. The Warrant is included as a component of Tier 1 capital. On June 12, 2013, the U. S. Treasury sold the Warrant to a third party. As of February 22, 2017, the Warrant is still outstanding, but expires on December 23, 2018. Adjustments to the \$24.43 per share Exercise Price of the Warrant will be made if the Company pays cash dividends in excess of 33 cents per semi-annual period or makes certain other shareholder distributions before the Warrant expires on December 23, 2018.

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 2016 and 2015, as quoted on the NASDAQ National Market for each of the quarters in the two year period ended December 31, 2016. 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 \$38.70 per share at February 22, 2017.

			High		Low
2016:	First quarter	\$	25.79	\$	21.05
	Second quarter		28.44		22.96
	Third quarter		30.44		24.82
	Fourth quarter		42.25		29.31
			High		Low
2015:	First quarter	\$	26.80	\$	22.47
	Second quarter		27.75		25.32
	Third quarter		27.96		24.02
	Fourth quarter		31.00		23.90

The Company paid cash dividends to the common shareholders of \$.29 per share on April 18, 2016 to all holders of record on April 1, 2016. The Company paid cash dividends to the common shareholders of \$.31 per share on October 17, 2016 to all holders of record on September 30, 2016. The Company paid cash dividends to the common shareholders of \$.29 per share on April 17, 2015 and October 15, 2015 to all holders of record on April 1, 2015 and September 30, 2015.

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 March 11, 2016, 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, 2016, 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. During the fourth quarter of 2016, the Company's Board of Directors adopted a Rule 10b5-1 plan and intends to adopt additional Rule 10b5-1 trading plans that will allow the Company to purchase its shares of common stock during certain trading blackout periods when the Company ordinarily would not be in the market due to trading restrictions in its internal trading policy. During the term of a 10b5-1 Plan, purchases of common stock are automatic to the extent the conditions of the 10b5-1 Plan's trading instructions are met. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of February 22, 2017, a total of 9,240,788 shares had been repurchased under all programs at a cost of \$271,103,000. The Company is not obligated to repurchase shares under its stock repurchase program or to enter into additional Rule 10b5-1 plans. The timing, actual number and value of shares purchased will depend on many factors, including the Company's cash flow and the liquidity and price performance of its shares of common stock.

Except for repurchases in connection with the administration of an employee benefit plan in the ordinary course of business and consistent with past practices, common stock repurchases are only conducted under publicly announced repurchase programs approved by the Board of Directors. The following table includes information about common stock share repurchases for the quarter ended December 31, 2016.

	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, 2016	—	\$ —	—	\$ 40,000,000
November 1 – November 30, 2016	—	—	—	40,000,000
December 1 – December 31, 2016	159	40.88	—	39,993,500
Total	159	\$ 40.88	—	

- (1) The repurchase program was extended on March 11, 2016 and allows for the repurchase of up to an additional \$40,000,000 of treasury stock through April 9, 2017.

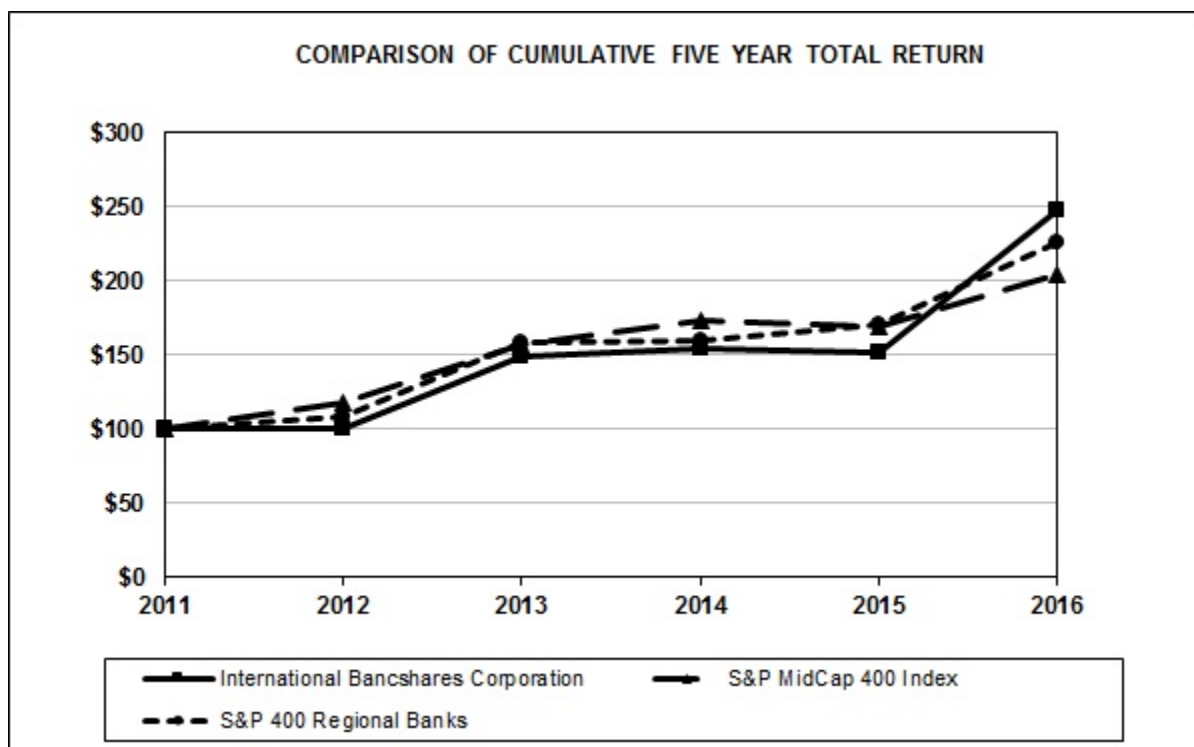
Equity Compensation Plan Information

The following table sets forth information as of December 31, 2016, 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	800,502	\$ 19.24	266,392
Total	800,502	\$ 19.24	266,392

Stock Performance

COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN



Total Return To Shareholders (Includes reinvestment of dividends)

Company / Index	Base Period	INDEXED RETURNS				
		December 31,				
	2011	2012	2013	2014	2015	2016
International Bancshares Corporation	100	100.64	149.64	153.82	152.36	247.27
S&P 500 Index	100	117.88	157.37	172.74	168.98	204.03
S&P 500 Banks	100	108.56	158.00	159.88	170.38	226.64

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, 2016 and 2015, 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, 2016. 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, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, 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, 2016, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 27, 2017 expressed an unqualified opinion on the effectiveness of International Bancshares Corporation and subsidiaries' internal control over financial reporting.

/s/ RSM US LLP

Dallas, Texas
February 27, 2017

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition

December 31, 2016 and 2015

(Dollars in Thousands, Except Per Share Amounts)

	December 31, 2016	December 31, 2015
Assets		
Cash and cash equivalents	\$ 269,198	\$ 273,053
Investment securities:		
Held to maturity (Market value of \$2,400 on December 31, 2016 and \$2,400 on December 31, 2015)	2,400	2,400
Available for sale (Amortized cost of \$4,218,841 on December 31, 2016 and \$4,196,034 on December 31, 2015)	4,177,349	4,199,372
Total investment securities	4,179,749	4,201,772
Loans	5,964,688	5,950,914
Less allowance for probable loan losses	(64,661)	(66,988)
Net loans	5,900,027	5,883,926
Bank premises and equipment, net	527,583	516,716
Accrued interest receivable	32,172	31,572
Other investments	517,162	468,791
Identified intangible assets, net	25	153
Goodwill	282,532	282,532
Other assets	95,593	114,354
Total assets	<u>\$ 11,804,041</u>	<u>\$ 11,772,869</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition Continued

December 31, 2016 and 2015

(Dollars in Thousands, Except Per Share Amounts)

	December 31, 2016	December 31, 2015
Liabilities and Shareholders' Equity		
Liabilities:		
Deposits:		
Demand—non-interest bearing	\$ 3,158,051	\$ 3,149,618
Savings and interest bearing demand	3,203,728	3,020,222
Time	<u>2,248,310</u>	<u>2,366,413</u>
Total deposits	8,610,089	8,536,253
Securities sold under repurchase agreements	504,985	827,772
Other borrowed funds	733,375	505,750
Junior subordinated deferrable interest debentures	160,416	161,416
Other liabilities	70,509	76,175
Total liabilities	<u>10,079,374</u>	<u>10,107,366</u>
Shareholders' equity:		
Common shares of \$1.00 par value. Authorized 275,000,000 shares; issued 95,910,143 shares on December 31, 2016 and 95,866,218 shares on December 31, 2015	95,910	95,866
Surplus	169,567	167,980
Retained earnings	1,777,963	1,683,600
Accumulated other comprehensive (loss) income (including \$(3,287) on December 31, 2016 and \$(4,026) on December 31, 2015 of comprehensive loss related to other-than-temporary impairment for non-credit related issues)	<u>(26,697)</u>	<u>2,167</u>
	2,016,743	1,949,613
Less cost of shares in treasury, 29,934,675 shares on December 31, 2016 and 29,585,646 on December 31, 2015	<u>(292,076)</u>	<u>(284,110)</u>
Total shareholders' equity	<u>1,724,667</u>	<u>1,665,503</u>
Total liabilities and shareholders' equity	<u>\$ 11,804,041</u>	<u>\$ 11,772,869</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2016, 2015 and 2014

(Dollars in Thousands, Except Per Share Amounts)

	2016	2015	2014
Interest income:			
Loans, including fees	\$ 297,820	\$ 297,283	\$ 281,546
Investment securities:			
Taxable	79,533	88,008	100,095
Tax-exempt	10,356	11,319	11,767
Other interest income	205	144	191
Total interest income	<u>387,914</u>	<u>396,754</u>	<u>393,599</u>
Interest expense:			
Savings deposits	4,562	3,593	3,597
Time deposits	9,963	11,233	12,033
Securities sold under repurchase agreements	20,876	23,777	24,616
Other borrowings	3,128	1,615	2,033
Junior subordinated deferrable interest debentures	4,600	4,099	4,264
Total interest expense	<u>43,129</u>	<u>44,317</u>	<u>46,543</u>
Net interest income	344,785	352,437	347,056
Provision for probable loan losses	<u>19,859</u>	<u>24,405</u>	<u>14,423</u>
Net interest income after provision for probable loan losses	<u>324,926</u>	<u>328,032</u>	<u>332,633</u>
Non-interest income:			
Service charges on deposit accounts	73,581	78,825	88,586
Other service charges, commissions and fees			
Banking	46,267	44,971	44,435
Non-banking	7,006	7,223	7,463
Investment securities transactions, net	(2,626)	(3,682)	1,283
Other investments, net	23,827	16,969	22,023
Other income	<u>13,647</u>	<u>11,428</u>	<u>14,558</u>
Total non-interest income	<u>161,702</u>	<u>155,734</u>	<u>178,348</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued

Years ended December 31, 2016, 2015 and 2014

(Dollars in Thousands, Except Per Share Amounts)

	2016	2015	2014
Non-interest expense:			
Employee compensation and benefits	\$ 128,661	\$ 125,135	\$ 121,511
Occupancy	26,583	28,019	32,530
Depreciation of bank premises and equipment	24,738	25,009	24,013
Professional fees	13,672	12,278	10,925
Deposit insurance assessments	5,777	5,938	6,082
Net expense, other real estate owned	5,688	5,695	2,358
Amortization of identified intangible assets	128	644	2,389
Advertising	7,814	7,585	7,742
Early termination fee—securities sold under repurchase agreements	7,042	3,510	11,000
Software and software maintenance	15,087	11,225	9,824
Impairment charges (Total other-than-temporary impairment charges, \$793 net of \$1,147, \$371, net of \$1,325, and \$(366), net of \$(1,183), included in other comprehensive loss)	354	954	817
Other	<u>54,081</u>	<u>50,932</u>	<u>51,852</u>
Total non-interest expense	<u>289,625</u>	<u>276,924</u>	<u>281,043</u>
Income before income taxes	197,003	206,842	229,938
Provision for income taxes	<u>63,071</u>	<u>70,116</u>	<u>76,787</u>
Net income	<u>\$ 133,932</u>	<u>\$ 136,726</u>	<u>\$ 153,151</u>
Basic earnings per common share:			
Weighted average number of shares outstanding	65,967,989	66,411,193	66,872,500
Net income	<u>\$ 2.03</u>	<u>\$ 2.06</u>	<u>\$ 2.29</u>
Fully diluted earnings per common share:			
Weighted average number of shares outstanding	66,313,490	66,636,353	67,056,456
Net income	<u>\$ 2.02</u>	<u>\$ 2.05</u>	<u>\$ 2.28</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Years ended December 31, 2016, 2015, and 2014

(Dollars in Thousands)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Net income	\$ 133,932	\$ 136,726	\$ 153,151
Other comprehensive income (loss), net of tax:			
Net unrealized holding (losses) gains on securities available for sale arising during period (net of tax effects of \$(16,585), \$(6,593), and \$29,870)	(30,801)	(12,243)	55,474
Reclassification adjustment for losses (gains) on securities available for sale included in net income (net of tax effects of \$919, \$1,289, and \$(449))	1,707	2,393	(834)
Reclassification adjustment for impairment charges on available for sale securities included in net income (net of tax effects of \$124, \$334, and \$286)	230	620	531
	<u>(28,864)</u>	<u>(9,230)</u>	<u>55,171</u>
Comprehensive income	<u>\$ 105,068</u>	<u>\$ 127,496</u>	<u>\$ 208,322</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Years ended December 31, 2016, 2015 and 2014

(in Thousands, except per share amounts)

	Preferred Stock	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2013	\$ —	95,744	\$ 95,744	\$ 163,947	\$ 1,467,000	\$ (43,774)	\$ (258,509)	\$ 1,424,408
Net Income	—	—	—	—	153,151	—	—	153,151
Dividends:								
Cash (\$.43 per share)	—	—	—	—	(34,762)	—	—	(34,762)
Purchase of treasury (787,387 shares)	—	—	—	—	—	—	(18,923)	(18,923)
Exercise of stock options	—	40	40	515	—	—	—	555
Stock compensation expense recognized in earnings	—	—	—	1,058	—	—	—	1,058
Other comprehensive (loss), net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustment	—	—	—	—	—	55,171	—	55,171
Balance at December 31, 2014	—	95,784	95,784	165,520	1,585,389	11,397	(277,432)	1,580,658
Net Income	—	—	—	—	136,726	—	—	136,726
Dividends:								
Cash (\$.58 per share)	—	—	—	—	(38,515)	—	—	(38,515)
Purchase of treasury (261,079 shares)	—	—	—	—	—	—	(6,678)	(6,678)
Exercise of stock options	—	82	82	1,288	—	—	—	1,370
Stock compensation expense recognized in earnings	—	—	—	1,172	—	—	—	1,172
Other comprehensive (loss), net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	—	(9,230)	—	(9,230)
Balance at December 31, 2015	—	95,866	\$ 95,866	\$ 167,980	\$ 1,683,600	\$ 2,167	\$ (284,110)	\$ 1,665,503
Net Income	—	—	—	—	133,932	—	—	133,932
Dividends:								
Cash (\$.60 per share)	—	—	—	—	(39,569)	—	—	(39,569)
Purchase of treasury (349,029 shares)	—	—	—	—	—	—	(7,966)	(7,966)
Exercise of stock options	—	44	44	505	—	—	—	549
Stock compensation expense recognized in earnings	—	—	—	1,082	—	—	—	1,082
Other comprehensive income, net of tax:								
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	—	(28,864)	—	(28,864)
Balance at December 31, 2016	—	95,910	\$ 95,910	\$ 169,567	\$ 1,777,963	\$ (26,697)	\$ (292,076)	\$ 1,724,667

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2016, 2015 and 2014

(Dollars in Thousands)

	2016	2015	2014
Operating activities:			
Net income	\$ 133,932	\$ 136,726	\$ 153,151
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for probable loan losses	19,859	24,405	14,423
Specific reserve, other real estate owned	2,351	1,023	779
Depreciation of bank premises and equipment	24,738	25,009	24,013
(Gain) loss on sale of bank premises and equipment	(450)	14	(3,658)
Loss (gain) on sale of other real estate owned	86	(57)	(933)
Accretion of investment securities discounts	(539)	(1,704)	(2,608)
Amortization of investment securities premiums	26,873	28,000	26,729
Investment securities transactions, net	2,626	3,682	(1,283)
Impairment charges on available for sale securities	354	954	817
Amortization of identified intangible assets	128	644	2,389
Stock based compensation expense	1,082	1,172	1,058
Earnings from affiliates and other investments	(14,315)	(12,176)	(10,903)
Deferred tax expense (benefit)	7,306	(332)	(1,027)
Increase in accrued interest receivable	(600)	(111)	(807)
Decrease (increase) in other assets	7,494	2,967	(1,621)
Net increase in other liabilities	(7,705)	(6,567)	(7,482)
Net cash provided by operating activities	203,220	203,649	193,037
Investing activities:			
Proceeds from maturities of securities	1,200	1,075	—
Proceeds from sales and calls of available for sale securities	352,743	164,163	621,588
Purchases of available for sale securities	(1,325,657)	(352,513)	(971,358)
Principal collected on mortgage backed securities	919,594	854,736	787,361
Net increase in loans	(38,523)	(297,689)	(502,129)
Purchases of other investments	(49,013)	(16,355)	(20,602)
Distributions from other investments	23,276	18,293	18,152
Purchases of bank premises and equipment	(38,856)	(19,831)	(50,360)
Proceeds from sales of bank premises and equipment	3,701	4,515	8,424
Proceeds from sales of other real estate owned	13,772	16,831	18,525
Net cash (used in) provided by investing activities	(137,763)	373,225	(90,399)

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Continued)

Years ended December 31, 2016, 2015 and 2014

(Dollars in Thousands)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Financing activities:			
Net increase in non-interest bearing demand deposits	\$ 8,433	\$ 219,365	\$ 263,743
Net increase (decrease) in savings and interest bearing demand deposits	183,506	(5,458)	100,068
Net decrease in time deposits	(118,103)	(116,279)	(168,611)
Net decrease in securities sold under repurchase agreements	(322,787)	(30,578)	(99,031)
Net increase (decrease) in other borrowed funds	227,625	(568,194)	(150,006)
Redemption of long-term debt	(1,000)	(14,000)	(15,310)
Purchase of treasury stock	(7,966)	(6,678)	(18,923)
Proceeds from stock transactions	549	1,370	555
Payments of cash dividends - common	(39,569)	(38,515)	(34,762)
Net cash used in financing activities	<u>(69,312)</u>	<u>(558,967)</u>	<u>(122,277)</u>
(Decrease) increase in cash and cash equivalents	(3,855)	17,907	(19,639)
Cash and cash equivalents at beginning of year	<u>273,053</u>	<u>255,146</u>	<u>274,785</u>
Cash and cash equivalents at end of year	<u>\$ 269,198</u>	<u>\$ 273,053</u>	<u>\$ 255,146</u>
Supplemental cash flow information:			
Interest paid	\$ 44,069	\$ 44,560	\$ 47,273
Income taxes paid	49,925	65,234	80,374
Non-cash investing and financing activities:			
Net transfers from loans to other real estate owned	2,563	3,775	2,363

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., IBC Charitable and Community Development Corporation, 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 one insurance-related subsidiary, IBC Insurance Agency, Inc., a wholly owned subsidiary of IBC, the bank subsidiary. The insurance-related subsidiary does not conduct underwriting activities.

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

Subsequent Events

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.

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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

accumulated other comprehensive income until realized. The Company did not maintain any trading securities during the three year period ended December 31, 2016.

Mortgage-backed securities held at December 31, 2016 and 2015 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.

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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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.

Troubled Debt Restructured Loans

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

Non-Accrual Loans

The non-accrual loan policy of 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 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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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 through a valuation allowance. Other real estate owned totaled approximately \$42,204,000 and \$55,850,000 at December 31, 2016 and 2015, 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 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, 2016 and 2015, 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, 2016, 2015 and 2014, 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 2013.

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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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, 2016, 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 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, 2016, 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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. The Company applies the provisions of ASC Topic 280, "Segment Reporting," in determining its reportable segments and related disclosures.

Comprehensive Income (Loss)

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

Advertising

Advertising costs are expensed as incurred.

Reclassifications

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

New Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09 to ASC 606, "Revenue from Contracts with Customers." The update sets a common standard that defines revenue and the principles for recognizing revenue. The update outlines when an entity should recognize revenue, among other matters. At its core, the update states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The update also outlines the steps that entities should take to determine and record the correct revenue number. The update was originally effective for annual periods beginning after December 15, 2016 and the interim periods within that reporting period. In August 2015, the FASB issued accounting Standards Update No. 2015-14 which deferred the effective date of Accounting Standards Update No. 2014-09 by one year to annual and interim periods beginning after December 15, 2017. The Company's revenue is primarily comprised of net interest income on financial assets and financial liabilities and non-interest income, which is explicitly excluded from the scope of the update. The Company will continue to evaluate the impact of the update on certain other revenue items, such as the sales of other real estate, however, the adoption of the update is not expected to have a significant impact on the Company's consolidated financial statements.

In January 2015, the FASB issued Accounting Standards Update No. 2015-01 to ASC 225-20, "Income Statement- Extraordinary and Unusual Items." The update amends existing standards and is being issued as part of the FASB's initiative to reduce complexity in accounting standards. The update eliminates the concept of extraordinary items. The update is effective for interim and annual periods after December 15, 2015. The adoption of the update did not have a significant impact to the Company's consolidated financial statements.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02 to ASC 810, "Consolidation." The update amends existing standards regarding the evaluation of certain legal entities and their consolidation in the financial statements. The amendments modify the evaluation process to assess whether limited partnerships and similar

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

legal entities are variable interest entities or voting interest entities, eliminate the presumption that a general partner should consolidate a limited partnership, affect the consolidation analysis of entities that are involved in variable interest entities, particularly those that have fee arrangements and related party relationships and provides a scope exception for reporting entities with legal interests that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The update is effective for interim and annual periods after December 15, 2015. The adoption of the update to existing standards did not have a significant impact to the Company's consolidated financial statements.

In September 2015, the FASB issued Accounting Standards Update No. 2015-16 to ASC 805, "Business Combinations." The update amends existing standards regarding the methodology used to recognize adjustments related to provisional amounts that are identified during the measurement period of a business combination. The update requires that adjustments to provisional amounts be recognized in the reporting period in which the adjustment amounts are determined. The update requires that the reporting entity disclose on the face of the income statement or in the notes, the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The update is effective for interim and annual periods after December 15, 2015. The adoption of the update to existing standards did not have a significant impact to the Company's consolidated financial statements.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01 to ASC 825-10, "Financial Instruments – Overall." The update amends existing standards regarding certain aspects of recognition and measurement of financial assets and financial liabilities. The amendments in the update establish the following guidance: (i) requires equity investments, except those accounted for under the equity method of accounting or those that result in consolidation of the investee, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity securities without readily determinable fair values by requiring a qualitative assessment, (iii) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities, (iv) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (v) requires public business entities to use the exit price notion when measuring fair value for disclosure purposes, (vi) requires an entity to present separately, in other comprehensive income, the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option, (vii) requires separate presentation of financial assets and liabilities by measurement category and form of financial assets on the balance sheet or in the accompanying notes to the financial statements, and (viii) clarifies that an entity should evaluate the need to a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The update is effective for interim and annual periods beginning after December 15, 2017. The adoption of the update is not expected to have a significant impact to the Company's consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02 to ASC 820, "Leases." The update amends existing standards for accounting for leases by lessees, with accounting for leases by lessors remaining mainly unchanged from current guidance. The update requires that lessees recognize a lease liability and a right of use asset for all leases (with the exception of short-term leases) at the commencement date of the lease and disclose key information about leasing arrangements. The update is effective for interim and annual periods beginning after December 15, 2015 and is to be applied on a modified retrospective basis. The Company is evaluating the potential impact to the Company's consolidated financial statements.

In March 2016, the FB issued Accounting Standards Update No. 2016-09 to ASC 718, "Compensation – Stock Compensation." The update amends existing standards for accounting for share-based payment transactions, including the income tax effects, the classification of awards on the balance sheet and the classification on the statement of cash flows. The update is effective for annual and interim periods after December 15, 2016. The adoption of the update is not expected to have a significant impact to the Company's consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 to ASC 326, "Financial Instruments – Credit Losses." The update amends existing standards for accounting for credit losses for financial assets. The update

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Notes to Consolidated Financial Statements (Continued)

requires that the expected credit losses on the financial instruments held as of the end of the period being reported be measured based on historical experience, current conditions, and reasonable and supportable forecasts. The update also expands the required disclosures related to significant estimates and judgements used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's financial assets. The update also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The update is effective for interim and annual periods beginning after December 15, 2019. The Company is evaluating the potential impact of the update on the Company's consolidated financial statements.

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

(2) Investment Securities

The amortized cost and estimated fair value by type of investment security at December 31, 2016 are as follows:

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

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value ⁽¹⁾
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 3,946,144	\$ 18,246	\$ (69,920)	\$ 3,894,470	\$ 3,894,470
Obligations of states and political subdivisions	244,622	10,783	(433)	254,972	254,972
Equity securities	28,075	314	(482)	27,907	27,907
Total investment securities	\$ 4,218,841	\$ 29,343	\$ (70,835)	\$ 4,177,349	\$ 4,177,349

- (1) Included in the carrying value of residential mortgage-backed securities are \$850,033 of mortgage-backed securities issued by Ginnie Mae, \$3,026,832 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and \$17,605 issued by non-government entities

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The amortized cost and estimated fair value of investment securities at December 31, 2016, 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	—	—	1,218	1,288
Due after ten years	—	—	243,404	253,684
Residential mortgage-backed securities	—	—	3,946,144	3,894,470
Equity securities	—	—	28,075	27,907
Total investment securities	<u>\$ 2,400</u>	<u>\$ 2,400</u>	<u>\$ 4,218,841</u>	<u>\$ 4,177,349</u>

The amortized cost and estimated fair value by type of investment security at December 31, 2015 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	\$ 3,908,809	\$ 30,959	\$ (46,557)	\$ 3,893,211	\$ 3,893,211
Obligations of states and political subdivisions	259,150	18,579	(25)	277,704	277,704
Equity securities	28,075	627	(245)	28,457	28,457
Total investment securities	<u>\$ 4,196,034</u>	<u>\$ 50,165</u>	<u>\$ (46,827)</u>	<u>\$ 4,199,372</u>	<u>\$ 4,199,372</u>

(1) Included in the carrying value of residential mortgage-backed securities are \$1,147,143 of mortgage-backed securities issued by Ginnie Mae, \$2,724,839 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and \$21,229 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 \$1,780,513,000 and \$1,754,763,000, respectively, at December 31, 2016.

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Notes to Consolidated Financial Statements (Continued)

Proceeds from the sale and call of securities available-for-sale were \$352,743,000 \$164,163,000 and \$621,588,000 during 2016, 2015 and 2014, respectively, which amounts included \$338,138,000, \$128,444,000 and \$620,933 of mortgage-backed securities. Gross gains of \$586,000, \$2,450,000 and \$9,479,000 and gross losses of \$3,212,000, \$6,132,000 and \$8,196,000 were realized on the sales in 2016, 2015 and 2014, respectively.

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, 2016 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	\$ 2,513,872	\$ (52,245)	\$ 396,695	\$ (17,675)	\$ 2,910,567	\$ (69,920)
Obligations of states and political subdivisions	31,104	(433)	—	—	31,104	(433)
Equity securities	14,066	(184)	5,452	(298)	19,518	(482)
	<u>\$ 2,559,042</u>	<u>\$ (52,862)</u>	<u>\$ 402,147</u>	<u>\$ (17,973)</u>	<u>\$ 2,961,189</u>	<u>\$ (70,835)</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, 2015 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	\$ 1,083,137	\$ (9,333)	\$ 1,454,550	\$ (37,224)	\$ 2,537,687	\$ (46,557)
Obligations of states and political subdivisions	6,814	(19)	544	(6)	7,358	(25)
Equity securities	5,041	(35)	5,540	(210)	10,581	(245)
	<u>\$ 1,094,992</u>	<u>\$ (9,387)</u>	<u>\$ 1,460,634</u>	<u>\$ (37,440)</u>	<u>\$ 2,555,626</u>	<u>\$ (46,827)</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 more likely than 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 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 \$354,000 (\$230,100 after tax), was recorded in 2016 on the non-agency residential mortgage backed securities. Impairment charges of \$954,000 (\$620,100, after tax) and \$817,000 (\$531,050, after tax) were recorded in 2015 and 2014, respectively on the non-agency residential mortgage backed securities. The impairment charges represent the credit related impairment on the securities.

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Notes to Consolidated Financial Statements (Continued)

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 likely than 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, 2016 (in Thousands):

Balance at December 31, 2015	\$	13,577
Impairment charges recognized during period		354
Balance at December 31, 2016	\$	<u>13,931</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, 2015 (in Thousands):

Balance at December 31, 2014	\$	12,623
Impairment charges recognized during period		954
Balance at December 31, 2015	\$	<u>13,577</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, 2014 (in Thousands):

Balance at December 31, 2013	\$	11,806
Impairment charges recognized during period		817
Balance at December 31, 2014	\$	<u>12,623</u>

(3) Loans

A summary of loans, by loan type at December 31, 2016 and 2015 is as follows:

	December 31, 2016	December 31, 2015
	(Dollars in Thousands)	
Commercial, financial and agricultural	\$ 2,993,203	\$ 3,101,748
Real estate - mortgage	1,032,222	962,582
Real estate - construction	1,716,875	1,649,827
Consumer	55,168	57,744
Foreign	167,220	179,013
Total loans	<u>\$ 5,964,688</u>	<u>\$ 5,950,914</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

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Notes to Consolidated Financial Statements (Continued)

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.

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 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 U.S. economy continues to face uncertainty, with particular attention being paid to continued depressed oil and gas prices, the unprecedented debt and trade deficit of the United States, possible interest rate movement, political changes, the continued impact of overseas markets on the U.S. and the negative impact on US exports and cross border trade between the U.S. and Mexico arising from the strength of the U.S. dollar. Although the Texas and Oklahoma economies continue to perform better than the U.S. economy as a whole, the same issues that are creating uncertainty in the U.S. economy may also negatively impact the economies of Texas and Oklahoma. Economic 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 in which the bank subsidiaries invest.

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

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

Commercial real estate loans demonstrate a risk of repayment when market values deteriorate, the business experiences turnover in key management, the business has an inability to attract or keep occupancy levels stable, or

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Notes to Consolidated Financial Statements (Continued)

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.

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

	December 31, 2016								
	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,	\$ 21,431	\$ 13,920	\$ 19,769	\$ 1,248	\$ 3,509	\$ 5,321	\$ 638	\$ 1,152	\$ 66,988
Losses charge to allowance	(32,959)	(16)	(1,890)	(180)	(70)	(331)	(414)	(41)	(35,901)
Recoveries credited to allowance	7,110	6,099	119	—	21	278	69	19	13,715
Net losses charged to allowance	(25,849)	6,083	(1,771)	(180)	(49)	(53)	(345)	(22)	(22,186)
Provision (credit) charged to operations	30,067	(6,114)	(1,267)	(262)	(1,005)	(1,552)	238	(246)	19,859
Balance at December 31,	<u>\$ 25,649</u>	<u>\$ 13,889</u>	<u>\$ 16,731</u>	<u>\$ 806</u>	<u>\$ 2,455</u>	<u>\$ 3,716</u>	<u>\$ 531</u>	<u>\$ 884</u>	<u>\$ 64,661</u>
	December 31, 2015								
	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,	\$ 22,352	\$ 12,955	\$ 18,683	\$ 846	\$ 3,589	\$ 4,683	\$ 660	\$ 1,060	\$ 64,828
Losses charge to allowance	(24,802)	(695)	(492)	—	(157)	(275)	(704)	—	(27,125)
Recoveries credited to allowance	3,135	141	963	—	30	431	170	10	4,880
Net losses charged to allowance	(21,667)	(554)	471	—	(127)	156	(534)	10	(22,245)
Provision (credit) charged to operations	20,746	1,519	615	402	47	482	512	82	24,405
Balance at December 31,	<u>\$ 21,431</u>	<u>\$ 13,920</u>	<u>\$ 19,769</u>	<u>\$ 1,248</u>	<u>\$ 3,509</u>	<u>\$ 5,321</u>	<u>\$ 638</u>	<u>\$ 1,152</u>	<u>\$ 66,988</u>
	December 31, 2014								
	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,	\$ 22,433	\$ 12,541	\$ 24,467	\$ 776	\$ 3,812	\$ 4,249	\$ 750	\$ 1,133	\$ 70,161
Losses charge to allowance	(19,110)	(680)	(1,893)	—	(351)	(661)	(719)	(51)	(23,465)
Recoveries credited to allowance	2,979	72	107	—	49	242	210	50	3,709
Net losses charged to allowance	(16,131)	(608)	(1,786)	—	(302)	(419)	(509)	(1)	(19,756)
Provision (credit) charged to operations	16,050	1,022	(3,998)	70	79	853	419	(72)	14,423
Balance at December 31,	<u>\$ 22,352</u>	<u>\$ 12,955</u>	<u>\$ 18,683</u>	<u>\$ 846</u>	<u>\$ 3,589</u>	<u>\$ 4,683</u>	<u>\$ 660</u>	<u>\$ 1,060</u>	<u>\$ 64,828</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 increase in losses charged to the allowance for probable loan losses for the year ended December 31, 2016 can be attributed to further deterioration in a previously identified and charged down

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relationship primarily secured by multiple pieces of transportation equipment. In March 2016, litigation against the management of the borrower was filed in the State of Nevada, resulting in a going concern issue with the borrower's operations and the future use of the transportation equipment pledged as collateral on the relationship. As a result, management, in accordance with its credit review procedures, re-evaluated the collateral values on the equipment in light of the new circumstances and reduced the collateral values accordingly, resulting in a further charge-down of the relationship of approximately \$19.4 million, which is included in the losses charged to the allowance in the commercial category in the table detailing the year ended December 31, 2016 activity. The impact of the charge-down is also reflected in the various tables in this Note including impaired loans, non-accrual loans and the credit quality indicator summary. The relationship was classified as Watch-List Impaired at December 31, 2015. Two large recoveries on loans charged off in prior years are included in the recoveries credited to the allowance in the table detailing activity for the year ended December 31, 2016. The recoveries occurred in the first and third quarters of 2016 in the amounts of \$4.4 million and \$6 million, respectively and are included in the Commercial and Commercial Real Estate: Other Construction and Land Development categories. The increase in charge-offs for the years ended December 31, 2015 and 2014 in the Commercial category can be attributed to a charge down of the previously discussed relationship that is primarily secured by multiple pieces of transportation equipment. The relationship was charged down by \$13.5 million and \$8.5 million for the years ended December 31, 2015 and December 31, 2014, respectively.

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, 2016			
	Loans Individually Evaluated For Impairment		Loans Collectively Evaluated For Impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$ 22,412	\$ —	\$ 887,255	\$ 25,649
Commercial real estate: other construction & land development	4,776	371	1,712,099	13,518
Commercial real estate: farmland & commercial	10,810	546	1,932,260	16,185
Commercial real estate: multifamily	552	—	139,914	806
Residential: first lien	6,836	44	415,068	2,411
Residential: junior lien	978	—	609,340	3,716
Consumer	1,295	—	53,873	531
Foreign	746	—	166,474	884
Total	\$ 48,405	\$ 961	\$ 5,916,283	\$ 63,700

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Notes to Consolidated Financial Statements (Continued)

	December 31, 2015			
	Loans Individually Evaluated For Impairment		Loans Collectively Evaluated For Impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$ 30,946	\$ 1,704	\$ 935,905	\$ 19,727
Commercial real estate: other construction & land development	6,221	100	1,643,606	13,820
Commercial real estate: farmland & commercial	13,806	202	1,981,643	19,567
Commercial real estate: multifamily	777	200	138,671	1,048
Residential: first lien	5,699	—	404,545	3,509
Residential: junior lien	950	—	551,388	5,321
Consumer	1,297	—	56,447	638
Foreign	752	—	178,261	1,152
Total	<u>\$ 60,448</u>	<u>\$ 2,206</u>	<u>\$ 5,890,466</u>	<u>\$ 64,782</u>

Loans accounted for on a non-accrual basis at December 31, 2016, 2015 and 2014 amounted to \$37,245,000, \$47,685,000 and \$63,559,000, respectively. The effect of such non-accrual loans reduced interest income by approximately \$2,461,800, \$3,298,000 and \$4,013,000 for the years ended December 31, 2016, 2015 and 2014, respectively. Amounts received on non-accruals are applied, for financial accounting purposes, first to principal and then to interest after all principal has been collected. Accruing loans contractually past due 90 days or more as to principal or interest payments at December 31, 2016, 2015 and 2014 amounted to approximately \$5,226,000, \$11,616,000 and \$9,988,000, respectively.

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

	December 31, 2016	December 31, 2015
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 22,369	\$ 30,894
Commercial real estate: other construction & land development	4,776	3,668
Commercial real estate: farmland & commercial	8,314	11,543
Commercial real estate: multifamily	552	777
Residential: first lien	655	383
Residential: junior lien	166	21
Consumer	26	34
Foreign	387	365
Total non-accrual loans	<u>\$ 37,245</u>	<u>\$ 47,685</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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The following tables detail key information regarding the Company's impaired loans by loan class for the year ended December 31, 2016:

	December 31, 2016				
	<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 real estate: other construction & land development	\$ 1,958	\$ 1,971	\$ 371	\$ 2,512	\$ —
Commercial real estate: farmland & commercial	2,808	3,948	546	3,247	—
Residential: first lien	62	62	44	62	—
Total impaired loans with related allowance	<u>\$ 4,828</u>	<u>\$ 5,981</u>	<u>\$ 961</u>	<u>\$ 5,821</u>	<u>\$ —</u>

	December 31, 2016				
	<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	\$ 21,412	\$ 50,737	\$ 19,354	\$ 3	
Commercial real estate: other construction & land development	2,818	4,419	2,336	67	
Commercial real estate: farmland & commercial	8,002	9,054	8,523	110	
Commercial real estate: multifamily	552	562	401	—	
Residential: first lien	6,774	6,847	6,860	298	
Residential: junior lien	978	1,017	1,011	52	
Consumer	1,295	1,295	1,214	1	
Foreign	746	746	751	16	
Total impaired loans with no related allowance	<u>\$ 42,577</u>	<u>\$ 74,677</u>	<u>\$ 40,450</u>	<u>\$ 547</u>	

The following tables detail key information regarding the Company's impaired loans by loan class for the year ended December 31, 2015:

	December 31, 2015				
	<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	\$ 4,016	\$ 4,156	\$ 1,704	\$ 3,758	\$ —
Commercial real estate: other construction & land development	167	169	100	893	—
Commercial real estate: farmland & commercial	4,003	4,309	202	444	92
Commercial real estate: multifamily	599	599	200	599	—
Total impaired loans with related allowance	<u>\$ 8,785</u>	<u>\$ 9,233</u>	<u>\$ 2,206</u>	<u>\$ 5,694</u>	<u>\$ 92</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

	December 31, 2015			
	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Recognized
(Dollars in Thousands)				
Loans with No Related Allowance				
Domestic				
Commercial	\$ 26,930	\$ 38,845	\$ 30,847	\$ 4
Commercial real estate: other construction & land development	6,054	6,204	6,455	85
Commercial real estate: farmland & commercial	9,803	10,717	7,258	—
Commercial real estate: multifamily	178	178	205	—
Residential: first lien	5,699	5,822	5,853	264
Residential: junior lien	950	972	1,182	68
Consumer	1,297	1,298	1,227	3
Foreign	752	752	548	17
Total impaired loans with no related allowance	<u>\$ 51,663</u>	<u>\$ 64,788</u>	<u>\$ 53,575</u>	<u>\$ 441</u>

A portion of the impaired loans have adequate collateral and credit enhancements not requiring a related allowance for loan loss. 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.

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.

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

	December 31, 2016	December 31, 2015
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 10,710	\$ 2,419
Commercial real estate: other construction & land development	—	2,553
Commercial real estate: farmland & commercial	3,086	2,853
Residential: first lien	6,181	5,316
Residential: junior lien	812	929
Consumer	1,269	1,263
Foreign	360	386
Total troubled debt restructuring	<u>\$ 22,418</u>	<u>\$ 15,719</u>

The increase in loans accounted for as troubled debt restructurings for December 31, 2016 is due to the renewal of an impaired loan that was previously charged down. The loan is primarily secured by multiple pieces of transportation equipment, as previously discussed with respect to the detail in the changes in the allowance for probable loan losses in this Note. The loan remains on non-accrual status and is included in total impaired loans in the various tables in this Note.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (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, 2016 and December 31, 2015, 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, 2016							
	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	\$ 4,081	\$ 829	\$ 21,123	\$ 392	\$ 26,033	\$ 883,634	\$ 909,667
Commercial real estate: other construction & land development	1,502	396	4,456	9	6,354	1,710,521	1,716,875
Commercial real estate: farmland & commercial	3,454	3,054	6,150	289	12,658	1,930,412	1,943,070
Commercial real estate: multifamily	44	—	552	—	596	139,870	140,466
Residential: first lien	5,615	1,350	4,143	3,756	11,108	410,796	421,904
Residential: junior lien	762	178	540	382	1,480	608,838	610,318
Consumer	910	95	413	387	1,418	53,750	55,168
Foreign	931	425	397	11	1,753	165,467	167,220
Total past due loans	<u>\$ 17,299</u>	<u>\$ 6,327</u>	<u>\$ 37,774</u>	<u>\$ 5,226</u>	<u>\$ 61,400</u>	<u>\$ 5,903,288</u>	<u>\$ 5,964,688</u>

December 31, 2015							
	30 - 59 Days	60 - 89 Days	90 Days or Greater	90 Days or greater & still accruing	Total Past Due	Current	Total Portfolio
(Dollars in Thousands)							
Domestic							
Commercial	\$ 3,361	\$ 940	\$ 28,615	\$ 2,566	\$ 32,916	\$ 933,936	\$ 966,852
Commercial real estate: other construction & land development	193	293	3,502	—	3,988	1,645,839	1,649,827
Commercial real estate: farmland & commercial	2,684	1,328	8,292	3,373	12,304	1,983,144	1,995,448
Commercial real estate: multifamily	49	442	826	49	1,317	138,131	139,448
Residential: first lien	5,299	1,545	4,295	4,093	11,139	399,105	410,244
Residential: junior lien	713	413	646	640	1,772	550,566	552,338
Consumer	646	175	487	453	1,308	56,436	57,744
Foreign	2,639	83	807	442	3,529	175,484	179,013
Total past due loans	<u>\$ 15,584</u>	<u>\$ 5,219</u>	<u>\$ 47,470</u>	<u>\$ 11,616</u>	<u>\$ 68,273</u>	<u>\$ 5,882,641</u>	<u>\$ 5,950,914</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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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 in accordance with the provision of ASC 310-10, “Receivables,” and, if deemed necessary, a specific reserve is allocated to the credit. The specific reserve allocated under ASC 310-10, is based on (i) the present value of expected future cash flows discounted at the loan’s effective interest rate; (ii) the loan’s observable market price; or (iii) the fair value of the collateral if the loan is collateral dependent. Substantially all of 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. 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:

	Pass	December 31, 2016			
		Special Review	Watch List—Pass	Watch List—Substandard	Watch List—Impaired
		(Dollars in Thousands)			
Domestic					
Commercial	\$ 720,350	\$ 90,746	\$ 1,121	\$ 75,038	\$ 22,412
Commercial real estate: other construction & land development	1,648,633	1,986	—	61,480	4,776
Commercial real estate: farmland & commercial	1,792,542	7,983	59,872	71,863	10,810
Commercial real estate: multifamily	139,914	—	—	—	552
Residential: first lien	413,638	814	—	616	6,836
Residential: junior lien	609,190	150	—	—	978
Consumer	53,873	—	—	—	1,295
Foreign	166,474	—	—	—	746
Total	\$ 5,544,614	\$ 101,679	\$ 60,993	\$ 208,997	\$ 48,405

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

	Pass	December 31, 2015			
		Special Review	Watch List—Pass	Watch List—Substandard	Watch List—Impaired
		(Dollars in Thousands)			
Domestic					
Commercial	\$ 771,999	\$ 42,152	\$ 31,539	\$ 90,215	\$ 30,946
Commercial real estate: other construction & land development	1,582,683	1,164	13,765	45,994	6,221
Commercial real estate: farmland & commercial	1,849,587	2,283	37,765	92,008	13,806
Commercial real estate: multifamily	138,546	—	—	125	777
Residential: first lien	401,053	—	—	3,492	5,699
Residential: junior lien	551,138	—	—	250	950
Consumer	56,440	—	—	7	1,297
Foreign	178,261	—	—	—	752
Total	\$ 5,529,707	\$ 45,599	\$ 83,069	\$ 232,091	\$ 60,448

The increase in Special Review credits for December 31, 2016 compared to December 31, 2015 can be attributed to the re-classification of a commercial loan relationship secured mainly by transportation equipment used in the shipping industry to the Pass category. The decrease in Watch-List Pass credits can be attributed to the re-classification of a commercial loan relationship secured mainly by assets, including contract rights of the borrower to the Pass category. Additionally impacting the Watch-List Pass credits in the real estate farmland and commercial category is a reclassification of a relationship secured mainly by warehouses from the Pass category. Also impacting the Watch-List Pass and Watch-List Substandard category at December 31, 2016 is the reclassification of a relationship secured by all assets, equipment, and accounts receivable from Watch-List Substandard to the Pass category. The decrease in Watch-List Impaired loans can be attributed to the charge-down of the loan relationship that is mainly secured by multiple pieces of transportation equipment previously discussed.

(5) Bank Premises and Equipment

A summary of bank premises and equipment, by asset classification, at December 31, 2016 and 2015 were as follows:

	Estimated useful lives	2016	2015
(Dollars in Thousands)			
Bank buildings and improvements	5 - 40 years	\$ 542,063	\$ 523,022
Furniture, equipment and vehicles	1 - 20 years	280,586	274,923
Land		125,213	121,936
Real estate held for future expansion:			
Land, building, furniture, fixture and equipment	7 - 27 years	—	—
Less: accumulated depreciation		(420,279)	(403,165)
Bank premises and equipment, net		\$ 527,583	\$ 516,716

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(6) Goodwill and Other Intangible Assets

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

	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net</u>
	(Dollars in Thousands)		
December 31, 2016:			
Core deposit premium	\$ 58,675	\$ 58,650	\$ 25
Identified intangible (contract rights)	2,022	2,022	—
Total identified intangibles	<u>\$ 60,697</u>	<u>\$ 60,672</u>	<u>\$ 25</u>
December 31, 2015:			
Core deposit premium	\$ 58,675	\$ 58,522	\$ 153
Identified intangible (contract rights)	2,022	2,022	—
Total identified intangibles	<u>\$ 60,697</u>	<u>\$ 60,544</u>	<u>\$ 153</u>

Amortization expense of intangible assets for the years ended December 31, 2016, 2015 and 2014, was \$128,000, \$644,000 and \$2,389,000, respectively. Estimated amortization expense for each of the five succeeding fiscal years, and thereafter, is as follows:

Fiscal year ending December 31:

	<u>Total</u>
	(in thousands)
2017	25
2018	—
2019	—
2020	—
2021	—
Thereafter	
Total	<u>\$ 25</u>

There were no changes in the carrying amount of goodwill for the years ended December 31, 2016 and 2015.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(7) Deposits

Deposits as of December 31, 2016 and 2015 and related interest expense for the years ended December 31, 2016, 2015 and 2014 were as follows:

	<u>2016</u>	<u>2015</u>
	(Dollars in Thousands)	
Deposits:		
Demand - non-interest bearing		
Domestic	\$ 2,509,544	\$ 2,536,192
Foreign	648,507	613,426
Total demand non-interest bearing	<u>3,158,051</u>	<u>3,149,618</u>
Savings and interest bearing demand		
Domestic	2,589,675	2,450,102
Foreign	614,053	570,120
Total savings and interest bearing demand	<u>3,203,728</u>	<u>3,020,222</u>
Time, certificates of deposit \$100,000 or more		
Domestic	748,104	800,393
Foreign	838,161	848,355
Less than \$100,000		
Domestic	389,682	430,102
Foreign	272,363	287,563
Total time, certificates of deposit	<u>2,248,310</u>	<u>2,366,413</u>
Total deposits	<u><u>\$ 8,610,089</u></u>	<u><u>\$ 8,536,253</u></u>

	<u>2016</u>	<u>2015</u>	<u>2014</u>
	(Dollars in Thousands)		
Interest expense:			
Savings and interest bearing demand			
Domestic	\$ 3,922	\$ 3,026	\$ 2,998
Foreign	640	567	599
Total savings and interest bearing demand	<u>4,562</u>	<u>3,593</u>	<u>3,597</u>
Time, certificates of deposit \$100,000 or more			
Domestic	3,881	4,693	4,615
Foreign	3,929	4,116	4,529
Less than \$100,000			
Domestic	1,447	1,680	2,074
Foreign	706	744	815
Total time, certificates of deposit	<u>9,963</u>	<u>11,233</u>	<u>12,033</u>
Total interest expense on deposits	<u><u>\$ 14,525</u></u>	<u><u>\$ 14,826</u></u>	<u><u>\$ 15,630</u></u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Scheduled maturities of time deposits as of December 31, 2016 were as follows:

	<u>Total</u>
	<u>(in thousands)</u>
2017	\$ 2,021,655
2018	156,078
2019	52,777
2020	17,064
2021	638
Thereafter	98
Total	\$ 2,248,310

Scheduled maturities of time deposits in amounts of \$100,000 or more at December 31, 2016, were as follows:

	<u>Total</u>
	<u>(in thousands)</u>
Due within 3 months or less	\$ 605,093
Due after 3 months and within 6 months	390,668
Due after 6 months and within 12 months	430,447
Due after 12 months	160,057
	<u>\$ 1,586,265</u>

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 at December 31, 2016 and December 31, 2015 were \$1,005,000 and \$1,021,000, respectively.

(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 \$759,458,000 and \$872,611,000 during 2016 and 2015, respectively, and the maximum amount outstanding at any month end during 2016 and 2015 was \$819,155,000 and \$907,211,000 respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

Further information related to repurchase agreements at December 31, 2016 and 2015 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, 2016 term:				
Overnight agreements	\$ 295,282	\$ 292,286	\$ 190,915	0.15 %
1 to 29 days	10,250	10,148	9,863	0.50
30 to 90 days	2,315	2,317	2,300	0.33
Over 90 days	382,304	375,060	301,907	4.01
Total	<u>\$ 690,151</u>	<u>\$ 679,811</u>	<u>\$ 504,985</u>	2.46 %
December 31, 2015 term:				
Overnight agreements	\$ 316,041	\$ 317,799	\$ 250,702	0.15 %
1 to 29 days	10,199	10,114	9,798	0.50
30 to 90 days	4,388	4,356	4,320	0.31
Over 90 days	647,086	644,131	562,952	3.84
Total	<u>\$ 977,714</u>	<u>\$ 976,400</u>	<u>\$ 827,772</u>	2.66 %

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.

Further information regarding the Company's other borrowed funds at December 31, 2016 and 2015 is set forth in the following table:

	December 31,	
	2016	2015
	(Dollars in Thousands)	
Federal Home Loan Bank advances—short-term		
Balance at year end	\$ 583,375	\$ 355,750
Rate on balance outstanding at year end	0.66 %	0.37 %
Average daily balance	\$ 483,379	\$ 859,220
Average rate	0.47 %	0.19 %
Maximum amount outstanding at any month end	\$ 600,875	\$ 1,239,200
Federal Home Loan Bank advances—long-term ⁽¹⁾		
Balance at year end	\$ 150,000	\$ 150,000
Rate on balance outstanding at year end	0.58 %	0.31 %
Average daily balance	\$ 150,000	\$ 5,314
Average rate	0.58 %	0.31 %
Maximum amount outstanding at any month end	\$ 150,000	\$ 150,000

(1) Long-term advances matured in January 2017.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(10) Junior Subordinated Deferrable Interest Debentures

The Company has formed six statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. The 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, 2016 and December 31, 2015, the principal amount of debentures outstanding totaled \$160,416,000 and \$161,416,000, respectively. On July 29, 2015, the Company bought back a portion of the Capital Securities of IB Capital Trusts X and XI from the holder of the securities for a price that reflected an approximate 24.5% discount from the redemption prices of the securities. The Company thereby retired \$13,000,000 of the total \$34,021,000 of related Junior Subordinated Deferrable Interest Debentures related to IB Capital Trust X and \$1,000,000 of the total \$27,990,000 of related Junior Subordinated Deferrable Interest Debentures related to IB Capital Trust XI. On November 1, 2016, the Company bought back a portion of the Capital Securities of IB Capital Trust XI from the holder of the securities for a price that reflected an approximate 24% discount from the redemption price of the securities. The Company thereby retired \$1,000,000 of the total \$26,990,000 of related Junior Subordinated Deferrable Interest Debentures related to IB Capital Trust XI. The discounts recorded in connection with the repurchases of the outstanding Capital Securities are included in other income on the consolidated financial statements.

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, 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, 2016 and December 31, 2015, the total \$160,416,000 and \$161,416,000, respectively, of the Capital Securities outstanding qualified as Tier 1 capital.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The following table illustrates key information about each of the Debentures and their interest rates at December 31, 2016:

	Junior Subordinated Deferrable Interest Debentures	Repricing Frequency	Interest Rate		Interest Rate Index(1)		Maturity Date	Optional Redemption Date(1)
	(Dollars in Thousands)							
Trust VI	\$ 25,774	Quarterly	4.36 %		LIBOR + 3.45		November 2032	February 2008
Trust VIII	25,774	Quarterly	3.93 %		LIBOR + 3.05		October 2033	October 2008
Trust IX	41,238	Quarterly	2.47 %		LIBOR + 1.62		October 2036	October 2011
Trust X	21,021	Quarterly	2.54 %		LIBOR + 1.65		February 2037	February 2012
Trust XI	25,990	Quarterly	2.47 %		LIBOR + 1.62		July 2037	July 2012
Trust XII	20,619	Quarterly	2.38 %		LIBOR + 1.45		September 2037	September 2012
	\$ 160,416							

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

(11) Earnings per Share ("EPS")

Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding. The computation of diluted EPS assumes the issuance of common shares for all dilutive potential common shares outstanding during the reporting period. The calculation of the basic EPS and the diluted EPS for the years ended December 31, 2016, 2015, and 2014 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, 2016:			
Basic EPS			
Net income available to common shareholders	\$ 133,932	65,967,989	\$ 2.03
Potential dilutive common shares and warrants	—	345,501	
Diluted EPS	<u>\$ 133,932</u>	<u>66,313,490</u>	\$ 2.02
December 31, 2015:			
Basic EPS			
Net income available to common shareholders	\$ 136,726	66,411,193	\$ 2.06
Potential dilutive common shares and warrants	—	225,160	
Diluted EPS	<u>\$ 136,726</u>	<u>66,636,353</u>	\$ 2.05
December 31, 2014:			
Basic EPS			
Net income available to common shareholders	\$ 153,151	66,872,500	\$ 2.29
Potential dilutive common shares	—	183,956	
Diluted EPS	<u>\$ 153,151</u>	<u>67,056,456</u>	\$ 2.28

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(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 \$3,650,000 \$3,525,000 and \$3,510,000 were charged to income for the years ended December 31, 2016, 2015, and 2014, 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.

A summary of assets attributable to international operations at December 31, 2016 and 2015 are as follows:

	2016	2015
	(Dollars in Thousands)	
Loans:		
Commercial	\$ 124,079	\$ 138,125
Others	43,141	40,888
	167,220	179,013
Less allowance for probable loan losses	(884)	(1,152)
Net loans	\$ 166,336	\$ 177,861
Accrued interest receivable	\$ 603	\$ 697

At December 31, 2016, the Company had \$93,154,000 in outstanding standby and commercial letters of credit to facilitate trade activities.

Revenues directly attributable to international operations were approximately \$5,495,000, \$6,113,000 and \$6,034,000 for the years ended December 31, 2016, 2015 and 2014, respectively.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

(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:

	2016	2015	2014
	(Dollars in Thousands)		
Current			
U.S.	\$ 52,403	\$ 65,196	\$ 72,561
State	3,362	5,258	5,252
Foreign	—	(6)	1
Total current taxes	55,765	70,448	77,814
Deferred			
U.S.	7,279	(261)	(969)
State	27	(71)	(58)
Total deferred taxes	7,306	(332)	(1,027)
Total income taxes	\$ 63,071	\$ 70,116	\$ 76,787

Total income tax expense differs from the amount computed by applying the U.S. Federal income tax rate of 35% for 2016, 2015 and 2014 to income before income taxes. The reasons for the differences for the years ended December 31 are as follows:

	2016	2015	2014
	(Dollars in Thousands)		
Computed expected tax expense	\$ 69,253	\$ 72,389	\$ 80,560
Change in taxes resulting from:			
Tax-exempt interest income	(3,940)	(3,910)	(4,554)
State tax, net of federal income taxes and tax credit	3,287	3,371	3,377
Other investment income	(3,694)	(3,540)	(3,615)
Other	(1,835)	1,806	1,019
Actual tax expense	\$ 63,071	\$ 70,116	\$ 76,787

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2016 and 2015 are reflected below:

	2016	2015
	(Dollars in Thousands)	
Deferred tax assets:		
Loans receivable, principally due to the allowance for probable loan losses	\$ 24,315	\$ 25,689
Other real estate owned	3,652	3,224
Impairment charges on available-for-sale securities	6,086	5,959
Accrued expenses	137	137
Net unrealized losses on available for sale investment securities	14,791	—
Other	6,917	7,411
Total deferred tax assets	55,898	42,420
Deferred tax liabilities:		
Bank premises and equipment, principally due to differences on depreciation	(19,837)	(18,266)
Net unrealized gains on available for sale investment securities	—	(1,171)
Identified intangible assets and goodwill	(21,386)	(20,169)
Other	(16,300)	(13,099)
Total deferred tax liabilities	(57,523)	(52,705)
Net deferred tax liability	\$ (1,625)	\$ (10,285)

The net deferred tax liability of \$1,625,000 at December 31, 2016 and \$10,285,000 at December 31, 2015 is included in other liabilities in the consolidated statements of condition.

(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, 2016, 198,675 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.

	2016	2015
Expected Life (Years)	7.61	7.61
Dividend yield	2.50 %	2.36 %
Interest rate	1.50 %	1.91 %
Volatility	41.32 %	46.52 %

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

A summary of option activity under the stock option plans for the twelve months ended December 31, 2016 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, 2015	871,727	\$ 19.08		
Plus: Options granted	9,000	26.14		
Less:				
Options exercised	43,925	12.51		
Options expired	2,000	20.83		
Options forfeited	34,300	21.17		
Options outstanding at December 31, 2016	<u>800,502</u>	19.43	5.91	\$ 17,108
Options fully vested and exercisable at December 31, 2016	266,392	\$ 15.91	3.71	\$ 6,630

Stock-based compensation expense included in the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014 was approximately \$1,082,000, \$1,172,000 and \$1,058,000, respectively. As of December 31, 2016, there was approximately \$2,322,000 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 1.7 years.

Other information pertaining to option activity during the twelve month period ending December 31, 2016, 2015 and 2014 is as follows:

	Twelve Months Ended December 31,		
	2016	2015	2014
Weighted average grant date fair value of stock options granted	\$ 8.74	\$ 9.42	\$ 9.07
Total fair value of stock options vested	\$ 1,015,000	\$ 872,000	\$ 376,000
Total intrinsic value of stock options exercised	\$ 792,000	\$ 781,000	\$ 468,000

(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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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 RSUs granted as of December 19, 2012 of \$425,000 for his performance in 2012. In order to meet the requirements of a CPP-compliant RSU, Mr. Nixon's 2012 RSUs vested and were paid in December 2014 in the cash amount of \$572,746.

(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, 2016, 2015 and 2014 were approximately \$5,870,000, \$6,200,000 and \$7,200,000, respectively. Future minimum lease payments due under non-cancellable operating leases at December 31, 2016 were as follows:

Fiscal year ending:

	Total
	(in thousands)
2017	\$ 3,078
2018	2,772
2019	2,726
2020	2,551
2021	1,633
Thereafter	88
Total	\$ 12,848

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, 2016 were \$101,562,000.

Cash of approximately \$111,353,000 and \$104,684,000 at December 31, 2016 and 2015, respectively, was maintained to satisfy regulatory reserve requirements.

The Company is involved in various legal proceedings that are in various stages of litigation. 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 \$26,662,000 and \$31,975,000 at December 31, 2016 and 2015, 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 include commitments to their

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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, 2016, the following financial amounts of instruments, whose contract amounts represent credit risks, were outstanding:

Commitments to extend credit	\$	2,262,717,000
Credit card lines		18,531,000
Standby letters of credit		88,504,000
Commercial letters of credit		4,650,000

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, 2016, the maximum potential amount of future payments is approximately \$88,504,000. At December 31, 2016, the fair value of these guarantees is not significant. Unsecured letters of credit totaled approximately \$40,738,000 and \$37,454,000 at December 31, 2016 and 2015, 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.

(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 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 20, 2016, the Warrant is still outstanding. Adjustments to the \$24.43 per share Exercise Price of the Warrant will be made if the Company pays cash dividends in excess of 33 cents per semi-annual period or makes certain other shareholder distributions before the Warrants expires on December 23, 2018.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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, 2016, the subsidiary banks could pay dividends of up to \$819,500,000 to the Corporation without prior regulatory approval and without adversely affecting their “well-capitalized” status under regulatory capital rules in effect at December 31, 2016. 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.

Current 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, 2016, that the Company and each of the bank subsidiaries met all capital adequacy requirements to which they are subject.

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

The CET1 (beginning in 2015), Tier 1 and Total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, excluding goodwill and other intangible assets, allocated by risk weight category, and certain off-balance-sheet items, among other things. The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets, among other things.

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

As of December 31, 2016, capital levels at the Company exceed all capital adequacy requirements under the Basel III Capital Rules as currently applicable to the Company. Based on the ratios presented below, capital levels as of December 31, 2016 at the Company exceed the minimum levels necessary to be considered “well capitalized.”

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

As of December 31, 2016, 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.

The Company’s and the bank subsidiaries’ actual capital amounts and ratios for 2016 under current guidelines are presented in the following table:

	Actual		For Capital Adequacy Purposes Phase In Schedule		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount (greater than or equal to)	Ratio (greater than or equal to)	Amount (greater than or equal to)	Ratio (greater than or equal to)
(Dollars in Thousands)						
As of December 31, 2016:						
Common Equity Tier 1 (to Risk Weighted Assets):						
Consolidated	\$ 1,468,662	16.95 %	\$ 390,021	5.125 %	N/A	N/A
International Bank of Commerce, Laredo	1,201,527	16.63	325,178	5.125	\$ 469,701	6.50 %
International Bank of Commerce, Brownsville	158,533	25.61	27,852	5.125	40,230	6.50
International Bank of Commerce, Zapata	65,989	34.09	8,712	5.125	12,584	6.50
Commerce Bank	73,765	31.84	10,425	5.125	15,058	6.50
Total Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,687,501	19.47 %	\$ 693,370	8.625 %	N/A	N/A
International Bank of Commerce, Laredo	1,260,886	17.45	578,094	8.625	\$ 722,618	10.00 %
International Bank of Commerce, Brownsville	163,937	26.49	49,514	8.625	61,892	10.00
International Bank of Commerce, Zapata	67,464	34.85	15,488	8.625	19,360	10.00
Commerce Bank	76,093	32.85	18,532	8.625	23,166	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,618,935	18.68 %	\$ 520,028	6.625 %	N/A	N/A
International Bank of Commerce, Laredo	1,201,527	16.63	433,571	6.625	\$ 578,094	8.00 %
International Bank of Commerce, Brownsville	158,533	25.61	37,135	6.625	49,514	8.00
International Bank of Commerce, Zapata	65,989	34.09	11,616	6.625	15,488	8.00
Commerce Bank	73,765	31.84	13,899	6.625	18,532	8.00
Tier 1 Capital (to Average Assets):						
Consolidated	\$ 1,618,935	13.91 %	\$ 471,135	4.00 %	N/A	N/A
International Bank of Commerce, Laredo	1,201,527	12.50	384,342	4.00	480,427	5.00 %
International Bank of Commerce, Brownsville	158,533	16.91	37,509	4.00	46,886	5.00
International Bank of Commerce, Zapata	65,989	13.87	19,029	4.00	23,786	5.00
Commerce Bank	73,765	13.05	22,607	4.00	28,259	5.00

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The Company's and the bank subsidiaries' actual capital amounts and ratios for 2015 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, 2015:						
Common Equity Tier 1 (to Risk Weighted Assets):						
Consolidated	\$ 1,380,801	16.81 %	\$ 369,726	4.50 %	N/A	N/A
International Bank of Commerce, Laredo	1,151,812	16.42	315,707	4.50	\$ 456,022	6.50 %
International Bank of Commerce, Brownsville	154,141	26.26	26,418	4.50	38,159	6.50
International Bank of Commerce, Zapata	66,153	35.71	8,336	4.50	12,042	6.50
Commerce Bank	72,882	36.17	9,067	4.50	13,097	6.50
Total Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,605,419	19.54 %	\$ 657,291	8.00 %	N/A	N/A
International Bank of Commerce, Laredo	1,213,377	17.30	561,258	8.00	\$ 701,572	10.00 %
International Bank of Commerce, Brownsville	159,913	27.24	46,965	8.00	58,706	10.00
International Bank of Commerce, Zapata	67,470	36.42	14,820	8.00	18,525	10.00
Commerce Bank	74,204	36.83	16,119	8.00	20,149	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$ 1,535,443	18.69 %	\$ 492,968	6.00 %	N/A	N/A
International Bank of Commerce, Laredo	1,151,812	16.42	420,943	6.00	\$ 561,258	8.00 %
International Bank of Commerce, Brownsville	154,141	26.26	35,224	6.00	46,965	8.00
International Bank of Commerce, Zapata	66,153	35.71	11,115	6.00	14,820	8.00
Commerce Bank	72,882	36.17	12,089	6.00	16,119	8.00
Tier 1 Capital (to Average Assets):						
Consolidated	\$ 1,535,443	13.15 %	\$ 466,897	4.00 %	\$ N/A	N/A
International Bank of Commerce, Laredo	1,151,812	12.09	381,105	4.00	476,381	5.00 %
International Bank of Commerce, Brownsville	154,141	15.03	41,034	4.00	51,293	5.00
International Bank of Commerce, Zapata	66,153	13.15	20,129	4.00	25,161	5.00
Commerce Bank	72,882	12.94	22,521	4.00	28,151	5.00

(21) Fair Value

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

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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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 financial instruments reported on the consolidated statements of condition at their fair value as of December 31, 2016 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, 2016	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	\$ 3,894,470	\$ —	\$ 3,876,865	\$ 17,605
States and political subdivisions	254,972	—	254,972	—
Equity securities	27,907	27,907	—	—
	<u>\$ 4,177,349</u>	<u>\$ 27,907</u>	<u>\$ 4,131,837</u>	<u>\$ 17,605</u>

The following table represents financial instruments reported on the consolidated balance sheets at their fair value as of December 31, 2015 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, 2015	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	\$ 3,893,210	\$ —	\$ 3,871,981	\$ 21,229
States and political subdivisions	277,705	—	277,705	—
Equity securities	28,457	28,457	—	—
	<u>\$ 4,199,372</u>	<u>\$ 28,457</u>	<u>\$ 4,149,686</u>	<u>\$ 21,229</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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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, 2016 and December 31, 2015 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 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, 2015	\$	21,229
Principal paydowns		(4,417)
Total unrealized gains (losses) included in:		
Other comprehensive loss		1,147
Impairment realized in earnings		(354)
Balance at December 31, 2016	\$	<u>17,605</u>

Certain financial instruments are measured at fair value on a nonrecurring basis. They are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended December 31, 2016 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, 2016		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net Provision (Credit) During Period
Measured on a non-recurring basis:					
Assets:					
Impaired loans	\$ 38,794	\$ —	\$ —	\$ 38,794	\$ 19,699
Other real estate owned	9,445	—	—	9,445	2,351

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the year ended December 31, 2015 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, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Net (Credit) Provision During Period	
<i>Measured on a non-recurring basis:</i>						
Assets:						
Impaired loans	\$ 18,033	\$ —	\$ —	\$ 18,033	\$ (8,589)	
Other real estate owned	12,705	—	—	12,705	1,023	

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. Understanding that as the primary sources of loan repayments decline, the secondary repayment source comes into play and correctly evaluating the fair value of that secondary source, the collateral, becomes even more important. Re-measurement of the impaired loan to fair value is done through a specific valuation allowance included in the allowance for probable loan losses. The fair value of impaired loans is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for 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. All appraisals and evaluations are "as is" (the property's highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of December 31, 2016, the Company had approximately \$38,108,000 of impaired commercial collateral dependent loans, of which approximately \$26,162,000 had an appraisal performed within the immediately preceding twelve months and of which approximately \$6,836,000 had an evaluation performed within the immediately preceding twelve months. As of December 31, 2015, the Company had approximately \$51,021,000 of impaired commercial collateral dependent loans, of which approximately \$39,520,000 had an appraisal performed within the immediately preceding twelve months and of which approximately \$2,958,000 had an evaluation performed within the immediately preceding twelve months.

The determination to either seek an appraisal or to perform an evaluation begins in weekly credit quality meetings, where the committee analyzes the existing collateral values of the impaired loans and where obsolete

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate owned is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal) within level 3 of the fair value hierarchy. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. The fair value is reviewed periodically and subsequent write downs are made accordingly through a charge to operations. Other real estate owned is included in other assets on the consolidated financial statements. For the twelve months ended December 31, 2016, December 31, 2015 and December 31, 2014, respectively the Company recorded approximately \$381,000, \$696,000 and \$367,000 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, 2016, December 31, 2015 and December 31, 2014, respectively, the Company recorded approximately \$2,351,000, \$1,023,000 and \$597,000 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, 2016 and December 31, 2015 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.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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, 2016, and December 31, 2015, the carrying amount of fixed rate performing loans was \$1,411,272,000 and \$1,383,836,000, respectively, and the estimated fair value was \$1,375,807,000 and \$1,362,248,000, respectively.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposits

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of December 31, 2016 and December 31, 2015. 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, 2016 and December 31, 2015, the carrying amount of time deposits was \$2,248,310,000 and \$2,366,413,000, respectively, and the estimated fair value was \$2,247,648,000 and \$2,365,390,000, 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, 2016 and December 31, 2015. The fair value of the long-term instruments is based on established market spread using option adjusted spreads methodology. Long-term repurchase agreements are within level 3 of the fair value hierarchy. At December 31, 2016 and December 31, 2015, respectively, the carrying amount of long-term repurchase agreements was \$300,000,000 and \$560,000,000 and the estimated fair value was \$289,324,000 and \$527,198,600, 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, 2016 and December 31, 2015.

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, 2016 and December 31, 2015. The long-term borrowings outstanding at December 31, 2016 are variable rate borrowings and re-price on a monthly basis.

Commitments to Extend Credit and Letters of Credit

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

Limitations

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time 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

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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, 2016 and 2015

(Dollars in Thousands)

	2016	2015
ASSETS		
Cash	\$ 18,555	\$ 2,977
Other investments	94,908	69,160
Notes receivable	—	99
Investment in subsidiaries	1,787,120	1,766,592
Other assets	1,098	45
Total assets	\$ 1,901,681	\$ 1,838,873
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Junior subordinated deferrable interest debentures	\$ 160,416	\$ 161,416
Due to IBC Trading	21	21
Other liabilities	16,577	11,933
Total liabilities	177,014	173,370
Shareholders' equity:		
Common shares	95,910	95,866
Surplus	169,567	167,980
Retained earnings	1,777,963	1,683,600
Accumulated other comprehensive (loss) income	(26,697)	2,167
	2,016,743	1,949,613
Less cost of shares in treasury	(292,076)	(284,110)
Total shareholders' equity	1,724,667	1,665,503
Total liabilities and shareholders' equity	\$ 1,901,681	\$ 1,838,873

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, 2016, 2015 and 2014

(Dollars in Thousands)

	2016	2015	2014
Income:			
Dividends from subsidiaries	\$ 84,432	\$ 51,575	\$ 71,389
Interest income on notes receivable	2	7	15
Interest income on other investments	8,958	5,738	6,862
Other	255	3,442	1,923
Total income	93,647	60,762	80,189
Expenses:			
Interest expense (Debentures)	4,600	4,099	4,264
Other	3,637	3,037	1,099
Total expenses	8,237	7,136	5,363
Income before federal income taxes and equity in undistributed net income of subsidiaries	85,410	53,626	74,826
Income tax expense	311	386	1,370
Income before equity in undistributed net income of subsidiaries	85,099	53,240	73,456
Equity in undistributed net income of subsidiaries	48,833	83,486	79,695
Net income	\$ 133,932	\$ 136,726	\$ 153,151

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, 2016, 2015 and 2014
(Dollars in Thousands)**

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating activities:			
Net income	\$ 133,932	\$ 136,726	\$ 153,151
Adjustments to reconcile net income to net cash provided by operating activities:			
Impairment charges on available for sale securities	112	385	254
Stock compensation expense	1,082	1,172	1,058
Increase (decrease) in other liabilities	3,901	(1,998)	416
Equity in undistributed net income of subsidiaries	(48,833)	(83,486)	(79,695)
Net cash provided by operating activities	<u>90,194</u>	<u>52,799</u>	<u>75,184</u>
Investing activities:			
Principal collected on mortgage-backed securities	1,105	474	1,301
Net decrease in notes receivable	99	105	109
Increase in other assets and other investments	(27,834)	(1,830)	(7,008)
Net cash used in investing activities	<u>(26,630)</u>	<u>(1,251)</u>	<u>(5,598)</u>
Financing activities:			
Redemption of long-term debt	(1,000)	(14,000)	(15,310)
Proceeds from stock transactions	549	1,370	555
Payments of cash dividends - common	(39,569)	(38,515)	(34,762)
Purchase of treasury stock	(7,966)	(6,678)	(18,923)
Net cash used in financing activities	<u>(47,986)</u>	<u>(57,823)</u>	<u>(68,440)</u>
Increase (decrease) in cash	15,578	(6,275)	1,146
Cash at beginning of year	2,977	9,252	8,106
Cash at end of year	<u>\$ 18,555</u>	<u>\$ 2,977</u>	<u>\$ 9,252</u>

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

	<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
2016				
Interest income	\$ 96,337	\$ 96,624	\$ 97,896	\$ 97,057
Interest expense	10,113	11,175	11,024	10,817
Net interest income	86,224	85,449	86,872	86,240
Provision for probable loan losses	4,975	(1,347)	7,097	9,134
Non-interest income	43,630	40,530	36,611	40,931
Non-interest expense	73,056	76,667	71,984	67,918
Income before income taxes	51,823	50,659	44,402	50,119
Income taxes	16,350	14,872	14,714	17,135
Net income	<u>\$ 35,473</u>	<u>\$ 35,787</u>	<u>\$ 29,688</u>	<u>\$ 32,984</u>
Per common share:				
Basic				
Net income	<u>\$ 0.54</u>	<u>\$ 0.54</u>	<u>\$ 0.45</u>	<u>\$ 0.50</u>
Diluted				
Net income	<u>\$ 0.53</u>	<u>\$ 0.54</u>	<u>\$ 0.45</u>	<u>\$ 0.50</u>

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

	<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
2015				
Interest income	\$ 97,923	\$ 100,724	\$ 98,975	\$ 99,132
Interest expense	10,730	11,133	11,210	11,244
Net interest income	87,193	89,591	87,765	87,888
Provision for probable loan losses	5,429	8,832	7,767	2,377
Non-interest income	35,734	43,022	40,144	36,834
Non-interest expense	66,132	74,898	68,271	67,623
Income before income taxes	51,366	48,883	51,871	54,722
Income taxes	16,393	16,864	17,996	18,863
Net income	<u>\$ 34,973</u>	<u>\$ 32,019</u>	<u>\$ 33,875</u>	<u>\$ 35,859</u>
Per common share:				
Basic				
Net income	<u>\$ 0.53</u>	<u>\$ 0.48</u>	<u>\$ 0.51</u>	<u>\$ 0.54</u>
Diluted				
Net income	<u>\$ 0.52</u>	<u>\$ 0.48</u>	<u>\$ 0.51</u>	<u>\$ 0.54</u>

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

Distribution of Assets, Liabilities and Shareholders' Equity

The following table sets forth a comparative summary of average interest earning assets and average interest bearing liabilities and related interest yields for the years ended December 31, 2016, 2015, and 2014. Tax-exempt income has not been adjusted to a tax-equivalent basis:

	2016			2015			2014		
	Average Balance	Interest	Average Rate/Cost	Average Balance	Interest	Average Rate/Cost	Average Balance	Interest	Average Rate/Cost
	(Dollars in Thousands)								
Assets									
Interest earning assets:									
Loan, net of unearned discounts:									
Domestic	\$ 5,781,466	\$ 292,325	5.06 %	\$ 5,662,616	\$ 291,180	5.14 %	\$ 5,312,177	\$ 275,512	5.19 %
Foreign	167,582	5,495	3.28	182,226	6,103	3.35	179,664	6,034	3.36
Investment securities:									
Taxable	4,044,843	79,533	1.97	4,404,569	88,008	2.00	4,810,068	100,095	2.08
Tax-exempt	253,990	10,356	4.08	275,267	11,319	4.11	257,557	11,767	4.57
Other	84,275	205	0.24	100,816	144	0.14	66,199	191	0.29
Total interest-earning assets	10,332,156	387,914	3.75 %	10,625,494	396,754	3.73 %	10,625,665	393,599	3.7 %
Non-interest earning assets:									
Cash and cash equivalents	154,334			166,460			226,817		
Bank premises and equipment, net	488,110			499,233			497,927		
Other assets	1,006,286			951,728			866,691		
Less allowance for probable loan losses	(66,021)			(65,857)			(73,544)		
Total	\$ 11,914,865			\$ 12,177,058			\$ 12,143,556		
Liabilities and Shareholders' Equity									
Interest bearing liabilities:									
Savings and interest bearing demand deposits	\$ 3,090,355	\$ 4,562	0.15 %	\$ 3,036,542	\$ 3,593	0.12 %	\$ 2,983,028	\$ 3,597	0.12 %
Time deposits:									
Domestic	1,169,156	5,328	0.46	1,278,148	6,374	0.50	1,358,119	6,689	0.49
Foreign	1,123,315	4,635	0.41	1,155,698	4,859	0.42	1,221,981	5,344	0.44
Securities sold under repurchase agreements	759,458	20,876	2.75	872,611	23,777	2.72	893,836	24,616	2.75
Other borrowings	633,380	3,128	0.49	864,535	1,615	0.19	1,085,311	2,033	0.19
Junior subordinated interest deferrable debentures	161,249	4,600	2.85	170,843	4,099	2.40	181,574	4,264	2.35
Total interest bearing liabilities	6,936,913	43,129	0.62 %	7,378,377	44,317	0.60 %	7,723,849	46,543	0.60 %
Non-interest bearing liabilities:									
Demand Deposits	3,148,590			3,059,527			2,594,727		
Other liabilities	90,308			82,571			97,237		
Shareholders' equity	1,739,054			1,620,583			1,411,597		
Total	\$ 11,914,865			\$ 12,141,058			\$ 11,827,410		
Net interest income		\$ 344,785			\$ 352,437			\$ 347,056	
Net yield on interest earning assets			3.34 %			3.32 %			3.27 %

**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
Chairman of the Board
International Bank of Commerce

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

IRVING GREENBLUM
International Investments/Real Estate

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

DOUG HOWLAND
Investments

IMELDA NAVARRO
President
International Bank of Commerce

PEGGY NEWMAN
Investments

LARRY NORTON
President
Norton Stores, Inc.

ROBERTO R. RESENDEZ
Owner
Cattle Ranching and Real Estate Investment Company

LEONARDO SALINAS
Investments

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

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, 2016

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 ☐
(Do not check if a
smaller reporting company)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, 2016 was \$1,720,588,000.00 based on the closing sales price per share of the Registrant's common stock on such date as reported by NASDAQ.

As of February 22, 2017, there were 65,989,631 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, 2016 (in Parts I and II) and (b) Proxy Statement relating to the Company's 2017 Annual Meeting of Shareholders (in Part III).

The amortized cost and estimated fair value by type of investment security at December 31, 2016 are as follows:

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

	Available for Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value ⁽¹⁾
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 3,946,144	\$ 18,246	\$ (69,920)	\$ 3,894,470	\$ 3,894,470
Obligations of states and political subdivisions	244,622	10,783	(433)	254,972	254,972
Equity securities	28,075	314	(482)	27,907	27,907
Total investment securities	\$ 4,218,841	\$ 29,343	\$ (70,835)	\$ 4,177,349	\$ 4,177,349

(1) Included in the carrying value of residential mortgage- backed securities are \$850,033 of mortgage-backed securities issued by Ginnie Mae, \$3,026,832 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and \$17,605 issued by non-government entities

The amortized cost and estimated fair value by type of investment security at December 31, 2015 are as follows:

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

Available for Sale				
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	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Estimated fair value</u>	<u>Carrying value⁽¹⁾</u>
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 3,908,809	\$ 30,959	\$ (46,557)	\$ 3,893,211	\$ 3,893,211
Obligations of states and political subdivisions	259,150	18,579	(25)	277,704	277,704
Equity securities	28,075	627	(245)	28,457	28,457
Total investment securities	<u>\$ 4,196,034</u>	<u>\$ 50,165</u>	<u>\$ (46,827)</u>	<u>\$ 4,199,372</u>	<u>\$ 4,199,372</u>

(1) Included in the carrying value of residential mortgage-backed securities are \$1,147,143 of mortgage-backed securities issued by Ginnie Mae, \$2,724,839 of mortgage-backed securities issued by Fannie Mae and Freddie Mac and \$21,229 issued by non-government entities

List of Subsidiaries

Subsidiaries of International Bancshares Corporation

Name	State of Incorporation or Organization	Business	% of Ownership	
IBC Subsidiary Corporation	Delaware	Bank Holding Company	100	%
IBC Trading Company	Texas	Export Trading	100	%
IBC Capital Corporation	Texas	Investments	100	%
IBC Charitable and Community Development Corporation	Texas	Community Development	100	%
Premier Tierra Holdings, Inc.	Texas	Liquidating Subsidiary	100	%

Subsidiaries of IBC Subsidiary Corporation

Name	State of Incorporation or Organization	Business	% of Ownership
International Bank of Commerce	Texas	State Bank	100 %
Commerce Bank	Texas	State Bank	100 %
International Bank of Commerce, Zapata	Texas	State Bank	100 %
International Bank of Commerce, Brownsville	Texas	State Bank	100 %
International Bank of Commerce, Oklahoma	Oklahoma	State Bank	100 %
Gulfstar Merchant Banking I, Ltd.	Texas	Merchant Banking	70 %
Gulfstar Merchant Banking II, Ltd.	Texas	Merchant Banking	70 %
Gulfstar Merchant Banking III, Ltd.	Texas	Merchant Banking	50 %
Gulfstar Merchant Banking IV, Ltd.	Texas	Merchant Banking	50 %

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement (No. 333-183958) on Form S-8 filed on September 18, 2012 of International Bancshares Corporation of our reports dated February 27, 2017, 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, 2016.

/s/ RSM US LLP

Dallas, Texas
February 27, 2017

Certification

I, Dennis E. Nixon, certify that:

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

Date: February 27, 2017

By: /s/ DENNIS E. NIXON

Dennis E. Nixon

President (Chief Executive 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, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Dennis E. Nixon, President and Principal Executive Officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

By: /s/ DENNIS E. NIXON

Dennis E. Nixon

President

Date: February 27, 2017

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

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 27, 2017

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, 2016 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:

- (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/ IMELDA NAVARRO

Imelda Navarro

Treasurer

Date: February 27, 2017

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.