

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2021
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 000-09439

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 offices)
(Zip Code)

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

None
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Emerging growth company ☐

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date

<u>Class</u>	<u>Shares Issued and Outstanding</u>
Common Stock, \$1.00 par value	63,372,301 shares outstanding at August 2, 2021

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition (Unaudited)

(Dollars in Thousands)

	June 30, 2021	December 31, 2020
Assets		
Cash and cash equivalents	\$ 2,326,880	\$ 1,997,238
Investment securities:		
Held to maturity debt securities (Market value of \$3,400 on June 30, 2021 and \$3,400 on December 31, 2020)	3,400	3,400
Available for sale debt securities (Amortized cost of \$4,148,673 on June 30, 2021 and \$3,054,289 on December 31, 2020)	4,171,881	3,080,768
Equity securities with readily determinable fair values	6,136	6,202
Total investment securities	4,181,417	3,090,370
Loans	7,387,537	7,541,754
Less allowance for credit losses	(108,281)	(109,059)
Net loans	7,279,256	7,432,695
Bank premises and equipment, net	463,521	479,878
Accrued interest receivable	32,979	37,881
Other investments	289,706	254,413
Cash surrender value of life insurance policies	293,808	292,381
Goodwill	282,532	282,532
Other assets	160,906	162,079
Total assets	<u>\$ 15,311,005</u>	<u>\$ 14,029,467</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Condition, continued (Unaudited)

(Dollars in Thousands)

	June 30, 2021	December 31, 2020
Liabilities:		
Deposits:		
Demand—non-interest bearing	\$ 5,419,228	\$ 4,715,814
Savings and interest bearing demand	4,313,554	3,852,505
Time	2,143,987	2,153,541
Total deposits	<u>11,876,769</u>	<u>10,721,860</u>
Securities sold under repurchase agreements	430,530	428,148
Other borrowed funds	436,233	436,327
Junior subordinated deferrable interest debentures	134,642	134,642
Other liabilities	147,161	130,492
Total liabilities	<u>13,025,335</u>	<u>11,851,469</u>
Shareholders' equity:		
Common shares of \$1.00 par value. Authorized 275,000,000 shares; issued 96,332,239 shares on June 30, 2021 and 96,240,977 shares on December 31, 2020	96,332	96,241
Surplus	151,512	
Retained earnings	2,397,610	2,289,626
Accumulated other comprehensive income	18,292	
	<u>2,663,746</u>	<u>2,556,026</u>
	<u>(378,076)</u>	<u>(378,028)</u>
Total shareholders' equity	<u>2,285,670</u>	<u>2,177,998</u>
Total liabilities and shareholders' equity	<u>\$ 15,311,005</u>	<u>\$ 14,029,467</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Interest income:				
Loans, including fees	\$ 91,816	\$ 97,764	\$ 183,930	\$ 196,994
Investment securities:				
Taxable	5,014	15,092	9,889	31,580
Tax-exempt	377	653	772	1,419
Other interest income	772	141	1,262	269
Total interest income	97,979	113,650	195,853	230,262
Interest expense:				
Savings deposits	990	1,161	1,919	4,396
Time deposits	2,929	5,319	6,127	11,289
Securities sold under repurchase agreements	142	148	283	613
Other borrowings	1,908	2,088	3,797	4,914
Junior subordinated deferrable interest debentures	702	1,080	1,410	2,353
Total interest expense	6,671	9,796	13,536	23,565
Net interest income	91,308	103,854	182,317	206,697
Provision for credit losses	1,144	10,989	2,336	27,825
Net interest income after provision for credit losses	90,164	92,865	179,981	178,872
Non-interest income:				
Service charges on deposit accounts	15,774	12,880	30,677	30,517
Other service charges, commissions and fees				
Banking	13,233	11,229	25,416	22,395
Non-banking	2,345	2,030	3,785	3,784
Investment securities transactions, net	—	—	(4)	(5)
Other investments, net	58,920	617	63,005	386
Other income	7,634	6,840	11,264	11,649
Total non-interest income	\$ 97,906	\$ 33,596	\$ 134,143	\$ 68,726

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income, continued (Unaudited)

(Dollars in Thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Non-interest expense:				
Employee compensation and benefits	\$ 30,548	\$ 32,319	\$ 60,710	\$ 68,649
Occupancy	6,530	5,770	12,147	12,669
Depreciation of bank premises and equipment	6,436	7,190	13,235	14,299
Professional fees	2,281	3,913	5,117	7,883
Deposit insurance assessments	927	202	1,814	202
Net expense, other real estate owned	3,668	2,835	4,913	5,837
Advertising	1,456	1,892	2,879	3,876
Software and software maintenance	4,526	5,257	8,966	9,748
Other	13,582	14,530	22,358	27,726
Total non-interest expense	69,954	73,908	132,139	150,889
Income before income taxes	118,116	52,553	181,985	96,709
Provision for income taxes	26,090	11,044	39,188	20,361
Net income	\$ 92,026	\$ 41,509	\$ 142,797	\$ 76,348
Basic earnings per common share:				
Weighted average number of shares outstanding	63,362,817	63,295,597	63,335,289	64,183,093
Net income	\$ 1.45	\$ 0.66	\$ 2.25	\$ 1.19
Fully diluted earnings per common share:				
Weighted average number of shares outstanding	63,518,556	63,397,199	63,469,284	64,313,011
Net income	\$ 1.45	\$ 0.65	\$ 2.25	\$ 1.19

See accompanying notes to consolidated financial statements

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in Thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Net income	\$ 92,026	\$ 41,509	\$ 142,797	\$ 76,348
Other comprehensive income, net of tax:				
Net unrealized holding gains (losses) on securities available for sale arising during period (net of tax effects of \$127, \$(6,123), \$(674) and \$10,359)	479	(23,033)	(2,536)	38,970
Reclassification adjustment for losses on securities available for sale included in net income (net of tax effects of \$0, \$0, \$1 and \$1)	—	—	3	4
	<u>479</u>	<u>(23,033)</u>	<u>(2,533)</u>	<u>38,974</u>
Comprehensive income	<u>\$ 92,505</u>	<u>\$ 18,476</u>	<u>\$ 140,264</u>	<u>\$ 115,322</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Three and Six Months ended June 30, 2021 and 2020

(in Thousands, except per share amounts)

	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at March 31, 2021	96,312	\$ 96,312	\$ 150,972	\$ 2,305,584	\$ 17,813	\$ (378,076)	\$ 2,192,605
Net income	—	—	—	92,026	—	—	92,026
Exercise of stock options	20	20	426	—	—	—	446
Stock compensation expense recognized in earnings	—	—	114	—	—	—	114
Other comprehensive income, net of tax:							
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	479	—	479
Balance at June 30, 2021	<u>96,332</u>	<u>\$ 96,332</u>	<u>\$ 151,512</u>	<u>\$ 2,397,610</u>	<u>\$ 18,292</u>	<u>\$ (378,076)</u>	<u>\$ 2,285,670</u>
	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at March 31, 2020	96,226	\$ 96,226	\$ 148,508	\$ 2,191,946	\$ 64,352	\$ (358,521)	\$ 2,142,511
Net income	—	—	—	41,509	—	—	41,509
Purchase of treasury (740,598 shares)	—	—	—	—	—	(19,366)	(19,366)
Exercise of stock options	3	3	59	—	—	—	62
Stock compensation expense recognized in earnings	—	—	177	—	—	—	177
Other comprehensive income, net of tax:							
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	(23,033)	—	(23,033)
Balance at June 30, 2020	<u>96,229</u>	<u>\$ 96,229</u>	<u>\$ 148,744</u>	<u>\$ 2,233,455</u>	<u>\$ 41,319</u>	<u>\$ (377,887)</u>	<u>\$ 2,141,860</u>

	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2020	96,241	\$ 96,241	\$ 149,334	\$ 2,289,626	\$ 20,825	\$ (378,028)	\$ 2,177,998
Net income	—	—	—	142,797	—	—	142,797
Dividends:							
Cash (\$.55 per share)	—	—	—	(34,813)	—	—	(34,813)
Purchase of treasury stock (999 shares)	—	—	—	—	—	(48)	(48)
Exercise of stock options	91	91	1,905	—	—	—	1,996
Stock compensation expense recognized in earnings	—	—	273	—	—	—	273
Other comprehensive income, net of tax:							
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	(2,533)	—	(2,533)
Balance at June 30, 2021	<u>96,332</u>	<u>\$ 96,332</u>	<u>\$ 151,512</u>	<u>\$ 2,397,610</u>	<u>\$ 18,292</u>	<u>\$ (378,076)</u>	<u>\$ 2,285,670</u>

	Number of Shares	Common Stock	Surplus	Retained Earnings	Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2019	96,215	\$ 96,215	\$ 148,075	\$ 2,200,568	\$ 2,345	\$ (329,150)	\$ 2,118,053
Net income	—	—	—	76,348	—	—	76,348
Dividends:							
Cash (\$.55 per share)	—	—	—	(35,128)	—	—	(35,128)
Purchase of treasury stock (1,941,212 shares)	—	—	—	—	—	(48,737)	(48,737)
Exercise of stock options	14	14	274	—	—	—	288
Stock compensation expense recognized in earnings	—	—	395	—	—	—	395
Cumulative adjustment for adoption of new accounting standards, net of tax	—	—	—	(8,333)	—	—	(8,333)
Other comprehensive income, net of tax:							
Net change in unrealized gains and losses on available for sale securities, net of reclassification adjustments	—	—	—	—	38,974	—	38,974
Balance at June 30, 2020	<u>96,229</u>	<u>\$ 96,229</u>	<u>\$ 148,744</u>	<u>\$ 2,233,455</u>	<u>\$ 41,319</u>	<u>\$ (377,887)</u>	<u>\$ 2,141,860</u>

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in Thousands)

	Six Months Ended June 30,	
	2021	2020
Operating activities:		
Net income	\$ 142,797	\$ 76,348
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit loss	2,336	27,825
Specific reserve, other real estate owned	2,065	537
Depreciation of bank premises and equipment	13,235	14,299
Loss (gain) on sale of bank premises and equipment	15	(155)
Loss on sale of other real estate owned	519	13
Accretion of investment securities discounts	(279)	(241)
Amortization of investment securities premiums	22,329	14,877
Investment securities transactions, net	4	5
Unrealized loss (gain) on equity securities with readily determinable fair values	65	(99)
Proceeds from settlements of claims	2,870	—
Stock based compensation expense	273	395
(Earnings) losses from affiliates and other investments	(61,313)	203
Deferred income taxes	(821)	(14,861)
Decrease (increase) in accrued interest receivable	4,902	(11,064)
Decrease in other assets	12,097	244
Decrease in other liabilities	24,904	28,186
Net cash provided by operating activities	<u>165,998</u>	<u>136,512</u>
Investing activities:		
Proceeds from maturities of securities	1,501,881	1,075
Proceeds from sales and calls of available for sale securities	2,865	18,920
Purchases of available for sale securities	(3,630,564)	(458,184)
Principal collected on mortgage backed securities	1,009,379	753,483
Net decrease (increase) in loans	134,517	(598,176)
Purchases of other investments	(42,037)	(25,329)
Distributions from other investments	59,955	26,688
Purchases of bank premises and equipment	(4,259)	(4,593)
Proceeds from sales of bank premises and equipment	1,255	786
Proceeds from sales of other real estate owned	6,320	3,625
Net cash used in investing activities	<u>\$ (960,688)</u>	<u>\$ (281,705)</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued (Unaudited)

(Dollars in Thousands)

	Six Months Ended June 30,	
	2021	2020
Financing activities:		
Net increase in non-interest bearing demand deposits	\$ 703,414	\$ 870,839
Net increase in savings and interest bearing demand deposits	461,049	290,105
Net (decrease) increase in time deposits	(9,554)	48,745
Net increase in securities sold under repurchase agreements	2,382	150,559
Net decrease in other borrowed funds	(94)	(190,092)
Purchase of treasury stock	(48)	(48,737)
Proceeds from stock transactions	1,996	288
Payments of cash dividends	(34,813)	(35,128)
Net cash provided by financing activities	<u>1,124,332</u>	<u>1,086,579</u>
Increase in cash and cash equivalents	329,642	941,386
Cash and cash equivalents at beginning of period	<u>1,997,238</u>	<u>256,820</u>
Cash and cash equivalents at end of period	<u>\$ 2,326,880</u>	<u>\$ 1,198,206</u>
Supplemental cash flow information:		
Interest paid	\$ 13,991	\$ 23,555
Income taxes paid	16,130	370
Non-cash investing and financing activities:		
Net transfers from loans to other real estate owned	\$ 16,587	\$ 2,234
Net transfers from bank premises and equipment to other assets	—	4,260

See accompanying notes to consolidated financial statements.

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

As used in this report, the words “Company,” “we,” “us” and “our” refer to International Bancshares Corporation, a Texas corporation, its five wholly-owned subsidiary banks, and other subsidiaries. The information that follows may contain forward-looking statements, which are qualified as indicated under “Cautionary Notice Regarding Forward-Looking Statements” in Item 2 (Management’s Discussion and Analysis of Financial Condition and Results of Operations) of this report. Our website address is www.ibc.com.

Note 1 — Basis of Presentation

Our accounting and reporting policies conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. Our consolidated financial statements include the accounts of International Bancshares Corporation, and our wholly-owned bank subsidiaries, International Bank of Commerce, Laredo (“IBC”), Commerce Bank, International Bank of Commerce, Zapata, International Bank of Commerce, Brownsville, International Bank of Commerce, Oklahoma (the “Subsidiary Banks”) and our wholly-owned non-bank subsidiaries, IBC Trading Company, Premier Tierra Holdings, Inc., IBC Charitable and Community Development Corporation, Emerald Galveston Holdings, LLC and IBC Capital Corporation. Our consolidated financial statements are unaudited, but include all adjustments, which, in the opinion of management, are necessary for a fair presentation of the results of the periods presented. All such adjustments were of a normal and recurring nature. These financial statements should be read in conjunction with the financial statements and the notes thereto in our latest Annual Report on Form 10-K. Our consolidated statement of condition at December 31, 2020 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America (“US GAAP”) for complete financial statements. Certain reclassifications have been made to make prior periods comparable. Operating results for the three and six months ended June 30, 2021 are not necessarily indicative of the results for the year ending December 31, 2021 or any future period.

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

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

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 to ASC 326, “Financial Instruments – Credit Losses.” The update amends existing standards for accounting for credit losses for financial assets. The update requires that the expected credit losses on the financial instruments held as of the end of the period being reported be measured based on historical experience, current conditions, and reasonable and supportable forecasts. The update also expands the required disclosures related to significant estimates and judgements used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s financial assets. The update also amended the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The impact of the adoption of the standard is to be recorded as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The accounting standard was effective for us on January 1, 2020. The task force formed last year, which includes key members of the teams that work with the current calculation of the allowance for probable loan losses plus members representing the corporate accounting and risk management areas, has worked with the implementation of the update and validation to complete our model/tool. Based on the composition of the portfolio at December 31, 2019 and after finalizing the methodology, the adoption of the update increased our allowance for probable loan losses (referred to as the allowance for credit losses under ASU 2016-13), by approximately 17.2%, resulting in a cumulative-effect adjustment to retained earnings of approximately

\$8.3 million, net of tax. Please refer to Note 4 – Allowance for Credit Losses and the Critical Accounting Policies discussion in Management’s Discussion and Analysis.

Note 2 — Fair Value Measurements

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

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

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of June 30, 2021 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using		
		(in Thousands)		
	Assets/Liabilities Measured at Fair Value June 30, 2021	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available for sale debt securities				
Residential mortgage-backed securities	\$ 4,123,636	\$ —	\$ 4,123,636	\$ —
States and political subdivisions	48,245	—	48,245	—
Equity Securities	6,136	6,136	—	—
	<u>\$ 4,178,017</u>	<u>\$ 6,136</u>	<u>\$ 4,171,881</u>	<u>\$ —</u>

The following table represents assets and liabilities reported on the consolidated balance sheets at their fair value on a recurring basis as of December 31, 2020 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in Thousands)		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets/Liabilities Measured at Fair Value December 31, 2020				
Assets:				
Available for sale securities				
Residential mortgage - backed securities	\$ 3,029,954	\$ —	\$ 3,029,954	\$ —
States and political subdivisions	50,814	—	50,814	—
Equity Securities	6,202	6,202	—	—
	<u>\$ 3,086,970</u>	<u>\$ 6,202</u>	<u>\$ 3,080,768</u>	<u>\$ —</u>

Available-for-sale debt securities are classified within Level 1 or 2 of the valuation hierarchy. Equity securities with readily determinable fair values are classified within Level 1. For debt investments classified as Level 2 in the fair value hierarchy, we obtain fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Certain financial assets and financial liabilities are measured at fair value on a non-recurring basis. The instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment).

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended June 30, 2021 by level within the fair value measurement hierarchy:

		Fair Value Measurements at Reporting Date Using (in thousands)			
		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
Assets/Liabilities Measured at Fair Value Period ended June 30, 2021					
Measured on a non-recurring basis:					
Assets:					
Watch List-Doubtful loans	\$ 144	\$ —	\$ —	\$ 144	\$ 29
Other real estate owned	\$ 1,980	\$ —	\$ —	\$ 1,980	\$ 2,065

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended December 31, 2020 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, 2020	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	
Measured on a non-recurring basis:						
Assets:						
Watch List-Doubtful loans	\$ 393	\$ —	\$ —	\$ 393	\$ (86)	
Other real estate owned	6,241	—	—	6,241	1,539	

Our assets measured at fair value on a non-recurring basis are limited to loans classified as Watch List – Doubtful and other real estate owned. The fair value of Watch List-Doubtful loans is derived in accordance with FASB ASC 310, “Receivables”. They are primarily comprised of collateral-dependent commercial loans. As the primary sources of loan repayments decline, the secondary repayment source, the collateral, takes on greater significance. Correctly evaluating the fair value becomes even more important. Re-measurement of the loan to fair value is done through a specific valuation allowance included in the allowance for credit losses. The fair value of the loan is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for our appraisal and appraisal review process is based on regulatory guidelines and strives to comply with all regulatory appraisal laws, regulations, and the Uniform Standards of Professional Appraisal Practice. All appraisals and evaluations are “as is” (the property’s highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of June 30, 2021, we had \$1,267,000 of doubtful commercial collateral dependent loans, of which \$1,082,000 had an appraisal performed within the immediately preceding twelve months, and of which \$0 had an evaluation performed within the immediately preceding twelve months. As of December 31, 2020, we had approximately \$18,361,000 of doubtful commercial collateral dependent loans, of which \$16,587,000 had an appraisal performed within the immediately preceding twelve months and of which \$1,283,000 had an evaluation performed within the immediately preceding twelve months.

Our 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 doubtful loans and where obsolete appraisals are identified. In order to determine whether we would obtain a new appraisal or perform an internal evaluation to determine the fair value of the collateral, the credit committee reviews the existing appraisal to determine if the collateral value is reasonable in view of the current use of the collateral and the economic environment related to the collateral. If the analysis of the existing appraisal does not find that the collateral value is reasonable under the current circumstances, we would obtain a new appraisal on the collateral or perform an internal evaluation of the collateral. The ultimate decision to get a new appraisal rests with the independent credit administration group. A new appraisal is not required if an internal evaluation, as performed by in-house experts, is able to appropriately update the original appraisal assumptions to reflect current market conditions and provide an estimate of the collateral’s market value for analysis of the doubtful loan. 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 credit losses (“ACL”), 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 three and six months ended June 30, 2021 and the twelve months ended

December 31, 2020, we recorded \$0, \$0 and \$22,000, respectively, in charges to the ACL in connection with loans transferred to other real estate owned. For the three and six months ended June 30, 2021 and the twelve months ended December 31, 2020, we recorded \$1,915,000, \$2,065,000 and \$1,539,000, respectively, in adjustments to fair value in connection with other real estate owned.

The fair value estimates, methods, and assumptions for our financial instruments at June 30, 2021 and December 31, 2020 are outlined below.

Cash and Cash Equivalents

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

Time Deposits with Banks

The carrying amounts of time deposits with banks approximate 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 6.

Loans

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

For variable rate performing loans, the carrying amount approximates the fair value. For fixed-rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed-rate performing loans are within Level 3 of the fair value hierarchy. At June 30, 2021 and December 31, 2020, the carrying amount of fixed rate performing loans was \$1,664,177,000 and \$1,812,413,000, respectively, and the estimated fair value was \$1,610,401,000 and \$1,747,257,000, 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 June 30, 2021 and December 31, 2020. The fair value of time deposits is based on the discounted value of contractual cashflows. The discount rate is based on currently offered rates. Time deposits are within Level 3 of the fair value

hierarchy. At June 30, 2021 and December 31, 2020, the carrying amount of time deposits was \$2,143,987,000 and \$2,153,541,000, respectively, and the estimated fair value was \$2,141,515,000 and \$2,148,976,000, respectively.

Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements are short-term maturities. Due to the contractual terms of the instruments, the carrying amounts approximated fair value at June 30, 2021 and December 31, 2020.

Junior Subordinated Deferrable Interest Debentures

We currently have floating-rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating-rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at June 30, 2021 and December 31, 2020.

Other Borrowed Funds

We currently have long-term borrowings issued from the Federal Home Loan Bank (“FHLB”). The long-term borrowings outstanding at June 30, 2021 and December 31, 2020 are fixed-rate borrowings and the fair value is based on established market spreads for similar types of borrowings. The fixed rate long-term borrowings are included in Level 2 of the fair value hierarchy. At June 30, 2021 and December 31, 2020, the carrying amount of the fixed rate long-term FHLB borrowings was \$436,233,000 and \$436,372,000, respectively, and the estimated fair value was \$475,671,000 and \$480,475,000, respectively.

Commitments to Extend Credit and Letters of Credit

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

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 our entire holdings of a particular financial instrument. Because no market exists for a significant portion of our financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

Note 3 — Loans

A summary of loans, by loan type at June 30, 2021 and December 31, 2020 is as follows:

	June 30, 2021	December 31, 2020
	(Dollars in Thousands)	
Commercial, financial and agricultural	\$ 4,671,168	\$ 4,516,288
Real estate - mortgage	916,153	999,144
Real estate - construction	1,618,493	1,846,757
Consumer	40,505	40,595
Foreign	141,218	138,970
Total loans	<u>\$ 7,387,537</u>	<u>\$ 7,541,754</u>

Note 4 — Allowance for Credit Losses

The estimation of the ACL is based on a loss-rate methodology that measures lifetime losses on loan pools that have similar risk characteristics. Loans that do not have similar risk characteristics are evaluated on an individual basis. The segmentation of the loan portfolio into pools requires a balancing process between capturing similar risk characteristics and containing sufficient loss history to provide meaningful results. Our segmentation starts at the general loan category with further sub-segmentation based on collateral types that may be of meaningful size and/or may contain sufficient differences in risk characteristics based on management's judgement that would warrant further segmentation. The general loan categories along with primary risk characteristics used in our calculation are as follows:

Commercial and industrial loans. This category includes loans extended to a diverse array of businesses for working capital or equipment purchases. These loans are mostly secured by the collateral pledged by the borrower that is directly related to the business activities of the company such as equipment, accounts receivable and inventory. The borrower's abilities to generate revenues from equipment purchases, collect accounts receivable, and to turn inventory into sales are risk factors in the repayment of the loan. A small portion of this loan category is related to loans secured by oil & gas production and loans secured by aircraft.

Construction and land development loans. This category includes the development of land from unimproved land to lot development for both residential and commercial use and vertical construction across residential and commercial real estate classes. These loans carry risk of repayment when projects incur cost overruns, have an increase in the price of construction materials, encounter zoning, entitlement 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 mortgage rate risk and the practice by the mortgage industry of more restrictive underwriting standards, which inhibits the buyer from obtaining long term financing creating excessive housing and lot inventory in the market.

Commercial real estate loans. This category includes loans secured by farmland, multifamily properties, owner occupied commercial properties, and non-owner occupied commercial properties. Owner occupied commercial properties include warehouses often along the border for import/export operations, office space where the borrower is the primary tenant, restaurants and other single-tenant retail. Non-owner occupied commercial properties include hotels, retail centers, office and professional buildings, and leased warehouses. These loans carry risk of repayment when market values deteriorate, the business experiences turnover in key management, the business has an inability to attract or keep occupancy levels stable, or when the market experiences an exit of a specific business type that is significant to the local economy, such as a manufacturing plant.

1-4 family mortgages. This category includes both first and second lien mortgages for the purpose of home purchases or refinancing of existing mortgage loans. A small portion of this loan category is related to home equity

lines of credits, lots purchases, and home construction. Loan repayments may be affected by unemployment or underemployment and deteriorating market values of real estate.

Consumer loans. This category includes deposit secured, vehicle secured, and unsecured loans, including overdrafts, made to individuals. Repayment is primarily affected by unemployment or underemployment.

The loan pools are further broken down using a risk-based segmentation based on internal classifications for commercial loans and past due status for consumer mortgage loans. Non-mortgage consumer loans are evaluated as one segment. On a weekly basis, commercial loan past due reports are reviewed by the credit quality committee to determine if a loan has any potential problems and if a loan should be placed on our internal Watch List report. Additionally, our credit department reviews the majority of our loans for proper internal classification purposes regardless of whether they are past due and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, we will determine if a loan should be placed on an internal Watch List report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

Our internal Watch List report is segregated into the following categories: (i) Pass, (ii) Economic Monitoring, (iii) Special Review, (iv) Watch List—Pass, (v) Watch List—Substandard, and (vi) Watch List—Doubtful. The loans placed in the Special Review category and lower rated credits reflect our opinion that the loans reflect potential weakness which require monitoring on a more frequent basis. Credits in those categories are reviewed and discussed on a regular basis, no less frequently than quarterly, 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 category and lower rated credits reflect our opinion that the credit contains weaknesses which represent a greater degree of risk, which warrant “extra attention.” Credits in this category 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 category are considered to be potentially inadequately protected by the current sound worth and debt service capacity of the borrower or of any pledged collateral. These credit obligations, even if apparently protected by collateral value, have shown defined weaknesses related to adverse financial, managerial, economic, market or political conditions which may jeopardize repayment of principal and interest. Furthermore, there is the possibility that we may sustain some future loss if such weaknesses are not corrected. The loans placed in the Watch List—Doubtful category have shown defined weaknesses and it is likely, based on current information and events, that we will be unable to collect all principal and/or interest amounts contractually due. Watch List—Doubtful loans are placed on non-accrual when they are moved to that category.

For the purposes of the ACL, in order to maintain segments with sufficient history for meaningful results, the credits in the Pass and Economic Monitoring categories are aggregated, the credits in the Special Review and Watch List—Pass credits are aggregated, and the credits in the Watch List—Substandard category remain in their own segment. For loans that are classified as Watch List—Doubtful, management evaluates these credits in accordance with ASC 310-10, “Receivables,” and, if deemed necessary, a specific reserve is allocated to the loan. 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) net realizable value of the fair value of the collateral if the loan is collateral dependent. Substantially all of our loans evaluated as Watch List—Doubtful under ASC 310-10 are measured using the fair value of collateral method. In rare cases, we may use other methods to determine the specific reserve of a loan under ASC 310-10 if such loan is not collateral dependent.

Within each collectively evaluated pool, the robustness of the lifetime historical loss-rate is evaluated and, if needed, is supplemented with peer loss rates through a model risk adjustment. Certain qualitative loss factors are then evaluated to incorporate management’s two-year reasonable and supportable forecast period followed by a reversion to the pool’s average lifetime loss-rate. Those qualitative loss factors are: (i) trends in portfolio volume and composition, (ii) volume and trends in classified loans, delinquencies, non-accruals and TDR’s, (iii) concentration risk, (iv) trends in underlying collateral value, (v) changes in policies, procedures, and strategies, and (vi) economic conditions. Qualitative factors also include potential losses stemming from operational risk factors arising from fraud, natural disasters,

pandemics and geopolitical events. Should any of the factors considered by management in evaluating the adequacy of the ACL change, our estimate could also change, which could affect the level of future credit loss expense.

We have elected to not measure an ACL for accrued interest receivable given our timely approach in identifying and writing off uncollectible accrued interest. An ACL for off-balance sheet exposure is derived from a projected usage rate of any unfunded commitment multiplied by the historical loss rate, plus model risk adjustment, if any, of the on-balance sheet loan pools.

Our management continually reviews the ACL of the Subsidiary Banks using the amounts determined from the estimates established on specific doubtful loans, the estimate established on quantitative historical loss percentages, and the estimate based on qualitative current conditions and reasonable and supportable two-year forecasted data. Our methodology reverts to the average lifetime loss-rate beyond the forecast period when we can no longer develop reasonable and supportable forecasts. Should any of the factors considered by management in evaluating the adequacy of the estimate for current expected credit losses change, our estimate of current expected credit losses could also change, which could affect the level of future credit loss expense. While the calculation of our ACL utilizes management's best judgment and all information reasonably available, the adequacy of the ACL is dependent on a variety of factors beyond our control, including, among other things, the performance of the entire loan portfolio, the economy, government actions, changes in interest rates and the view of regulatory authorities towards loan classifications.

A summary of the transactions in the allowance for credit loan losses by loan class is as follows:

	Three Months Ended June 30, 2021								Total
	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	
	(Dollars in Thousands)								
Balance at March 31, 2021	\$ 22,163	\$ 34,406	\$ 32,203	\$ 5,935	\$ 3,917	\$ 8,736	\$ 279	\$ 769	\$ 108,408
Losses charged to allowance	(1,655)	—	—	—	(117)	(21)	(55)	—	(1,848)
Recoveries credited to allowance	498	—	7	—	24	37	11	—	577
Net (losses) recoveries charged to allowance	(1,157)	—	7	—	(93)	16	(44)	—	(1,271)
Credit loss expense	2,057	(803)	2,028	(1,729)	92	(556)	33	22	1,144
Balance at June 30, 2021	<u>\$ 23,063</u>	<u>\$ 33,603</u>	<u>\$ 34,238</u>	<u>\$ 4,206</u>	<u>\$ 3,916</u>	<u>\$ 8,196</u>	<u>\$ 268</u>	<u>\$ 791</u>	<u>\$ 108,281</u>

Three Months Ended June 30, 2020									
	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 March 31, 2020	\$ 19,067	\$ 37,421	\$ 15,004	\$ 1,758	\$ 2,782	\$ 8,452	\$ 323	\$ 466	\$ 85,273
Losses charged to allowance	(2,142)	(19)	—	—	—	(121)	(60)	—	(2,342)
Recoveries credited to allowance	599	1	12	—	1	17	4	—	634
Net (losses) recoveries charged to allowance	(1,543)	(18)	12	—	1	(104)	(56)	—	(1,708)
Credit loss expense	2,555	3,521	3,695	106	425	616	21	50	10,989
Balance at June 30, 2020	\$ 20,079	\$ 40,924	\$ 18,711	\$ 1,864	\$ 3,208	\$ 8,964	\$ 288	\$ 516	\$ 94,554

Six Months Ended June 30, 2021									
	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, 2020	\$ 21,908	\$ 37,612	\$ 30,000	\$ 5,051	\$ 3,874	\$ 9,570	\$ 291	\$ 753	\$ 109,059
Losses charged to allowance	(3,548)	—	(356)	—	(189)	(21)	(87)	—	(4,201)
Recoveries credited to allowance	956	—	19	—	35	58	19	—	1,087
Net (losses) recoveries charged to allowance	(2,592)	—	(337)	—	(154)	37	(68)	—	(3,114)
Credit loss expense	3,747	(4,009)	4,575	(845)	196	(1,411)	45	38	2,336
Balance at June 30, 2021	\$ 23,063	\$ 33,603	\$ 34,238	\$ 4,206	\$ 3,916	\$ 8,196	\$ 268	\$ 791	\$ 108,281

Six Months Ended June 30, 2020									
	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, 2019	\$ 11,145	\$ 18,152	\$ 16,533	\$ 1,786	\$ 3,762	\$ 7,535	\$ 542	\$ 823	\$ 60,278
Adoption of ASU 2016-13	4,247	13,391	(4,292)	(355)	(1,580)	(429)	(225)	(410)	10,347
Losses charged to allowance	(4,961)	(19)	(55)	—	(36)	(121)	(130)	—	(5,322)
Recoveries credited to allowance	1,270	1	21	—	2	120	12	—	1,426
Net (losses) recoveries charged to allowance	(3,691)	(18)	(34)	—	(34)	(1)	(118)	—	(3,896)
Credit loss expense	8,378	9,399	6,504	433	1,060	1,859	89	103	27,825
Balance at June 30, 2020	\$ 20,079	\$ 40,924	\$ 18,711	\$ 1,864	\$ 3,208	\$ 8,964	\$ 288	\$ 516	\$ 94,554

The credit loss expense charged to operations increased throughout 2020 as a result of increases in the ACL due to deteriorating economic conditions as a result of the novel Coronavirus Disease 2019 (“COVID-19”) and its variant strains the impact of those conditions on certain segments of our loan portfolio. Economic conditions during the first six months of 2021 have stabilized and, in some segments, slightly improved. The pool specific qualitative loss factors management deemed appropriate for the ACL calculation at December 31, 2020 remained constant in the June 30, 2021 ACL calculation, which positively impacted the calculation and resulted in a decrease in the credit loss expense charged to operations for the three and six months ended June 30, 2021 compared to the same period of 2020.

The table below provides additional information on the balance of loans individually or collectively evaluated for impairment and their related allowance, by loan class as of June 30, 2021 and December 31, 2020:

	June 30, 2021			
	Loans Individually Evaluated For Impairment		Loans Collectively Evaluated For Impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$ 567	\$ 238	\$ 1,706,857	\$ 22,825
Commercial real estate: other construction & land development	769	70	1,617,724	33,533
Commercial real estate: farmland & commercial	404	—	2,597,973	34,238
Commercial real estate: multifamily	121	—	365,246	4,206
Residential: first lien	79	—	399,092	3,916
Residential: junior lien	35	—	516,947	8,196
Consumer	—	—	40,505	268
Foreign	—	—	141,218	791
Total	<u>\$ 1,975</u>	<u>\$ 308</u>	<u>\$ 7,385,562</u>	<u>\$ 107,973</u>

	December 31, 2020			
	Loans Individually Evaluated For Impairment		Loans Collectively Evaluated For Impairment	
	Recorded Investment	Allowance	Recorded Investment	Allowance
	(Dollars in Thousands)			
Domestic				
Commercial	\$ 1,189	\$ 209	\$ 1,784,747	\$ 21,699
Commercial real estate: other construction & land development	17,496	70	1,829,261	37,542
Commercial real estate: farmland & commercial	439	—	2,288,869	30,000
Commercial real estate: multifamily	134	—	440,910	5,051
Residential: first lien	151	—	404,968	3,874
Residential: junior lien	38	—	593,987	9,570
Consumer	—	—	40,595	291
Foreign	—	—	138,970	753
Total	<u>\$ 19,447</u>	<u>\$ 279</u>	<u>\$ 7,522,307</u>	<u>\$ 108,780</u>

The table below provides additional information on loans accounted for on a non-accrual basis by loan class at June 30, 2021 and December 31, 2020:

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
	(Dollars in Thousands)	
Domestic		
Commercial	\$ 567	\$ 1,189
Commercial real estate: other construction & land development	769	17,496
Commercial real estate: farmland & commercial	404	439
Commercial real estate: multifamily	121	134
Residential: first lien	336	526
Residential: junior lien	35	38
Total non-accrual loans	<u>\$ 2,232</u>	<u>\$ 19,822</u>

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 Watch List—Doubtful loans.

	<u>June 30, 2021</u>	<u>December 31, 2020</u>
	(Dollars in Thousands)	
Domestic		
Residential: first lien	\$ 2,234	\$ 4,078
Residential: junior lien	265	521
Consumer	805	989
Foreign	18	233
Total troubled debt restructuring	<u>\$ 3,322</u>	<u>\$ 5,821</u>

We are actively working with our customers affected by the current economic crisis arising from COVID-19. We have been offering and are prepared to continue to offer assistance in accordance with current regulatory guidance. That includes continuously reaching out to our customers and, in some cases, offering short-term payment deferral plans. As of August 1, 2021, we had approximately \$364,296,000 in loans with some degree of payment deferrals in our system. In accordance with interagency regulatory guidance, these short-term deferrals are not considered troubled debt restructurings. The \$364,296,000 is comprised primarily of loans related to industries that have been significantly impacted by the COVID-19 pandemic, including the hospitality sector, the oil and gas industry, and retail developments.

With the passage of the Paycheck Protection Program (“PPP”), administered by the Small Business Association (“SBA”), we assisted our customers with applications for loans through the PPP. PPP loans earn interest at 1% and PPP loans made prior to June 5, 2020 have a two-year term, while those made after June 5, 2020 have a five-year term; however, PPP loans also include forgiveness provisions that we expect most customers will utilize. Customers began submitting applications for the forgiveness program in the third quarter of 2020. PPP loans were intended to support up to 24 weeks of payroll and certain other costs to help those businesses remain viable and allow their employees to pay their bills. As of August 1, 2021, we had 4,015 PPP loans totaling approximately \$272,831,000 outstanding. The PPP loans are fully guaranteed by the U.S. government through the SBA.

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

While our management believes 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 ACL can be made only on a

subjective basis. It is the judgment of our management that the ACL at June 30, 2021 was adequate to absorb probable losses from loans in the portfolio at that date.

The following tables present information regarding the aging of past due loans by loan class at June 30, 2021 and December 31, 2020:

June 30, 2021							
	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	\$ 2,171	\$ 286	\$ 1,646	\$ 1,646	\$ 4,103	\$ 1,703,321	\$ 1,707,424
Commercial real estate: other construction & land development	10,669	51	4,217	3,557	14,937	1,603,556	1,618,493
Commercial real estate: farmland & commercial	3,763	185	4	4	3,952	2,594,425	2,598,377
Commercial real estate: multifamily	—	—	—	—	—	365,367	365,367
Residential: first lien	1,967	749	6,582	6,451	9,298	389,873	399,171
Residential: junior lien	1,141	184	780	745	2,105	514,877	516,982
Consumer	211	79	14	14	304	40,201	40,505
Foreign	479	—	466	466	945	140,273	141,218
Total past due loans	<u>\$ 20,401</u>	<u>\$ 1,534</u>	<u>\$ 13,709</u>	<u>\$ 12,883</u>	<u>\$ 35,644</u>	<u>\$ 7,351,893</u>	<u>\$ 7,387,537</u>
December 31, 2020							
	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	\$ 1,931	\$ 1,109	\$ 563	\$ 318	\$ 3,603	\$ 1,782,333	\$ 1,785,936
Commercial real estate: other construction & land development	1,059	854	16,587	—	18,500	1,828,257	1,846,757
Commercial real estate: farmland & commercial	2,435	219	186	186	2,840	2,286,468	2,289,308
Commercial real estate: multifamily	126	—	—	—	126	440,918	441,044
Residential: first lien	2,399	926	6,165	5,890	9,490	395,629	405,119
Residential: junior lien	561	247	1,197	1,197	2,005	592,020	594,025
Consumer	318	71	79	79	468	40,127	40,595
Foreign	478	180	568	568	1,226	137,744	138,970
Total past due loans	<u>\$ 9,307</u>	<u>\$ 3,606</u>	<u>\$ 25,345</u>	<u>\$ 8,238</u>	<u>\$ 38,258</u>	<u>\$ 7,503,496</u>	<u>\$ 7,541,754</u>

The decrease in Commercial Real Estate – Other Construction and Land Development Loans 90 days or greater past due at June 30, 2021 can be primarily attributed to a relationship secured by commercial property that was placed on non-accrual in the fourth quarter of 2020 and foreclosed upon in the first quarter of 2021.

A summary of the loan portfolio by credit quality indicator by loan class and by year of origination at June 30, 2021 and December 31, 2020 is presented below:

	<u>2021</u>	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>Prior</u>	<u>Total</u>
	(Dollars in Thousands)						
Balance at June 30, 2021							
Domestic							
Commercial							
Pass	\$ 648,779	\$ 585,815	\$ 151,781	\$ 115,209	\$ 73,253	\$ 15,095	\$ 1,589,932
Special Review	1,528	74,697	—	—	—	1	76,226
Watch List - Pass	—	36,371	—	—	—	12	36,383
Watch List - Substandard	3,123	287	845	61	—	—	4,316
Watch List - Doubtful	320	144	—	—	103	—	567
Total Commercial	<u>\$ 653,750</u>	<u>\$ 697,314</u>	<u>\$ 152,626</u>	<u>\$ 115,270</u>	<u>\$ 73,356</u>	<u>\$ 15,108</u>	<u>\$ 1,707,424</u>
Commercial real estate: other construction & land development							
Pass	\$ 367,161	\$ 515,464	\$ 522,601	\$ 134,382	\$ 15,864	\$ 8,702	\$ 1,564,174
Special Review	30,398	—	—	—	—	—	30,398
Watch List - Pass	—	23,101	—	51	—	—	23,152
Watch List - Doubtful	—	769	—	—	—	—	769
Total Commercial real estate: other construction & land development	<u>\$ 397,559</u>	<u>\$ 539,334</u>	<u>\$ 522,601</u>	<u>\$ 134,433</u>	<u>\$ 15,864</u>	<u>\$ 8,702</u>	<u>\$ 1,618,493</u>
Commercial real estate: farmland & commercial							
Pass	\$ 464,047	\$ 752,584	\$ 340,132	\$ 445,558	\$ 203,489	\$ 258,935	\$ 2,464,745
Special Review	2,154	1,335	921	4,170	64	912	9,556
Watch List - Pass	17,228	44,226	—	277	97	—	61,828
Watch List - Substandard	—	54,661	4,497	—	2,220	466	61,844
Watch List - Doubtful	—	219	185	—	—	—	404
Total Commercial real estate: farmland & commercial	<u>\$ 483,429</u>	<u>\$ 853,025</u>	<u>\$ 345,735</u>	<u>\$ 450,005</u>	<u>\$ 205,870</u>	<u>\$ 260,313</u>	<u>\$ 2,598,377</u>
Commercial real estate: multifamily							
Pass	\$ 25,734	\$ 81,249	\$ 102,969	\$ 77,220	\$ 69,377	\$ 8,697	\$ 365,246
Watch List - Doubtful	—	121	—	—	—	—	121
Total Commercial real estate: multifamily	<u>\$ 25,734</u>	<u>\$ 81,370</u>	<u>\$ 102,969</u>	<u>\$ 77,220</u>	<u>\$ 69,377</u>	<u>\$ 8,697</u>	<u>\$ 365,367</u>
Residential: first lien							
Pass	\$ 67,108	\$ 68,283	\$ 70,479	\$ 56,313	\$ 34,787	\$ 102,064	\$ 399,034
Watch List - Substandard	58	—	—	—	—	—	58
Watch List - Doubtful	—	79	—	—	—	—	79
Total Residential: first lien	<u>\$ 67,166</u>	<u>\$ 68,362</u>	<u>\$ 70,479</u>	<u>\$ 56,313</u>	<u>\$ 34,787</u>	<u>\$ 102,064</u>	<u>\$ 399,171</u>
Residential: junior lien							
Pass	\$ 67,010	\$ 165,589	\$ 81,771	\$ 42,997	\$ 53,410	\$ 106,170	\$ 516,947
Watch List- Doubtful	—	35	—	—	—	—	35
Total Residential: junior lien	<u>\$ 67,010</u>	<u>\$ 165,624</u>	<u>\$ 81,771</u>	<u>\$ 42,997</u>	<u>\$ 53,410</u>	<u>\$ 106,170</u>	<u>\$ 516,982</u>
Residential: junior lien							
Consumer							
Pass	\$ 18,941	\$ 16,290	\$ 3,172	\$ 428	\$ 85	\$ 1,589	\$ 40,505
Total Consumer	<u>\$ 18,941</u>	<u>\$ 16,290</u>	<u>\$ 3,172</u>	<u>\$ 428</u>	<u>\$ 85</u>	<u>\$ 1,589</u>	<u>\$ 40,505</u>
Foreign							
Pass	\$ 48,504	\$ 60,159	\$ 11,376	\$ 10,049	\$ 5,524	\$ 5,606	\$ 141,218
Total Foreign	<u>\$ 48,504</u>	<u>\$ 60,159</u>	<u>\$ 11,376</u>	<u>\$ 10,049</u>	<u>\$ 5,524</u>	<u>\$ 5,606</u>	<u>\$ 141,218</u>
Total Loans	<u>\$ 1,762,093</u>	<u>\$ 2,481,478</u>	<u>\$ 1,290,729</u>	<u>\$ 886,715</u>	<u>\$ 458,273</u>	<u>\$ 508,249</u>	<u>\$ 7,387,537</u>

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>Prior</u>	<u>Total</u>
	(Dollars in Thousands)						
Balance at December 31, 2020							
Domestic							
Commercial							
Pass	\$ 1,168,671	\$ 240,869	\$ 145,670	\$ 85,434	\$ 13,901	\$ 10,000	\$ 1,664,545
Special Review	75,638	—	—	—	—	—	75,638
Watch List - Pass	39,886	11	—	3	—	17	39,917
Watch List - Substandard	3,360	683	289	—	315	—	4,647
Watch List - Doubtful	777	161	92	159	—	—	1,189
Total Commercial	<u>\$ 1,288,332</u>	<u>\$ 241,724</u>	<u>\$ 146,051</u>	<u>\$ 85,596</u>	<u>\$ 14,216</u>	<u>\$ 10,017</u>	<u>\$ 1,785,936</u>
Commercial real estate: other construction & land development							
Pass	\$ 773,165	\$ 576,707	\$ 320,308	\$ 78,174	\$ 10,534	\$ 3,343	\$ 1,762,231
Special Review	20,828	21,650	—	—	—	—	42,478
Watch List - Pass	23,101	1,451	—	—	—	—	24,552
Watch List - Doubtful	16,702	794	—	—	—	—	17,496
Total Commercial real estate: other construction & land development	<u>\$ 833,796</u>	<u>\$ 600,602</u>	<u>\$ 320,308</u>	<u>\$ 78,174</u>	<u>\$ 10,534</u>	<u>\$ 3,343</u>	<u>\$ 1,846,757</u>
Commercial real estate: farmland & commercial							
Pass	\$ 884,070	\$ 373,993	\$ 386,268	\$ 189,639	\$ 202,500	\$ 116,729	\$ 2,153,199
Special Review	3,041	—	4,758	177	3,218	—	11,194
Watch List - Pass	61,637	942	277	80	—	—	62,936
Watch List - Substandard	53,809	4,986	—	2,269	475	1	61,540
Watch List - Doubtful	—	202	—	—	—	237	439
Total Commercial real estate: farmland & commercial	<u>\$ 1,002,557</u>	<u>\$ 380,123</u>	<u>\$ 391,303</u>	<u>\$ 192,165</u>	<u>\$ 206,193</u>	<u>\$ 116,967</u>	<u>\$ 2,289,308</u>
Commercial real estate: multifamily							
Pass	\$ 74,577	\$ 208,356	\$ 82,818	\$ 64,110	\$ 6,801	\$ 4,248	\$ 440,910
Watch List - Doubtful	134	—	—	—	—	—	134
Total Commercial real estate: multifamily	<u>\$ 74,711</u>	<u>\$ 208,356</u>	<u>\$ 82,818</u>	<u>\$ 64,110</u>	<u>\$ 6,801</u>	<u>\$ 4,248</u>	<u>\$ 441,044</u>
Residential: first lien							
Pass	\$ 81,004	\$ 62,165	\$ 72,299	\$ 54,593	\$ 29,250	\$ 105,463	\$ 404,774
Watch List - Pass	—	14	131	—	—	—	145
Watch List - Substandard	—	—	—	—	49	—	49
Watch List - Doubtful	86	—	—	—	—	65	151
Total Residential: first lien	<u>\$ 81,090</u>	<u>\$ 62,179</u>	<u>\$ 72,430</u>	<u>\$ 54,593</u>	<u>\$ 29,299</u>	<u>\$ 105,528</u>	<u>\$ 405,119</u>
Residential: junior lien							
Pass	\$ 196,308	\$ 108,276	\$ 61,636	\$ 75,056	\$ 56,705	\$ 94,454	\$ 592,435
Special Review	740	—	—	812	—	—	1,552
Watch List - Doubtful	—	—	38	—	—	—	38
Total Residential: junior lien	<u>\$ 197,048</u>	<u>\$ 108,276</u>	<u>\$ 61,674</u>	<u>\$ 75,868</u>	<u>\$ 56,705</u>	<u>\$ 94,454</u>	<u>\$ 594,025</u>
Consumer							
Pass	\$ 30,910	\$ 7,159	\$ 875	\$ 225	\$ 55	\$ 1,371	\$ 40,595
Total Consumer	<u>\$ 30,910</u>	<u>\$ 7,159</u>	<u>\$ 875</u>	<u>\$ 225</u>	<u>\$ 55</u>	<u>\$ 1,371</u>	<u>\$ 40,595</u>
Foreign							
Pass	\$ 93,236	\$ 19,092	\$ 11,572	\$ 6,192	\$ 3,533	\$ 5,345	\$ 138,970
Total Foreign	<u>\$ 93,236</u>	<u>\$ 19,092</u>	<u>\$ 11,572</u>	<u>\$ 6,192</u>	<u>\$ 3,533</u>	<u>\$ 5,345</u>	<u>\$ 138,970</u>
Total Loans	<u>\$ 3,601,680</u>	<u>\$ 1,627,511</u>	<u>\$ 1,087,031</u>	<u>\$ 556,923</u>	<u>\$ 327,336</u>	<u>\$ 341,273</u>	<u>\$ 7,541,754</u>

The decrease in Special Review Commercial Real Estate – Other Construction and Land development loans at June 30, 2021 compared to December 31, 2020 can be primarily attributed to the payoff of a loan secured by commercial property in the first quarter of 2021. The decrease in Watch List-Doubtful loans in the same category for the same period can be primarily attributed to a relationship secured by commercial property that was placed on non-accrual status in the fourth quarter of 2020 and subsequently foreclosed upon in the first quarter of 2021.

Note 5 — 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 of common stock available for stock option grants under the 2012 Plan, which may be qualified incentive stock options (“ISOs”) or non-qualified stock options. 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 June 30, 2021, 31,090 shares were available for future grants under the 2012 Plan.

A summary of option activity under the stock option plan for the six months ended June 30, 2021 is as follows:

	<u>Number of options</u>	<u>Weighted average exercise price</u>	<u>Weighted average remaining contractual term (years)</u>	<u>Aggregate intrinsic value (\$)</u> (in Thousands)
Options outstanding at December 31, 2020	651,127	\$ 27.24		
Plus: Options granted	—	—		
Less:				
Options exercised	91,262	21.88		
Options expired	—	—		
Options forfeited	20,988	31.75		
Options outstanding at June 30, 2021	<u>538,877</u>	27.97	4.80	\$ 8,066
Options fully vested and exercisable at June 30, 2021	345,715	\$ 24.54	3.54	\$ 6,361

Stock-based compensation expense included in the consolidated statements of income for the three and six months ended June 30, 2021 was \$114,000 and \$273,000, respectively. Stock-based compensation expense included in the consolidated statements of income for the three and six months ended June 30, 2020 was \$177,000 and \$395,000, respectively. As of June 30, 2021, there was approximately \$982,000 of total unrecognized stock-based compensation cost related to non-vested options granted under our plans that will be recognized over a weighted average period of 1.6 years.

Note 6 — Investment Securities, Equity Securities with Readily Determinable Fair Values and Other Investments

We classify debt securities into one of three categories: held-to-maturity, available-for-sale, or trading. Such debt securities are reassessed for appropriate classification at each reporting date. Securities classified as “held-to-maturity” are carried at amortized cost for financial statement reporting, while securities classified as “available-for-sale” and “trading” 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 (loss) and accumulated other comprehensive income (loss) until realized, or in the case of losses, when deemed other than temporary. In accordance with ASU 2016-13, which we adopted on January 1, 2020, available-for-sale and held-to-maturity debt securities in an unrealized loss position must be evaluated for the underlying cause of the loss. In the event that the deterioration in value is attributable to credit related reasons, then the amount of credit-related impairment would be recorded as a charge to our ACL with subsequent changes in the amount of impairment, up or down, also recorded through our ACL. The exception to this process will occur if we intend to sell an impaired available-for-sale debt security or if we will more likely than not be required to sell a credit impaired available-for-sale debt security prior to the value recovering to the security’s amortized cost. In those situations, the entire credit-related impairment amount would be required to be recognized in earnings. We have evaluated the debt securities classified as available-for-sale and held-to-maturity at June 30, 2021 and have determined that no debt securities in an unrealized loss position are arising from credit related reasons and have therefore not recorded any allowances for debt securities in our ACL for the period. Unrealized gains and losses related to equity securities with readily determinable fair values are included in net income.

The amortized cost and estimated fair value by type of investment security at June 30, 2021 are as follows:

	Held-to-Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	\$ 3,400	\$ —	\$ —	\$ 3,400	\$ 3,400
Total investment securities	\$ 3,400	\$ —	\$ —	\$ 3,400	\$ 3,400

	Available for Sale Debt Securities				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value ⁽¹⁾
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 4,103,989	\$ 26,331	\$ (6,684)	\$ 4,123,636	\$ 4,123,636
Obligations of states and political subdivisions	44,684	3,570	(9)	48,245	48,245
Total investment securities	\$ 4,148,673	\$ 29,901	\$ (6,693)	\$ 4,171,881	\$ 4,171,881

- (1) Included in the carrying value of residential mortgage-backed securities are \$917,895 of mortgage-backed securities issued by Ginnie Mae and \$3,205,741 of mortgage-backed securities issued by Fannie Mae and Freddie Mac.

The amortized cost and estimated fair value by type of investment security at December 31, 2020 are as follows:

	Held-to-Maturity				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value
	(Dollars in Thousands)				
Other securities	\$ 3,400	\$ —	\$ —	\$ 3,400	\$ 3,400
Total investment securities	\$ 3,400	\$ —	\$ —	\$ 3,400	\$ 3,400

	Available-for-Sale				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Carrying value ⁽¹⁾
	(Dollars in Thousands)				
Residential mortgage-backed securities	\$ 3,006,592	\$ 32,701	\$ (9,339)	\$ 3,029,954	\$ 3,029,954
Obligations of states and political subdivisions	47,697	3,131	(14)	50,814	50,814
Total investment securities	\$ 3,054,289	\$ 35,832	\$ (9,353)	\$ 3,080,768	\$ 3,080,768

- (1) Included in the carrying value of residential mortgage-backed securities are \$371,407 of mortgage-backed securities issued by Ginnie Mae and \$2,658,547 of mortgage-backed securities issued by Fannie Mae and Freddie.

The amortized cost and estimated fair value of investment securities at June 30, 2021, 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	\$ 2,075	\$ 2,075	\$ —	\$ —
Due after one year through five years	1,325	1,325	—	—
Due after five years through ten years	—	—	—	—
Due after ten years	—	—	44,684	48,245
Residential mortgage-backed securities	—	—	4,103,989	4,123,636
Total investment securities	<u>\$ 3,400</u>	<u>\$ 3,400</u>	<u>\$ 4,148,673</u>	<u>\$ 4,171,881</u>

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

The amortized cost and fair value of available-for-sale debt investment securities pledged to qualify for fiduciary powers, to secure public monies as required by law, repurchase agreements and short-term fixed borrowings was \$1,372,241,000 and \$1,372,942,000, respectively, at June 30, 2021.

Proceeds from the sale and calls of debt securities available-for-sale were \$355,000 and \$2,865,000 for the three and six months ended June 30, 2021, respectively, which included \$0 and \$0 of mortgage-backed securities, respectively. Gross gains of \$0 and \$0 and gross losses of \$0 and \$4,000, respectively, were realized on the sales and calls for the three and six months ended June 30, 2021. Proceeds from the sale and call of debt securities available-for-sale were \$0 and \$18,920,000 for the three and six months ended June 30, 2020, which included \$0 and \$0 of mortgage-backed securities, respectively. Gross gains of \$0 and \$0 and gross losses of \$0 and \$5,000 were realized on the sales and calls for the three and six months ended June 30, 2020, respectively.

Gross unrealized losses on debt investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual debt securities have been in a continuous unrealized loss position at June 30, 2021, 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	\$ 1,672,076	\$ (6,661)	\$ 12,275	\$ (23)	\$ 1,684,351	\$ (6,684)
Obligations of states and political subdivisions	—	—	536	(9)	536	(9)
	<u>\$ 1,672,076</u>	<u>\$ (6,661)</u>	<u>\$ 12,811</u>	<u>\$ (32)</u>	<u>\$ 1,684,887</u>	<u>\$ (6,693)</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 unrealized loss position, at December 31, 2020 were as follows:

	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
	<u>(Dollars in Thousands)</u>					
Available for sale:						
Residential mortgage-backed securities	\$ 1,462,232	\$ (9,339)	\$ —	\$ —	\$ 1,462,232	\$ (9,339)
Obligations of states and political subdivisions	—	—	757	(14)	757	(14)
	<u>\$ 1,462,232</u>	<u>\$ (9,339)</u>	<u>\$ 757</u>	<u>\$ (14)</u>	<u>\$ 1,462,989</u>	<u>\$ (9,353)</u>

The unrealized losses on investments in residential mortgage-backed securities are primarily caused by changes in market interest rates. We have no intent to sell and will more than likely not be required to sell before a market price recovery or maturity of the securities; therefore, it is our conclusion that the investments in residential mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae are not considered other-than-temporarily impaired.

Equity securities with readily determinable fair values consist primarily of Community Reinvestment Act funds. At June 30, 2021 and December 31, 2020, the balance in equity securities with readily determinable fair values recorded at fair value were \$6,136,000 and \$6,202,000, respectively. The following is a summary of unrealized and realized gains and losses recognized in net income on equity securities during the three and six months ended June 30, 2021 and the three and six months ended June 30, 2020:

	<u>Three Months Ended June 30, 2021 (Dollars in Thousands)</u>
Net gains recognized during the period on equity securities	\$ 11
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	—
Unrealized losses recognized during the reporting period on equity securities still held at the reporting date	<u>\$ 11</u>
	<u>Six Months Ended June 30, 2021 (Dollars in Thousands)</u>
Net gains recognized during the period on equity securities	\$ (65)
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	—
Unrealized gains recognized during the reporting period on equity securities still held at the reporting date	<u>\$ (65)</u>

	Three Months Ended June 30, 2020 (Dollars in Thousands)
Net gains recognized during the period on equity securities	\$ 69
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	—
Unrealized gains recognized during the reporting period on equity securities still held at the reporting date	\$ 69
	Six Months Ended June 30, 2020 (Dollars in Thousands)
Net gains recognized during the period on equity securities	\$ 99
Less: Net gains and (losses) recognized during the period on equity securities sold during the period	—
Unrealized losses recognized during the reporting period on equity securities still held at the reporting date	\$ 99

Other investments include equity and merchant banking investments held by our subsidiary banks and non-banking entities. During the second quarter of 2021, one of our non-bank subsidiaries sold an equity interest in a merchant banking investment resulting in a gain on sale included in other investment income on the consolidated statements of income.

Note 7 — Other Borrowed Funds

Other borrowed funds include FHLB borrowings, which are short-term and long-term borrowings issued by the FHLB of Dallas and the FHLB of Topeka at the market price offered at the time of funding. These borrowings are secured by residential mortgage-backed investment securities and a portion of our loan portfolio. At June 30, 2021, other borrowed funds totaled \$436,233,000, a decrease of almost 0% from \$436,327,000 at December 31, 2020.

Note 8 — Junior Subordinated Interest Deferrable Debentures

As of June 30, 2021, we have five statutory business trusts under the laws of the State of Delaware, for the purpose of issuing trust preferred securities. The five statutory business trusts we formed (the “Trusts”) have each issued Capital and Common Securities and invested the proceeds thereof in an equivalent amount of junior subordinated debentures (“Debentures”) that we issued. As of June 30, 2021 and December 31, 2020, the principal amount of Debentures outstanding totaled \$134,642,000.

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

For financial reporting purposes, the Trusts are treated as our investments and not consolidated in our consolidated financial statements. Although the Capital and Common Securities issued by each of the Trusts are not included as a component of shareholders' equity on the consolidated statement of condition, the Capital and Common Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital and Common 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 June 30, 2021 and December 31, 2020, the total \$134,642,000 of the Capital and Common Securities outstanding qualified as Tier 1 capital.

The following table illustrates key information about each of the Capital and Common Securities and their interest rate at June 30, 2021:

	Junior Subordinated Deferrable Interest Debentures (Dollars in Thousands)	Repricing Frequency	Interest Rate	Interest Rate Index(1)	Maturity Date	Optional Redemption Date⁽¹⁾
Trust VIII	\$ 25,774	Quarterly	3.23 %	LIBOR + 3.05	October 2033	October 2008
Trust IX	41,238	Quarterly	1.82 %	LIBOR + 1.62	October 2036	October 2011
Trust X	21,021	Quarterly	1.83 %	LIBOR + 1.65	February 2037	February 2012
Trust XI	25,990	Quarterly	1.82 %	LIBOR + 1.62	July 2037	July 2012
Trust XII	20,619	Quarterly	1.58 %	LIBOR + 1.45	September 2037	September 2012
	<u>\$ 134,642</u>					

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

Note 9 — Common Stock and Dividends

We paid a cash dividend of \$0.55 per share on February 17, 2021 per share to record holders of our common Stock on February 5, 2021. We paid cash dividends of \$.55 per share on April 3, 2020 to record holders of our common stock on April 1, 2020.

In April 2009, the Board of Directors re-established a formal stock repurchase program that authorized the repurchase of up to \$40 million of common stock within the following 12 months. Annually since then, including on March 2, 2021, the Board of Directors extended the repurchase program to purchase up to \$50 million of common stock during the 12-month period commencing on March 17, 2021. Shares of common stock may be purchased from time to time on the open market or through privately negotiated transactions. Shares purchased in this program will be held in treasury for reissue for various corporate purposes, including employee compensation plans. During the second quarter of 2021, the Board of Directors adopted a Rule 10b5-1 trading plan, and intends to adopt additional Rule 10b5-1 trading plans, that will allow us to purchase shares of our common stock during certain trading blackout periods when we ordinarily would not be in the market due to trading restrictions in our insider trading policy. During the term of a Rule 10b5-1 trading plan, purchases of common stock are automatic to the extent the conditions of the plan's trading instructions are met. Shares purchased under the Rule 10b5-1 trading plan will be held in treasury for reissue for various corporate purposes, including employee stock compensation plans. As of August 2, 2021, a total of 12,268,401 shares had been repurchased under all programs at a cost of \$357,102,000. We are not obligated to purchase shares under our stock repurchase program outside of its Rule 10b5-1 trading plan.

Note 10 — Commitments and Contingent Liabilities and Other Tax Matters

We are involved in various legal proceedings that are in various stages of litigation. We have 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 our consolidated financial position or

results of operations. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

Note 11 — Capital Ratios

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amount and classifications are also subject to qualitative judgments by regulators about components, risk-weighting and other factors.

In July 2013, the Federal Deposit Insurance Corporation (“FDIC”) and other regulatory bodies established a new, comprehensive capital framework for U.S. banking organizations, consisting of minimum requirements that increase both the quantity and quality of capital held by banking organizations. The final rules are a result of the implementation of the BASEL III capital reforms and various Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank”) related capital provisions. Consistent with the Basel international framework, the rules include a minimum ratio of Common Equity Tier 1 (“CET1”) to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets. The capital conservation buffer began phasing-in on January 1, 2016 at .625% and increased each year until January 1, 2019, when we were required to have a 2.5% capital conservation buffer, effectively resulting in a minimum ratio of CET1 capital to risk-weighted assets of at least 7% upon full implementation. The rules also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. Regarding the quality of capital, the rules emphasize CET1 capital and implements strict eligibility criteria for regulatory capital instruments. The rules also improve the methodology for calculating risk-weighted assets to enhance risk sensitivity. The rules were subject to a four-year phase in period for mandatory compliance and we were required to begin to phase in the rules beginning on January 1, 2015. We believe that as of June 30, 2021, we continue to meet all fully phased-in capital adequacy requirements.

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

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

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 June 30, 2021, our capital levels continue to exceed all capital adequacy requirements under the Basel III Capital Rules as currently applicable to us.

On May 24, 2018, the EGRRCPA was enacted and, among other things, it includes a simplified capital rule change which effectively exempts banks with assets of less than \$10 billion that exceed the “community bank leverage ratio,” from all risk-based capital requirements, including Basel III and its predecessors. The federal banking agencies must establish the “community bank leverage ratio” (a ratio of tangible equity to average consolidated assets) between 8% and 10% before community banks can begin to take advantage of this regulatory relief provision. Some of the Subsidiary Banks, with assets of less than \$10 billion, may qualify for this exemption. Additionally, under the EGRRCPA, qualified bank holding companies with assets of up to \$3 billion (currently \$1 billion) will be eligible for the

Federal Reserve's Small Bank Holding Company Policy Statement, which eases limitations on the issuance of debt by holding companies. On August 28, 2018, the Federal Reserve issued an interim final rule expanding the applicability of its Small Bank Holding Company Policy Statement. While holding companies that meet the conditions of the policy statement are excluded from consolidated capital requirements, their depository institutions continue to be subject to minimum capital requirements. Finally, for banks that continue to be subject to the risk-based capital rules of Basel III (e.g., 150%), certain commercial real estate loans that were formally classified as high volatility commercial real estate 31 ("HVCRE") will not be subject to heightened risk weights if they meet certain criteria. Also, while acquisition, development, and construction ("ADC") loans will generally be subject to heightened risk weights, certain exceptions will apply. On September 18, 2018, the federal banking agencies issued a proposed rule modifying the agencies' capital rules for HVCRE.

We had a CET1 to risk-weighted assets ratio of 19.53% on June 30, 2021 and 19.05% on December 31, 2020. We had a Tier 1 capital-to-average-total-asset (leverage) ratio of 14.15% and 14.92%, risk-weighted Tier 1 capital ratio of 20.66% and 20.25% and risk-weighted total capital ratio of 21.75% and 21.40% at June 30, 2021 and December 31, 2020, respectively. Our CET1 capital consists of common stock and related surplus, net of treasury stock, and retained earnings. We and our Subsidiary Banks elected to opt-out of the requirement to include most components of accumulated other comprehensive income (loss) in the calculation of CET1 capital. CET1 is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities and subject to transition provisions. Tier 1 capital includes CET1 capital and additional Tier 1 capital. Additional Tier 1 capital includes the Capital and Common Securities issued by the Trusts (see Note 8 above) up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold qualifies as Tier 2 capital. As of June 30, 2021, the total of \$134,642,000 of the Capital and Common Securities outstanding qualified as Tier 1 capital. We actively monitor the regulatory capital ratios to ensure that our Subsidiary Banks are well-capitalized under the regulatory framework.

The CET1, 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.

We and our Subsidiary Banks are subject to the regulatory capital requirements administered by the Federal Reserve, and, for our Subsidiary Banks, the FDIC. Regulatory authorities can initiate certain mandatory actions if we or any of our Subsidiary Banks fail to meet the minimum capital requirements, which could have a direct material effect on our financial statements. Management believes, as of June 30, 2021, that we and each of our Subsidiary Banks meet all capital adequacy requirements to which we are subject.

As used in this report, the words "Company," "we," "us" and "our" refer to International Bancshares Corporation, a Texas corporation, its five wholly-owned subsidiary banks, and other subsidiaries. The information that follows may contain forward-looking statements, which are qualified as indicated under "Cautionary Notice Regarding Forward-Looking Statements" in Item 2 (Management's Discussion and Analysis of Financial Condition and Results of Operations) of this report. Our website address is www.ibc.com.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our consolidated financial statements, and notes thereto, for the year ended December 31, 2020, included in our 2020 Form 10-K. Operating results for the three and six months ended June 30, 2021 are not necessarily indicative of the results for the year ending December 31, 2021, or any future period.

Special Cautionary Notice Regarding Forward Looking Information

Certain matters discussed in this report, excluding historical information, include forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities

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

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

- Local, regional, national and international economic business conditions and the impact they may have on us, our customers, and such customers’ ability to transact profitable business with us, including the ability of our borrowers to repay their loans according to their terms or a change in the value of the related collateral.
- Volatility and disruption in national and international financial markets.
- Government intervention in the U.S. financial system.
- The unavailability of funding from the FHLB, Fed or other sources in the future could adversely impact our growth strategy, prospects and performance.
- Changes in consumer spending, borrowing and saving habits.
- Changes in interest rates and market prices, including, the repeal of federal prohibitions on the payment of interest on demand deposits.
- Changes in the capital markets we utilize, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations, including the impact of the Consumer Financial Protection Bureau (“CFPB”) as a regulator of financial institutions, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance, employment, environmental and immigration laws and regulations and the risk of litigation that may follow.
- Changes in U.S.—Mexico trade, including, reductions in border crossings and commerce, renegotiation and recent changes made to the North American Free Trade Agreement, set to be replaced by the 2018 United States-Mexico-Canada Agreement or the possible imposition of tariffs on imported goods.
- The reduction of deposits from nonresident alien individuals due to the IRS rules requiring U.S. financial institutions to report deposit interest payments made to such individuals.
- The loss of senior management or operating personnel.
- The timing, impact and other uncertainties of potential future acquisitions as well as our ability to maintain our current branch network and enter new markets to capitalize on growth opportunities.
- Changes in estimates of future reserve requirements based upon periodic review thereof under relevant regulatory and accounting requirements.
- Additions to our allowance for credit loss as a result of changes in local, national or international conditions which adversely affect our customers.
- Greater than expected costs or difficulties related to the development and integration of new products and lines of business.
- Increased labor costs and effects related to health care reform and other laws, regulations and legal developments impacting labor costs.
- Impairment of carrying value of goodwill could negatively impact our earnings and capital.
- Changes in the soundness of other financial institutions with which we interact.
- Political instability in the United States or Mexico.
- Technological changes or system failures or breaches of our network security, as well as other cyber security risks, could subject us to increased operating costs, litigation and other liabilities.
- Acts of war or terrorism.
- Natural disasters.

- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale portfolios.
- The effect of changes in accounting policies and practices by the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.
- The costs and effects of regulatory developments or regulatory or other governmental inquiries and the results of regulatory examinations or reviews and obtaining 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, 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 and the implementing rules and regulations, including those that establish debit card interchange fee standards and prohibit network exclusivity arrangements and routing restrictions.
- The increase in required capital levels related to the implementation of capital and liquidity rules of the federal banking agencies that address or are impacted by the Basel III capital and liquidity standards.
- The enhanced due diligence burden imposed on banks related to the banks' inability to rely on credit ratings under Dodd-Frank.
- Our failure or circumvention of our internal controls and risk management, policies and procedures.
- Potential direct and indirect impacts, risks, and uncertainties associated with the novel Coronavirus Disease 2019 ("COVID-19") or similar global pandemics.

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

Overview

We are headquartered in Laredo, Texas with 186 facilities and 281 ATMs, and provide banking services for commercial, consumer and international customers of North, South, Central and Southeast Texas and the State of Oklahoma. We are one of the largest independent commercial bank holding companies headquartered in Texas. We, through our Subsidiary Banks, are in the business of gathering funds from various sources and investing those funds in order to earn a return. We, either directly or through a Subsidiary Bank, own an insurance agency, a liquidating subsidiary, a fifty percent interest in an investment banking unit that owns a broker/dealer, a controlling interest in four merchant banking entities, and a majority ownership in a real-estate development partnership. Our primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, we generate income from fees on products offered to commercial, consumer and international customers. The sales team of each of our Subsidiary Banks aims to match the right mix of products and services to each customer to best serve the customer's needs. That process entails spending time with customers to assess those needs and servicing the sales arising from those discussions on a long-term basis. The Subsidiary Banks have various compensation plans, including incentive based compensation, for fairly compensating employees. The Subsidiary Banks also have a robust process in place to review sales that support the incentive based compensation plan to monitor the quality of the sales and identify any significant irregularities, a process that has been in place for many years.

We are very active in facilitating trade along the United States border with Mexico. We do a large amount of business with customers domiciled in Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of our Subsidiary Banks. We also serve the growing Hispanic population through our facilities located throughout South, Central and Southeast Texas and the State of Oklahoma.

In March 2020, the World Health Organization recognized the outbreak of COVID-19 as a pandemic. The spread of COVID-19 and resulting global health crisis created extreme negative consequences and disruption in global financial markets and has curtailed activity in the governmental, commercial and consumer sectors in 2020 and has continued to impact 2021. Government responses at all levels included ordering non-essential businesses be closed, mandating that individuals not working in essential businesses restrict their movement, observing social distancing and shelter in place, and, in many communities, cancelling what remained of the school year. Although some of the

governmental mandates have been lifted with the development of several vaccines for COVID-19, the long-term consequences of those actions, and the responses by individuals and businesses affected, remain to be seen. The rapid decreases in consumer and commercial activity, rapid increases in unemployment, disruption in global supply chains, market downturns and volatility, drastic changes in consumer behavior, new legislation in response to the emergency and decreases in interest rates seen throughout 2020 continue to impact 2021.

We have continued to work with our customers to assist them through these difficult times and we are continuing to capitalize on our strong capital position and strong liquidity to ensure that we are correctly positioned and have the financial strength to continue to navigate the crisis to protect our Company, our employees, our customers and our shareholders. In order to protect the health of our employees and customers, while still filling the needs in the communities we serve as an essential business, we continue to take steps to ensure proper safety protocols are in place, including enforcing local ordinances, discontinuing significant travel, ensuring social distancing, increasing disinfecting of our facilities, establishing a human resources hotline to address employee concerns, and establishing a task force to ensure we are making good decisions. For our customers, we are also working with them on a case-by-case basis on temporary deferrals of interest and/or principal payments on loans and responding to other individual needs of those customers that continue to experience financial distress.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security (“CARES”) Act was signed into law. It contains substantial tax and spending provisions intended to address the impact of the COVID-19 pandemic. The CARES Act includes the Paycheck Protection Program (“PPP”), a nearly \$350 billion program designed to aid small businesses through federally guaranteed loans distributed through banks. These loans were originally intended to support eight weeks of payroll and certain other costs to help those businesses remain viable and allow their employees to pay their bills. Subsequently, on April 24, 2020, the Paycheck Protection Program and Health Care Enhancement Act (“CARES Part II”) was signed into law. CARES Part II provides an additional funding of \$320 billion for the PPP program. Then, on June 5, 2020, the Paycheck Protection Program Flexibility Act (“PPFPA”) was signed into law. The PPFPA, among other things, extended the period of time that businesses could spend PPP loan proceeds on payroll and other eligible costs from eight weeks to the earlier of 24 weeks or December 31, 2020. On December 27, 2020, the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act (the “Economic Aid Act”) was enacted, which among other things, reauthorized lending under the PPP to first-time borrowers and for second draws by certain borrowers who have previously received PPP loans. The Economic Aid Act made available an additional \$147 billion for PPP loans requested by March 31, 2021. We have been active participants in helping our customers obtain PPP loans under all the PPP programs, and as of August 1, 2021, have approximately 4,015 loans with an approximate value of \$272,831,000 outstanding.

Future economic conditions remain uncertain and the impact of those conditions on our business also remains uncertain. Our business depends on the willingness and ability of our customers to conduct banking and other financial transactions. Our revenue streams including service charges on deposits and banking and non-banking service charges and fees (ATM and Interchange Income) have been impacted and may continue to be impacted in the future if economic conditions do not improve. Expense control has been a long-time focus and essential element to our long-term profitability. We have kept that focus in mind as we continue to look at operations and create efficiencies and institute cost-control protocols at all levels. We will continue to monitor our efficiency ratio, a measure of non-interest expense to net interest income plus non-interest income and our overhead burden ratio, a ratio of our operating expenses against total assets, closely. We use these measures in determining if we are accomplishing our long-term goals of controlling our costs in order to provide superior returns to our shareholders.

Results of Operations

Summary

Consolidated Statements of Condition Information

	June 30, 2021	December 31, 2020	Percent Increase (Decrease)
	(Dollars in Thousands)		
Assets	\$ 15,311,005	\$ 14,029,467	9.1 %
Net loans	7,279,255	7,432,695	(2.1)
Deposits	11,876,769	10,721,860	10.8
Securities sold under repurchase agreements	430,530	428,148	0.6
Other borrowed funds	436,233	436,327	(0.0)
Junior subordinated deferrable interest debentures	134,642	134,642	—
Shareholders' equity	2,285,670	2,177,998	4.9

Consolidated Statements of Income Information

	Three Months Ended June 30, (Dollars in Thousands)		Percent Increase (Decrease)	Six Months Ended June 30, (Dollars in Thousands)		Percent Increase (Decrease)
	2021	2020		2021	2020	
Interest income	\$ 97,979	\$ 113,650	(13.8)%	\$ 195,853	\$ 230,262	(14.9)%
Interest expense	6,671	9,796	(31.9)	13,536	23,565	(42.6)
Net interest income	91,308	103,854	(12.1)	182,317	206,697	(11.8)
Provision for probable loan losses	1,144	10,989	(89.6)	2,336	27,825	(91.6)
Non-interest income	97,906	33,596	191.4	134,143	68,726	95.2
Non-interest expense	69,954	73,908	(5.3)	132,139	150,889	(12.4)
Net income	92,026	41,509	121.7 %	142,797	76,348	87.0 %
Per common share:						
Basic	\$ 1.45	\$.66	119.7 %	\$ 2.25	\$ 1.19	89.1 %
Diluted	1.45	.65	123.1	2.25	1.19	89.1

Net Income

Net income for the three and six months ended June 30, 2021 increased by 121.7% and 87.0% compared to the same periods of 2020. Net income for the three and six months ended June 30, 2021 was significantly impacted by the sale of an equity interest in a merchant banking investment held by one of our non-bank subsidiaries totaling \$42.8 million, net of tax. Net income for the periods was also positively impacted by a decrease in the provision for credit losses compared to the same periods of 2020. We adopted the provisions of ASU 2016-13 on January 1, 2020, resulting in a transition from the long-standing incurred loss model to an expected credit loss model, which recognizes credit losses over the life of a financial asset. Expected credit losses capture historical information, current conditions, and reasonable and supportable forecasts of future conditions. The impact of the adoption resulted in a charge to capital of \$8.3 million, net of tax. The credit loss expense charged to operations increased throughout 2020 as a result of increases in the allowance for credit losses ("ACL") due to deteriorating economic conditions as a result of COVID-19 and the impact of those conditions on certain segments of our loan portfolio. Economic conditions during the first six months of 2021 have stabilized or slightly improved in certain segments. The pool specific qualitative loss factors management deemed appropriate for the ACL calculation at December 31, 2020 remained constant in the June 30, 2021 ACL calculation, which positively impacted the calculation and resulted in a decrease of \$20.1 million, net of tax, in the credit loss expense charged to operations for the six months ended June 30, 2021 compared to the same period of 2020. Net interest income continues to be negatively impacted by the Federal Reserve Board ("FRB") action to decrease interest rates in March 2020.

Net Interest Income

	Three Months Ended June 30, (Dollars in Thousands) 2021		Percent Increase (Decrease)	Six Months Ended June 30, (Dollars in Thousands) 2021		Percent Increase (Decrease)
	2021	2020		2021	2020	
Interest Income:						
Loans, including fees	\$ 91,816	\$ 97,764	(6.1)%	\$ 183,930	\$ 196,994	(6.6)%
Investment securities:						
Taxable	5,014	15,092	(66.8)	9,889	31,580	(68.7)
Tax-exempt	377	653	(42.3)	772	1,419	(45.6)
Other interest income	772	141	447.5	1,262	269	369.1
Total interest income	97,979	113,650	(13.8)	195,853	230,262	(14.9)
Interest expense:						
Savings deposits	990	1,161	(14.7)	1,919	4,396	(56.3)
Time deposits	2,929	5,319	(44.9)	6,127	11,289	(45.7)
Securities sold under Repurchase agreements	142	148	(4.1)	283	613	(53.8)
Other borrowings	1,908	2,088	(8.6)	3,797	4,914	(22.7)
Junior subordinated interest deferrable debentures	702	1,080	(35.0)	1,410	2,353	(40.1)
Total interest expense	6,671	9,796	(31.9)	13,536	23,565	(42.6)
Net interest income	<u>\$ 91,308</u>	<u>\$ 103,854</u>	<u>(12.1)%</u>	<u>\$ 182,317</u>	<u>\$ 206,697</u>	<u>(11.8)%</u>

The decrease in net interest income for the three and six months ended June 30, 2021 can be attributed to a decrease in interest income on loans and investment securities arising from the Federal Reserve Board actions to lower interest rates in early 2020, a decrease in the average size of the available-for-sale securities portfolio, and an acceleration in principal paydowns of residential mortgage-backed securities in the portfolio. Interest expense on other borrowings consists of interest expense on FHLB borrowings and has decreased as the level of borrowings outstanding has decreased. Interest expense on savings and time deposits for the three and six months ended June 30, 2021 was positively impacted by internal rate decreases paid on such deposits in line with market interest rates. 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. As part of our strategy to manage interest rate risk, we strive to manage both assets and liabilities so that interest sensitivities match. One method of calculating interest rate sensitivity is through gap analysis. A gap is the difference between the amount of interest rate sensitive assets and interest rate sensitive liabilities that re-price or mature in a given time period. Positive gaps occur when interest rate sensitive assets exceed interest rate sensitive liabilities, and negative gaps occur when interest rate sensitive liabilities exceed interest rate sensitive assets. A positive gap position in a period of rising interest rates should have a positive effect on net interest income as assets will re-price faster than liabilities. Conversely, net interest income should contract somewhat in a period of falling interest rates. Our management can quickly change our interest rate position at any given point in time as market conditions dictate. Additionally, interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Analytical techniques we employ to supplement gap analysis include simulation analysis to quantify interest rate risk exposure. The gap analysis prepared by management is reviewed by our Investment Committee twice a year (see table on page 45 for the June 30, 2021 gap analysis). Our management currently believes that we are properly positioned for interest rate changes; however if our management determines at any time that we are not properly positioned, we will strive to adjust the interest rate sensitive assets and liabilities in order to manage the effect of interest rate changes.

Non-Interest Income

	Three Months Ended June 30, (Dollars in Thousands)		Percent Increase (Decrease)	Six Months Ended June 30, (Dollars in Thousands)		Percent Increase (Decrease)
	2021	2020		2021	2020	
Service charges on deposit accounts	\$ 15,774	\$ 12,880	22.5 %	\$ 30,677	\$ 30,517	0.5 %
Other service charges, commissions and fees						
Banking	13,233	11,229	17.8	25,416	22,395	13.5
Non-banking	2,345	2,030	15.5	3,785	3,784	0.0
Investment securities transactions, net	—	—	—	(4)	(5)	(20.0)
Other investments, net	58,920	617	9,449.4	63,005	386	16,222.5
Other income	7,634	6,840	11.6	11,264	11,649	(3.3)
Total non-interest income	<u>\$ 97,906</u>	<u>\$ 33,596</u>	<u>191.4 %</u>	<u>\$ 134,143</u>	<u>\$ 68,726</u>	<u>95.2 %</u>

Total non-interest income for the three and six months ended June 30, 2021 increased by 191.4% and 95.2%, respectively, compared to the same periods of 2020. Income from service charges on deposits increased for the three and six months ended June 30, 2021 compared to the same periods of 2020 due to an increase in customer activity as a result of the current economic environment and a decrease in the impact of the COVID-19 pandemic on day-to-day activities. Non-interest income from other investments for the three and six months ended June 30, 2021 was positively impacted by the sale of an equity interest in a merchant banking investment held by one of our non-bank subsidiaries.

Non-Interest Expense

	Three Months Ended June 30, (Dollars in Thousands)		Percent Increase (Decrease)	Six Months Ended June 30, (Dollars in Thousands)		Percent Increase (Decrease)
	2021	2020		2021	2020	
Employee compensation and benefits	\$ 30,548	\$ 32,319	(5.5)%	\$ 60,710	\$ 68,649	(11.6)%
Occupancy	6,530	5,770	13.2	12,147	12,669	(4.1)
Depreciation of bank premises and equipment	6,436	7,190	(10.5)	13,235	14,299	(7.4)
Professional fees	2,281	3,913	(41.7)	5,117	7,883	(35.1)
Deposit insurance assessments	927	202	100.0	1,814	202	798.0
Net expense, other real estate owned	3,668	2,835	29.4	4,913	5,837	(15.8)
Advertising	1,456	1,892	(23.0)	2,879	3,876	(25.7)
Software and software maintenance	4,526	5,257	(13.9)	8,966	9,748	(8.0)
Other	13,582	14,530	(6.5)	22,358	27,726	(19.4)
Total non-interest expense	<u>\$ 69,954</u>	<u>\$ 73,908</u>	<u>(5.3)%</u>	<u>\$ 132,139</u>	<u>\$ 150,889</u>	<u>(12.4)%</u>

Non-interest expense for the three and six months ended June 30, 2021 decreased by 5.3% and 12.4%, respectively, compared to the same periods of 2020. The decrease is primarily due to our continued employee compensation and benefits reductions, and is primarily being driven by efforts to right-size and closely manage our workforce commensurate with decreased activities in our branches arising from the COVID-19 pandemic while ensuring that we are able to continue to serve our customers. We continue to monitor and manage our controllable non-interest expenses through a variety of measures with the ultimate goal of ensuring we align non-interest expenses with our operations and revenue streams.

Financial Condition

Allowance for Credit Losses

The allowance for credit losses decreased .7% to \$108,281,000 at June 30, 2021 from \$109,059,000 at December 31, 2020. The provision for credit losses charged to expense decreased 89.6% and 91.6% for the three and six months ended June 30, 2021 to \$1,144,000 and \$2,336,000, respectively compared to \$10,989,000 and \$27,825,000 for the same periods of 2020. The credit loss expense charged to operations increased throughout 2020 as a result of increases in the ACL due to deteriorating economic conditions as a result of COVID-19 and the impact of those conditions on certain segments of our loan portfolio. Economic conditions during the first six months of 2021 have stabilized, and in some segments, slightly improved. The pool specific qualitative loss factors management deemed appropriate for the ACL calculation at December 31, 2020 remained constant in the June 30, 2021 ACL calculation, which positively impacted the calculation and resulted in a decrease in the credit loss expense charged to operations for the three and six months ended June 30, 2021 compared to the same periods of 2020. We adopted the provisions of ASU 2016-13 on January 1, 2020, resulting in a transition from the long-standing incurred loss model to an expected credit loss model, which recognizes credit losses over the life of a financial asset. Expected credit losses capture historical information, current conditions, and reasonable and supportable forecasts of future conditions. Expected credit losses capture historical information, current conditions, and reasonable and supportable forecasts of future conditions. The allowance for credit losses was 1.47% of total loans at June 30, 2021 and 1.45% of total loans at December 31, 2020.

Investment Securities

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

Total loans decreased by 2.0% to \$7,387,537,000 at June 30, 2021, from \$7,541,754,000 at December 31, 2020.

Deposits

Deposits increased by 10.8% to \$11,876,769,000 at June 30, 2021, compared to \$10,721,860,000 at December 31, 2020. Deposits have continued to increase as customers have received proceeds from CARES Act programs, such as stimulus payments and PPP loan proceeds, and presumably decided to save and preserve cash instead of spending during these uncertain times.

Foreign Operations

On June 30, 2021, we had \$15,311,005,000 of consolidated assets, of which approximately \$141,218,000, or .9%, was related to loans outstanding to borrowers domiciled in foreign countries, compared to \$138,970,000, or 1.0%, at December 31, 2020. Of the \$141,218,000, 86.7% is directly or indirectly secured by U.S. assets, certificates of deposits and real estate; 7.5% is secured by foreign real estate or other assets; and 5.8% is unsecured.

Critical Accounting Policies

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

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

We consider our estimated ACL as a policy critical to the sound operations of our Subsidiary Banks. We adopted the provisions of Accounting Standards Update No. 2016-13 to ASC 326, "Financial Instruments – Credit Losses," on January 1, 2020. ASU 2016-13 replaces the long-standing incurred loss model with an expected credit loss model that recognizes credit losses over the life of a financial asset. Expected credit losses capture historical information, current conditions, and reasonable and supportable forecasts of future conditions. The ACL is deducted from the amortized cost of an instrument to present the net amount expected to be collected on the financial asset. Our ACL primarily consists of the aggregate ACL estimates of our Subsidiary Banks. The estimates are established through charges to operations in the form of charges to provisions for credit loss expense. Loan losses or recoveries are charged or credited directly to the ACL. The ACL of each Subsidiary Bank is maintained at a level considered appropriate by management, based on estimated current expected credit losses in the current loan portfolio, including information about past events, current conditions and reasonable and supportable forecasts.

The estimation of the ACL is based on a loss-rate methodology that measures lifetime losses on loan pools that have similar risk characteristics. Loans that do not have similar risk characteristics are evaluated on an individual basis. The segmentation of the loan portfolio into pools requires a balancing process between capturing similar risk characteristics and containing sufficient loss history to provide meaningful results. Our segmentation starts at the general loan category with further sub-segmentation based on collateral types that may be of meaningful size and/or may contain sufficient differences in risk characteristics based on management's judgement that would warrant further segmentation. The general loan categories along with primary risk characteristics used in our calculation are as follows:

Commercial and industrial loans. This category includes loans extended to a diverse array of businesses for working capital or equipment purchases. These loans are mostly secured by the collateral pledged by the borrower that is directly related to the business activities of the company such as equipment, accounts receivable and inventory. The borrower's abilities to generate revenues from equipment purchases, collect accounts receivable, and to turn inventory into sales are risk factors in the repayment of the loan. A small portion of this loan category is related to loans secured by oil & gas production and loans secured by aircraft.

Construction and land development loans. This category includes the development of land from unimproved land to lot development for both residential and commercial use and vertical construction across residential and commercial real estate classes. These loans carry risk of repayment when projects incur cost overruns, have an increase in the price of construction materials, encounter zoning, entitlement 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 mortgage rate risk and the practice by the mortgage industry of more restrictive underwriting standards, which inhibits the buyer from obtaining long term financing creating excessive housing and lot inventory in the market.

Commercial real estate loans. This category includes loans secured by farmland, multifamily properties, owner occupied commercial properties, and non-owner occupied commercial properties. Owner occupied commercial properties include warehouses often along the border for import/export operations, office space where the borrower is the primary tenant, restaurants and other single-tenant retail. Non-owner occupied commercial properties include hotels, retail centers, office and professional buildings, and leased warehouses. These loans carry risk of repayment when market values deteriorate, the business experiences turnover in key management, the business has an inability to attract or keep occupancy levels stable, or when the market experiences an exit of a specific business type that is significant to the local economy, such as a manufacturing plant.

1-4 family mortgages. This category includes both first and second lien mortgages for the purpose of home purchases or refinancing of existing mortgage loans. A small portion of this loan category is related to home equity lines of credits, lots purchases, and home construction. Loan repayments may be affected by unemployment or underemployment and deteriorating market values of real estate.

Consumer loans. This category includes deposit secured, vehicle secured, and unsecured loans, including overdrafts, made to individuals. Repayment is primarily affected by unemployment or underemployment.

The loan pools are further broken down using a risk-based segmentation based on internal classifications for commercial loans and past due status for consumer mortgage loans. Non-mortgage consumer loans are evaluated as one segment. On a weekly basis, commercial loan past due reports are reviewed by the credit quality committee to determine if a loan has any potential problems and if a loan should be placed on our internal Watch List report. Additionally, our credit department reviews the majority of our loans for proper internal classification purposes regardless of whether they are past due and segregates any loans with potential problems for further review. The credit department will discuss the potential problem loans with the servicing loan officers to determine any relevant issues that were not discovered in the evaluation. Also, an analysis of loans that is provided through examinations by regulatory authorities is considered in the review process. After the above analysis is completed, we will determine if a loan should be placed on an internal Watch List report because of issues related to the analysis of the credit, credit documents, collateral and/or payment history.

Our internal Watch List report is segregated into the following categories: (i) Pass, (ii) Economic Monitoring, (iii) Special Review, (iv) Watch List—Pass, (v) Watch List—Substandard, and (vi) Watch List—Doubtful. The loans placed in the Special Review category and lower rated credits reflect our opinion that the loans reflect potential weakness which require monitoring on a more frequent basis. Credits in those categories are reviewed and discussed on a regular basis, no less frequently than quarterly, 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 category and lower rated credits reflect our opinion that the credit contains weaknesses which represent a greater degree of risk, which warrant “extra attention.” Credits in this category 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 category are considered to be potentially inadequately protected by the current sound worth and debt service capacity of the borrower or of any pledged collateral. These credit obligations, even if apparently protected by collateral value, have shown defined weaknesses related to adverse financial, managerial, economic, market or political conditions which may jeopardize repayment of principal and interest. Furthermore, there is the possibility that we may sustain some future loss if such weaknesses are not corrected. The loans placed in the Watch List—Doubtful category have shown defined weaknesses and it is likely, based on current information and events, that we will be unable to collect all principal and/or interest amounts contractually due. Watch List—Doubtful loans are placed on non-accrual when they are moved to that category.

For the purposes of the ACL, in order to maintain segments with sufficient history for meaningful results, the credits in the Pass and Economic Monitoring categories are aggregated, the credits in the Special Review and Watch List—Pass credits are aggregated, and the credits in the Watch List—Substandard category remain in their own segment. For loans that are classified as Watch List—Doubtful, management evaluates these credits in accordance with ASC 310-10, “Receivables,” and, if deemed necessary, a specific reserve is allocated to the loan. 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) net realizable value of the fair value of the collateral if the loan is collateral dependent. Substantially all of our loans evaluated as Watch List—Doubtful under ASC 310-10 are measured using the fair value of collateral method. In rare cases, we may use other methods to determine the specific reserve of a loan under ASC 310-10 if such loan is not collateral dependent.

Within each collectively evaluated pool, the robustness of the lifetime historical loss-rate is evaluated and, if needed, is supplemented with peer loss rates through a model risk adjustment. Certain qualitative loss factors are then evaluated to incorporate management’s two-year reasonable and supportable forecast period followed by a reversion to the pool’s average lifetime loss-rate. Those qualitative loss factors are: (i) trends in portfolio volume and composition, (ii) volume and trends in classified loans, delinquencies, non-accruals and TDR’s, (iii) concentration risk, (iv) trends in underlying collateral value, (v) changes in policies, procedures, and strategies, and (vi) economic conditions. Qualitative factors also include potential losses stemming from operational risk factors arising from fraud, natural disasters, pandemics and geopolitical events. Should any of the factors considered by management in evaluating the adequacy of the ACL change, our estimate could also change, which could affect the level of future credit loss expense.

We have elected to not measure an ACL for accrued interest receivable given our timely approach in identifying and writing off uncollectible accrued interest. An ACL for off-balance sheet exposure is derived from a projected usage rate of any unfunded commitment multiplied by the historical loss rate, plus model risk adjustment, if any, of the on-balance sheet loan pools.

Our management continually reviews the ACL of the Subsidiary Banks using the amounts determined from the estimates established on specific doubtful loans, the estimate established on quantitative historical loss percentages, and the estimate based on qualitative current conditions and reasonable and supportable two-year forecasted data. Our methodology reverts to the average lifetime loss-rate beyond the forecast period when we can no longer develop reasonable and supportable forecasts. Should any of the factors considered by management in evaluating the adequacy of the estimate for current expected credit losses change, our estimate of current expected credit losses could also change, which could affect the level of future credit loss expense. While the calculation of our ACL utilizes management's best judgment and all information reasonably available, the adequacy of the ACL is dependent on a variety of factors beyond our control, including, among other things, the performance of the entire loan portfolio, the economy, government actions, changes in interest rates and the view of regulatory authorities towards loan classifications.

Liquidity and Capital Resources

The maintenance of adequate liquidity provides our Subsidiary Banks with the ability to meet potential depositor withdrawals, provide for customer credit needs, maintain adequate statutory reserve levels and take full advantage of high-yield investment opportunities as they arise. Liquidity is afforded by access to financial markets and by holding appropriate amounts of liquid assets. Our Subsidiary Banks derive their liquidity largely from deposits of individuals and business entities. Deposits from persons and entities domiciled in Mexico comprise a stable portion of the deposit base of our Subsidiary Banks. Other important funding sources for our Subsidiary Banks during 2021 and 2020 were borrowings from the FHLB, securities sold under repurchase agreements and large certificates of deposit, requiring management to closely monitor our asset/liability mix in terms of both rate sensitivity and maturity distribution. Our Subsidiary Banks have had a long-standing relationship with the FHLB and keep open unused lines of credit in order to fund liquidity needs. In the event that the FHLB 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. We maintain a sizable, high quality investment portfolio to provide significant liquidity. These securities can be sold, or sold under agreements to repurchase, to provide immediate liquidity. We will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities and respond accordingly to anticipated fluctuations in interest rates over reasonable periods of time.

We maintain an adequate level of capital as a margin of safety for our depositors and shareholders. At June 30, 2021, shareholders' equity was \$2,285,670,000 compared to \$2,177,998,000 at December 31, 2020. The increase in shareholders' equity can be primarily attributed to the retention of earnings offset by the payment of dividends to shareholders and a decrease in other comprehensive income.

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amount and classifications are also subject to qualitative judgements by regulators about components, risk-weighting and other factors.

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 minimum ratio of Common Equity Tier 1 ("CET1") to risk-weighted assets of 4.5% and a CET1 capital conservation buffer of 2.5% of risk-weighted assets. The capital conservation buffer began phasing-in on January 1, 2016 at .625% and increased each year until January 1, 2019, when we were required to have a 2.5% capital conservation buffer, effectively resulting in a minimum ratio of CET1 capital to

risk-weighted assets of at least 7% upon full implementation. The rules also raised the minimum ratio of Tier 1 capital to risk-weighted assets from 4% to 6% and include a minimum leverage ratio of 4% for all banking organizations. Regarding the quality of capital, the rules emphasize CET1 capital and implements strict eligibility criteria for regulatory capital instruments. The rules also improve the methodology for calculating risk-weighted assets to enhance risk sensitivity. The rules were subject to a four year phase in period for mandatory compliance and we were required to begin to phase in the rules beginning on January 1, 2015. Management believes, as of June 30, 2021, that we and each of our Subsidiary Banks continue to meet all fully phased-in capital adequacy requirements.

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

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

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

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

We had a CET1 to risk-weighted assets ratio of 19.53% on June 30, 2021 and 19.05% on December 31, 2020. We had a Tier 1 capital-to-average-total-asset (leverage) ratio of 14.15% and 14.92%, risk-weighted Tier 1 capital ratio of 20.66% and 20.25% and risk-weighted total capital ratio of 21.75% and 21.40% at June 30, 2021 and December 31, 2020, respectively. Our CET1 capital consists of common stock and related surplus, net of treasury stock, and retained earnings. We and our Subsidiary Banks elected to opt-out of the requirement to include most components of accumulated other comprehensive income (loss) in the calculation of CET1 capital. CET1 is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities and subject to transition provisions. Tier 1 capital includes CET1 capital and additional Tier 1 capital. Additional Tier 1 capital includes the Capital and Common Securities issued by the Trusts (see Note 8 above) up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold qualifies as Tier 2 capital. As of June 30, 2021, the total of \$134,642,000 of the

Capital and Common Securities outstanding qualified as Tier 1 capital. We actively monitor the regulatory capital ratios to ensure that our Subsidiary Banks are well-capitalized under the regulatory framework.

The CET1, 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.

We and our Subsidiary Banks are subject to the regulatory capital requirements administered by the Federal Reserve, and, for our Subsidiary Banks, the FDIC. Regulatory authorities can initiate certain mandatory actions if we or any of our Subsidiary Banks fail to meet the minimum capital requirements, which could have a direct material effect on our financial statements. Management believes, as of June 30, 2021, that we and each of our Subsidiary Banks continue to meet all capital adequacy requirements to which we are subject.

We will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities, and respond accordingly to anticipate fluctuations in interest rates by adjusting the balance between sources and uses of funds as deemed appropriate. The net-interest rate sensitivity as of June 30, 2021 is illustrated in the table entitled “Interest Rate Sensitivity,” below. This information reflects the balances of assets and liabilities for which rates are subject to change. A mix of assets and liabilities that are roughly equal in volume and re-pricing characteristics represents a matched interest rate sensitivity position. Any excess of assets or liabilities results in an interest rate sensitivity gap.

We undertake an interest rate sensitivity analysis to monitor the potential risk on future earnings resulting from the impact of possible future changes in interest rates on currently existing net asset or net liability positions. However, this type of analysis is as of a point-in-time position, when in fact that position can quickly change as market conditions, customer needs, and management strategies change. Thus, interest rate changes do not affect all categories of assets and liabilities equally or at the same time. As indicated in the table, we are asset sensitive in both the short and long term scenarios. Our Asset and Liability Committee semi-annually reviews the consolidated position along with simulation and duration models, and makes adjustments as needed to control our interest rate risk position. We use modeling of future events as a primary tool for monitoring interest rate risk.

**Interest Rate Sensitivity
(Dollars in Thousands)**

June 30, 2021	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	\$ 689,662	\$ 2,032,401	\$ 1,411,109	\$ 48,245	\$ 4,181,417
Loans, net of non-accruals	5,756,999	313,066	390,594	924,646	7,385,305
Total earning assets	\$ 6,446,661	\$ 2,345,467	\$ 1,801,703	\$ 972,891	\$ 11,566,722
Cumulative earning assets	\$ 6,446,661	\$ 8,792,128	\$ 10,593,831	\$ 11,566,722	
Rate sensitive liabilities					
Time deposits	\$ 939,178	\$ 1,072,035	\$ 132,758	\$ 16	\$ 2,143,987
Other interest bearing deposits	4,313,554	—	—	—	4,313,554
Securities sold under repurchase agreements	419,116	11,414	—	—	430,530
Other borrowed funds	—	—	—	436,233	436,233
Junior subordinated deferrable interest debentures	134,642	—	—	—	134,642
Total interest bearing liabilities	\$ 5,806,490	\$ 1,083,449	\$ 132,758	\$ 436,249	\$ 7,458,946
Cumulative sensitive liabilities	\$ 5,806,490	\$ 6,889,939	\$ 7,022,697	\$ 7,458,946	
Repricing gap	\$ 640,171	\$ 1,262,018	\$ 1,668,945	\$ 536,642	\$ 4,107,776
Cumulative repricing gap	640,171	1,902,189	3,571,134	4,107,776	
Ratio of interest-sensitive assets to liabilities	1.11	2.16	13.57	2.23	1.55
Ratio of cumulative, interest-sensitive assets to liabilities	1.11	1.28	1.51	1.55	

Item 3. Quantitative and Qualitative Disclosures about Market Risk

During the six months ended June 30, 2021, there were no material changes in market risk exposures that affected the quantitative and qualitative disclosures regarding market risk presented under the caption “Liquidity and Capital Resources” located on pages 17 through 22 of our 2020 Annual Report as filed as Exhibit 13 to our Form 10-K for the year ended December 31, 2020.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within specified time periods. As of the end of the period covered by this Quarterly Report on Form 10-Q, our principal executive officer and principal financial officer evaluated, with the participation of our management, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act rules 13a-15(e) and 15d-15(e)). Based on the

evaluation, which disclosed no material weaknesses, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various legal proceedings that are in various stages of litigation. We have determined, based on discussions with our counsel that any material loss in any current legal proceedings, individually or in the aggregate, is remote or the damages sought, even if fully recovered, would not be considered material to our consolidated financial position or results of operations. However, many of these matters are in various stages of proceedings and further developments could cause management to revise its assessment of these matters.

1A. Risk Factors

There were no material changes in the risk factors as previously disclosed in Item 1A to Part I of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2020.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In April 2009, the Board of Directors re-established a formal stock repurchase program that authorized the repurchase of up to \$40 million of common stock within the following 12 months. Annually since then, including on March 2, 2021, the Board of Directors extended the repurchase program to purchase up to \$50 million of common stock during the 12-month period commencing on March 17, 2021. Shares of common stock may be purchased from time to time on the open market or through privately negotiated transactions. Shares purchased in this program will be held in treasury for reissue for various corporate purposes, including employee compensation plans. During the second quarter of 2021, the Board of Directors adopted a Rule 10b5-1 trading plan, and intends to adopt additional Rule 10b5-1 trading plans, that will allow us to purchase shares of our common stock during certain trading blackout periods when we ordinarily would not be in the market due to trading restrictions in our insider trading policy. During the term of a Rule 10b5-1 trading plan, purchases of common stock are automatic to the extent the conditions of the plan's trading instructions are met. Shares purchased under the Rule 10b5-1 trading plan will be held in treasury for reissue for various corporate purposes, including employee stock compensation plans. As of August 1, 2021, a total of 12,268,401 shares had been repurchased under all programs at a cost of \$357,102,000. We are not obligated to purchase shares under our stock repurchase program outside of its Rule 10b5-1 trading plan.

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 June 30, 2021.

	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)
April 1 – April 30, 2021	—	\$ —	—	\$ 50,000,000
May 1 – May 31, 2021	—	—	—	50,000,000
June 1 – June 30, 2021	—	—	—	50,000,000
Total	<u>—</u>	<u>\$ —</u>	<u>—</u>	

(1) The repurchase program was extended and increased on March 2, 2021 and allows for the purchase of up to an additional \$50,000,000 of common stock through March 17, 2022.

Item 6. Exhibits

The following exhibits are filed as a part of this Report:

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

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

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

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

101++ — Interactive Data File

104++ — Cover Page Interactive Data File (included in Exhibit 101)

++ Attached as Exhibit 101 to this report are the following documents formatted in Inline XBRL (Extensible Business Reporting Language): (i) the Cover Page to this Form 10-Q; (ii) the Condensed Consolidated Statement of Earnings for the three and six months ended June 30, 2021 and 2020; (iii) the Condensed Consolidated Balance Sheet as of June 30, 2021 and December 31, 2020; and (iv) the Condensed Consolidated Statement of Cash Flows for the six months ended June 30, 2021 and June 30, 2020.

SIGNATURES

Pursuant to the requirements 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

Date: August 5, 2021

/s/ Dennis E. Nixon

Dennis E. Nixon

President

Date: August 5, 2021

/s/ Judith I. Wawroski

Judith I. Wawroski

Treasurer

**Certification of Chief Executive Officer
pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Dennis E. Nixon, certify that:

1. I have reviewed this report on form 10-Q 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 the 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: August 5, 2021

/s/ Dennis E. Nixon

Dennis E. Nixon

President (Chief Executive Officer)

**Certification of Chief Financial Officer
pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Judith I. Wawroski, certify that:

1. I have reviewed this report on form 10-Q 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: August 5, 2021

/s/ Judith I. Wawroski

Judith I. Wawroski

Treasurer (Principal Financial Officer)

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

In connection with the Quarterly Report of International Bancshares Corporation (the “Company”) on Form 10-Q for the period ended June 30, 2021, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Dennis E. Nixon, Chief 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(a) 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: August 5, 2021

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. 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, before or after the date hereof, regardless of any general incorporation language in such filing.

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

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

In connection with the Quarterly Report of International Bancshares Corporation (the “Company”) on Form 10-Q for the period ended June 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Judith I. Wawroski, 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(a) or 78o(d)), as applicable; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Judith I. Wawroski
Judith I. Wawroski
Treasurer

Date: August 5, 2021

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. 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, 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.