



International Bancshares  
Corporation

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*We do more*







**INTERNATIONAL BANCSHARES CORPORATION**  
ALL BANKS MEMBER FDIC  
MEMBER BANKS:

**International Bank Of Commerce**  
**1200 San Bernardo Avenue**  
**(956) 722-7611**

<b>Laredo</b> 7002 San Bernardo Ave. (956) 728-0060 1002 Matamoros (956) 726-6622 1300 Guadalupe (956) 726-6601 2418 Jacaman Rd. (956) 764-6161 5300 San Dario Ste. 440D (956) 728-0063 5300 San Dario Ste. 202 (956) 790-6500 9710 Mines Road (956) 728-0092 4501 San Bernardo (956) 722-0485 7909 McPherson Ave. (956) 728-0064 2442 San Isidro Pkwy (956) 726-6611 2415 S. Zapata Hwy. (956) 728-0061 5610 San Bernardo (956) 726-6688 2320 Bob Bullock Lp 20 (956) 728-0062 4401 Highway 83 South (956) 794-8140 1600 Water Street, Suite B520 (956) 722-7611 <b>Administration Center</b> 2418 Jacaman Rd. (Rear) (956) 722-7611 <b>San Antonio</b> 130 East Travis (210) 518-2500 5029 Broadway (210) 518-2523 6630 Callaghan (210) 369-2960 2201 NW Military Dr. (210) 366-0617 12400 Hwy. 281 North (210) 369-2900 16339 Huebner Rd. (210) 369-2974 8650 Fredericksburg Rd. (210) 930-9811	1500 NE Lp. 410 (210) 281-2400 18750 Stone Oak Pkwy (210) 496-6111 5300 Walzem Rd. (210) 564-2300 11831 Bandera Rd. (210) 369-2980 3119 SE Military Drive (210) 354-6980 327 SW Loop 410 (210) 930-9825 938 SW Military Dr. (210) 930-9815 11002 Culebra (210) 930-9850 <b>Service Center</b> 2416 Cee Gee (210) 821-4700 8770 Tesoro (210) 821-4700 <b>Luling</b> 200 S. Pecan St. (830) 875-2445 <b>Marble Falls</b> 2401 Hwy. 281 North (830) 693-4301 <b>San Marcos</b> 1081 Wonder World (512) 353-1011 <b>Shertz</b> 3800 Hwy 3009 (210) 354-6982 <b>McAllen</b> One S. Broadway (956) 686-0263 7124 N. 23rd. (956) 630-9310 301 S. 10th St. (956) 688-3610 3600 N.10th. St. (956) 688-3690 2200 S. 10th St. (La Plaza East) (956) 688-3670 802 S. Jackson Road (956) 630-9360 2200 S. 10th St. (La Plaza West) (956) 688-3660	2225 Nolana (956) 688-3600 1200 E. Jackson (956) 688-3685 2800 Nolana (956) 688-3620 2900 W. Exp 83 (956) 630-9350 <b>Alamo</b> 1421 West Frontage Rd. (956) 688-3645 <b>Alton</b> 215 West Martin Ave. (956) 630-9319 <b>Edinburg</b> 400 S. Clossner (956) 688-3640 4101 S. McColl (956) 630-9337 1724 W. University Dr. Ste. B (956) 688-3680 2205 W. University Dr. (956) 630-9340 <b>Mission</b> 900 N. Bryan Rd. (956) 688-3630 200 E. Griffin Pkwy (956) 632-3512 2410 E. Expressway 83 (956) 688-3625 121 S. Shary Rd. (956) 630-9365 <b>Pharr</b> 401 South Cage (956) 688-3635 1007 North I Rd. (956) 688-3655 <b>Weslaco</b> 606 S. Texas Blvd. (956) 688-3605 1310 N. Texas (956) 937-9500 <b>Hidalgo</b> 1023 S. Bridge (956) 688-3665 <b>San Juan</b> 108 E. FM 495 (956) 630-9320	<b>Palmhurst</b> 215 E. Mile 3 Rd. (956) 688-3675 <b>Penitas</b> 1705 Expressway 83 (956) 630-9347 <b>Corpus Christi</b> 221 S. Shoreline (361) 888-4000 6130 S. Staples (361) 991-4000 4622 Everhart (361) 903-7265 14066 Northwest Blvd. (361) 903-7285 <b>Flour Bluff</b> 1317 Waldron Road (361) 886-9950 <b>Sinton</b> 301 West Sinton (361) 364-1230 <b>Rockport</b> 2701 Hwy. 35 N. (361) 729-0500 <b>Aransas Pass</b> 2501 W. Wheeler Ave. (361) 729-0500 <b>Portland</b> 1800 US Hwy 181 (361) 886-9910 <b>Port Lavaca</b> 311 N. Virginia St. (361) 552-9771 <b>Bay City</b> 1916 7th Street (979) 245-5781 <b>Victoria</b> 6411 N. Navarro (361) 575-8394 <b>Houston</b> 5615 Kirby Dr. (713) 526-1211 8203 S. Kirkwood (713) 285-2165 1001 McKinney Ste. 150 (713) 285-2140	3200 Woodridge, Ste. 1350 (713) 285-2266 3939 Montrose (713) 285-2195 5085 Westheimer Ste. 4640 (713) 285-2296 1545 Eldridge Parkway (713) 285-2042 <b>Richmond</b> 5250 FM 1460 (832) 595-0920 <b>Sugarland</b> 10570 State Hwy 6 (713) 285-2199 <b>Katy</b> 544 West Grand Parkway (713) 285-2037 <b>Lake Jackson</b> 212 That Way (979) 297-2466 <b>Angleton</b> 130 W. Mulberry (979) 849-7711 <b>Freeport</b> 1208 N. Brazosport Blvd. (979) 233-2677 <b>Dickinson</b> 2301 West FM 646 (713) 285-2021 <b>Eagle Pass</b> 2395 E. Main Street (830) 773-2313 2538 E. Main Street (830) 773-2313 439 Main Street (830) 773-2313 2305 Del Rio Blvd. (830) 773-2313 455 S. Bibb Ave. Ste. 502 (830) 773-2313 2135 East Main Street (830) 773-2313
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**International Bank Of Commerce  
1200 San Bernardo Avenue  
(956) 722-7611**

<b>Del Rio</b> 2410 Dodson St. (830) 775-4265 1507 Veterans Blvd (830) 775-4265 2205 Veterans Blvd, Suite E9 (830) 775-4265	<b>Round Rock</b> 1850 Gattis School Rd. (512) 320-9530 <b>Leander</b> 1695 US Hwy 183 (512) 320-9540 <b>Oklahoma Ardmore</b> 2302 12th Ave. (580) 223-0345 <b>Broken Arrow</b> 6412 S. Elm Pl. (918) 497-2492 <b>Austin</b> 500 West 5th St. (512) 397-4506 10405 FM 2222 (512) 397-4584 2817 E. Cesar Chavez (512) 320-9650 12625 North IH 35 Bldg. D (512) 397-4570 11400 Burnett Road Bldg. 46 (512) 397-4595 9900 South IH 35 Bldg. Y (512) 397-4530 4025 S. FM 620 (512) 320-9575 <b>First Equity</b> 9606 N. Mopac Expressway Ste 100 (512) 346-8892 <b>Bastrop</b> 701 W. Hwy 71 (512) 308-9412 <b>Cedar Park</b> 301 W. Whitestone Blvd (512) 397-4552	<b>Guthrie</b> 120 N. Division St. (405) 775-8064 <b>Tulsa</b> 2808 E. 101st St. (918) 497-2810 1951 S. Yale Ave. (918) 497-2452 4202 S. Garnett (918) 497-2880 2250 E. 73rd St (918) 497-2400 11 E. 5th St. (918) 497-2449 8202 E. 71st St (918) 497-2454 5302 E. Skelly Dr. (918) 497-2453 <b>Chandler</b> 3108 E. First St. (405) 258-2351 <b>Oklahoma City</b> 3817 NW Expressway (405) 841-2100 100 W. Park Ave. (405) 775-8093 5701 N. May Ave. (405) 775-8056 10500 S. Pennsylvania Ave (405) 775-8058 2301 N. Portland Ave. (405) 775-8068 12241 N. May Ave. (405) 775-8059 4902 N. Western Ave. (405) 775-8054	14001 N. McArthur Blvd (405) 775-1710 <b>Lawton</b> 2101 W. Gore (580) 355-0253 6425 NW Cache Rd. (580) 250-4311 <b>Miami</b> 2520 N. Main (918) 542-4411 <b>Midwest City</b> 2200 S. Douglas Blvd. (405) 775-8057 <b>Moore</b> 513 NE 12th (405) 775-8066 901 SW 19th (405) 775-1720 <b>Pauls Valley</b> 700 W. Grant Ave. (405) 238-7318 <b>Purcell</b> 430 W. Lincoln St. (405) 775-8094 <b>Sand Springs</b> 3402 State Hwy. 97 (918) 497-2459 <b>Sapulpa</b> 911 E. Taft St. (918) 497-2458 <b>Shawnee</b> 2512 N. Harrison Ave. (405) 775-8067	<b>Sulphur</b> 2009 W. Broadway Ave. (580) 622-3118 <b>Weatherford</b> 109 E. Franklin Ave. (580) 772-7441 <b>Yukon</b> 1203 Cornwell Dr. (405) 775-1711 <b>Stillwater</b> 1900 N. Perkins (405) 372-0889 <b>Owasso</b> 9350 N. Garnett (918) 497-2835 <b>Elk City</b> 1504 W. 3rd St. (580) 225-7200 <b>Norman</b> 2403 W. Main St. (405) 775-8069 <b>Lindsey</b> 209 E. Cherokee (405) 756-4494 <b>Muskogee</b> 3143 Azalea Park Drive (918) 682-2300 <b>Bixby</b> 11886 S. Memorial (918) 497-2855 <b>Bethany</b> 7723 NW 23rd St. (405) 775-8063
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**Commerce Bank  
5800 San Dario  
Laredo, Texas 78041  
(956) 724-1616**

2120 Saunders  
(956) 724-1616

2302 Blaine St.  
(956) 724-1616

1200 Welby Court  
(956) 724-1616

**International Bank of Commerce, Brownsville  
1600 Ruben Torres Blvd  
Brownsville, TX 78522-1831  
(956) 547-1000**

1623 Central Blvd.  
(956) 547-1323  
4520 E. 14th St.  
(956) 547-1300  
79 E. Alton Gloor Blvd  
(956) 547-1360

2370 N. Expressway  
(956) 547-1380  
630 E. Elizabeth St.  
(956) 547-1350  
3600 W. Alton Gloor Blvd.  
(956) 547-1390

**South Padre Island**  
911 Padre Blvd.  
(956) 547-1471  
**Port Isabel**  
1401 W. Hwy. 100  
(956) 943-2108

**Harlingen**  
501 S. Dixieland Rd.  
(956) 428-6902  
321 S. 77th Sunshine Strip  
(956) 428-6454

1801 W. Lincoln  
(956) 428-4559

**International Bank of Commerce, Zapata  
908 N. US Highway 83  
Zapata, TX 78076  
(956) 765-8361**

**Roma**  
1702 Grant St.  
(956) 849-1047  
**Alice**  
2001 E. Main St.  
(361) 661-1211

**Rio Grande City**  
4015 E. Hwy. 83  
(956) 487-5531  
4534 E. Hwy. 83  
(956) 488-6367

4031 E. Hwy 83  
(956) 487-5535  
**Hebbronville**  
401 N. Smith Ave.  
(361) 527-2645

**Kingsville**  
1320 General Cavazos Blvd  
(361) 516-1040  
**Freer**  
405 S. Norton  
(361) 661-1211

**Beeville**  
802 E. Houston St.  
(361) 358-8700

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

The following consolidated selected financial data is derived from the Corporation's audited financial statements as of and for the five years ended December 31, 2016. The following consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes in this report.

**SELECTED FINANCIAL DATA**

	AS OF OR FOR THE YEARS ENDED DECEMBER 31,				
	2016	2015	2014	2013	2012
	(Dollars in Thousands, Except Per Share Data)				
<b>STATEMENT OF CONDITION</b>					
Assets .....	\$ 11,804,041	\$ 11,772,869	\$ 12,196,520	\$ 12,079,477	\$ 11,882,673
Investment securities available-for-sale .....	4,177,349	4,199,372	4,911,963	5,304,579	5,525,015
Net loans .....	5,900,027	5,883,926	5,614,417	5,129,074	4,716,811
Deposits .....	8,610,089	8,536,253	8,438,625	8,243,425	8,287,213
Other borrowed funds .....	733,375	505,750	1,073,944	1,223,950	749,027
Junior subordinated deferrable interest debentures .....	160,416	161,416	175,416	190,726	190,726
Shareholders' equity .....	1,724,667	1,665,503	1,580,658	1,424,408	1,435,708
<b>INCOME STATEMENT</b>					
Interest income .....	\$ 387,914	\$ 396,754	\$ 393,599	\$ 363,217	\$ 375,639
Interest expense .....	43,129	44,317	46,543	54,632	74,499
Net interest income .....	344,785	352,437	347,056	308,585	301,140
Provision for probable loan losses ..	19,859	24,405	14,423	22,968	27,959
Non-interest income .....	161,702	155,734	178,348	189,605	200,591
Non-interest expense .....	289,625	276,924	281,043	292,632	315,372
Income before income taxes .....	197,003	206,842	229,938	182,590	158,400
Income taxes .....	63,071	70,116	76,787	56,239	50,565
Net income .....	133,932	136,726	153,151	126,351	107,835
Preferred stock dividends and discount accretion .....	—	—	—	—	14,362
Net income available to common shareholders .....	\$ 133,932	\$ 136,726	\$ 153,151	\$ 126,351	\$ 93,473
Per common share:					
Basic .....	\$ 2.03	\$ 2.06	\$ 2.29	\$ 1.88	\$ 1.39
Diluted .....	\$ 2.02	\$ 2.05	\$ 2.28	\$ 1.88	\$ 1.39

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

Management's discussion and analysis represents an explanation of significant changes in the financial position and results of operations of International Bancshares Corporation and its subsidiaries (the "Company" or the "Corporation") on a consolidated basis for the three-year period ended December 31, 2016. The following discussion should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016, and the Selected Financial Data and Consolidated Financial Statements included elsewhere herein.

### Special Cautionary Notice Regarding Forward Looking Information

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

Risk factors that could cause actual results to differ materially from any results that are projected, forecasted, estimated or budgeted by the Company in forward-looking statements include, among others, the following possibilities:

- Local, regional, national and international economic business conditions and the impact they may have on the Company, the Company's customers, and such customers' ability to transact profitable business with the Company, including the ability of its borrowers to repay their loans according to their terms or a change in the value of the related collateral.
- Volatility and disruption in national and international financial markets.
- Government intervention in the U.S. financial system.
- The Company relies, in part, on external financing to fund the Company's operations from the FHLB, the Fed and other sources, and the unavailability of such funding sources in the future could adversely impact the Company's growth strategy, prospects and performance.
- Changes in consumer spending, borrowing and saving habits.
- Changes in interest rates and market prices, which could reduce the Company's net interest margins, asset valuations and expense expectations, including, without limitation, the repeal of federal prohibitions on the payment of interest on demand deposits.
- Changes in the capital markets utilized by the Company and its subsidiaries, including changes in the interest rate environment that may reduce margins.
- Changes in state and/or federal laws and regulations to which the Company and its subsidiaries, as well as their customers, competitors and potential competitors, are subject, including, without limitation, the impact of the Consumer Financial Protection Bureau ("CFPB") as a regulator of financial institutions, changes in the accounting, tax and regulatory treatment of trust preferred securities, as well as changes in banking, tax, securities, insurance, employment, environmental and immigration laws and regulations and the risk of litigation that may follow.
- Changes in our liquidity position.
- Changes in U.S.—Mexico trade, including, without limitation, reductions in border crossings and commerce resulting from the Homeland Security Programs called "US-VISIT," which is derived from Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996, or the possible imposition of tariffs on imported goods.
- The reduction of deposits from nonresident alien individuals due to the new IRS rules requiring U.S. financial institutions to report to the IRS deposit interest payments made to nonresident alien individuals.
- The loss of senior management or operating personnel.

- Increased competition from both within and outside the banking industry.
- The timing, impact and other uncertainties of the Company's potential future acquisitions, including the Company's ability to identify suitable potential future acquisition candidates, the success or failure in the integration of their operations and the Company's ability to maintain its current branch network and to enter new markets successfully and capitalize on growth opportunities.
- Changes in the Company's ability to pay dividends on its Common Stock.
- Changes in estimates of future reserve requirements based upon periodic review thereof under relevant regulatory and accounting requirements.
- Additions to the Company's loan loss allowance as a result of changes in local, national or international conditions which adversely affect the Company's customers, including, without limitation, lower real estate values, lower oil prices or environmental liability risks associated with foreclosed properties.
- Greater than expected costs or difficulties related to the development and integration of new products and lines of business, including the restrictions of arbitration clauses by the CFPB related to the CFPB proposal to restrict such clauses.
- Increased labor costs and effects related to health care reform and other laws, regulations and legal developments impacting labor costs.
- Impairment of carrying value of goodwill could negatively impact our earnings and capital.
- Changes in the soundness of other financial institutions with which the Company interacts.
- Political instability in the United States or Mexico.
- Technological changes or system failures or breaches of our network security, as well as other cyber security risks, could subject us to increased operating costs, litigation and other liabilities.
- Acts of war or terrorism.
- Natural disasters.
- Reduced earnings resulting from the write down of the carrying value of securities held in our securities available-for-sale portfolio following a determination that the securities are other-than-temporarily impaired.
- The effect of changes in accounting policies and practices as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standards setters.
- The costs and effects of regulatory developments, including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews and the ability to obtain required regulatory approvals.
- The effect of final rules amending Regulation E that prohibit financial institutions from charging consumer fees for paying overdrafts on ATM and one-time debit card transactions, unless the consumer consents or opts-in to the overdraft service for those types of transactions, as well as the effect of any other regulatory or legal developments that limit overdraft services.
- The reduction of income and possible increase in required capital levels related to the adoption of legislation, including, without limitation, the Dodd-Frank Regulatory Reform Act (the "Dodd-Frank Act") and the implementing rules and regulations, including the Federal Reserve's rule that establishes debit card interchange fee standards and prohibits network exclusivity arrangements and routing restrictions that is negatively affecting interchange revenue from debit card transactions as well as revenue from consumer services.
- The increase in required capital levels related to the implementation of capital and liquidity rules of the federal banking agencies that address or are impacted by the Basel III capital and liquidity standards.
- The enhanced due diligence burden imposed on banks related to the banks' inability to rely on credit ratings under Dodd-Frank, which may result in a limitation on the types of securities certain banks will be able to purchase as a result of the due diligence burden.
- The Company's success at managing the risks involved in the foregoing items, or a failure or circumvention of the Company's internal controls and risk management, policies and procedures.

Forward-looking statements speak only as of the date on which such statements are made. It is not possible to foresee or identify all such factors. The Company makes no commitment to update any forward-looking statement, or to

disclose any facts, events or circumstances after the date hereof that may affect the accuracy of any forward-looking statement, unless required by law.

## **Overview**

The Company, which is headquartered in Laredo, Texas, with 193 facilities and 307 ATMs, provides banking services for commercial, consumer and international customers of South, Central and Southeast Texas and the State of Oklahoma. The Company is one of the largest independent commercial bank holding companies headquartered in Texas. The Company, through its bank subsidiaries, is in the business of gathering funds from various sources and investing those funds in order to earn a return. The Company, either directly or through a bank subsidiary, owns two insurance agencies, a liquidating subsidiary, and a fifty percent interest in an investment banking unit that owns a broker/dealer. The Company's primary earnings come from the spread between the interest earned on interest-bearing assets and the interest paid on interest-bearing liabilities. In addition, the Company generates income from fees on products offered to commercial, consumer and international customers. The sales team of each of the Company's bank subsidiaries aim to match the right mix of products and services to each customer to best serve the customer's needs. That process entails spending time with customers to assess those needs and servicing the sales arising from those discussions on a long term basis. The bank subsidiaries have various compensation plans, including incentive based compensation, for fairly compensating employees. The bank subsidiaries also have a robust process in place to review sales that support the incentive based compensation plan to monitor the quality of the sales and identify any significant irregularities, a process that has been in place for many years.

A primary goal of the Company is to grow net interest income and non-interest income while adequately managing credit risk, interest rate risk and expenses. Effective management of capital is a critical objective of the Company. A key measure of the performance of a banking institution is the return on average common equity ("ROE"). The Company's ROE for the year ended December 31, 2016 was 7.70% as compared to 8.44% for the year ended December 31, 2015.

The Company is very active in facilitating trade along the United States border with Mexico. The Company does a large amount of business with customers domiciled in Mexico. Deposits from persons and entities domiciled in Mexico comprise a large and stable portion of the deposit base of the Company's bank subsidiaries. The loan policies of the Company's bank subsidiaries generally require that loans to borrowers domiciled in foreign countries be primarily secured by assets located in the United States or have credit enhancements, in the form of guarantees, from significant United States corporations. The Company also serves the growing Hispanic population through the Company's facilities located throughout South, Central and Southeast Texas and the State of Oklahoma.

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



## Results of Operations

### Summary

#### Consolidated Statements of Condition Information

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

#### Consolidated Statements of Income Information

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

#### Net Income

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

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

## Net Interest Income

Net interest income is the spread between income on interest-earning assets, such as loans and securities, and the interest expense on liabilities used to fund those assets, such as deposits, repurchase agreements and funds borrowed. Net interest income is the Company's largest source of revenue. Net interest income is affected by both changes in the level of interest rates and changes in the amount and composition of interest-earning assets and interest-bearing liabilities. Tax-exempt yields have not been adjusted to a tax-equivalent basis.

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

The level of interest rates and the volume and mix of earning assets and interest-bearing liabilities impact net income and net interest margin. The yield on average interest-earning assets increased 0.5% from 3.73% in 2015 to 3.75% in 2016, and the rates paid on average interest-bearing liabilities increased 3.3% from 0.60% in 2015 to 0.62% in 2016. The yield on average interest-earning assets increased 0.8% from 3.70% in 2014 to 3.73% in 2015, and the rates paid on average interest-bearing liabilities remained the same in 2015 and 2014 at 0.60%. The majority of the Company's taxable investment securities are invested in mortgage backed securities and during rapid increases or reduction in interest rates, the yield on these securities do not re-price as quickly as the loans.

The following table analyzes the changes in net interest income during 2016, 2015 and 2014 and the relative effect of changes in interest rates and volumes for each major classification of interest-earning assets and interest-bearing

liabilities. Non-accrual loans have been included in assets for the purpose of this analysis, which reduces the resulting yields:

	2016 compared to 2015			2015 compared to 2014		
	Net increase (decrease) due to			Net increase (decrease) due to		
	Volume(1)	Rate(1)	Total	Volume(1)	Rate(1)	Total
	(Dollars in Thousands)			(Dollars in Thousands)		
Interest earned on:						
Loans, net of unearned discounts:						
Domestic.....	\$ 6,111	\$ (4,966)	\$ 1,145	\$ 18,175	\$ (2,507)	\$ 15,668
Foreign.....	(490)	(118)	(608)	86	(17)	69
Investment securities:						
Taxable.....	(7,188)	(1,287)	(8,475)	(8,438)	(3,649)	(12,087)
Tax-exempt.....	(875)	(88)	(963)	809	(1,257)	(448)
Other.....	(24)	85	61	100	(147)	(47)
Total interest income.....	<u>\$ (2,466)</u>	<u>\$ (6,374)</u>	<u>\$ (8,840)</u>	<u>\$ 10,732</u>	<u>\$ (7,577)</u>	<u>\$ 3,155</u>
Interest incurred on:						
Savings and interest bearing demand deposits.....						
	\$ 64	\$ 905	\$ 969	\$ 65	\$ (69)	\$ (4)
Time deposits:						
Domestic.....	(544)	(502)	(1,046)	(394)	78	(316)
Foreign.....	(136)	(88)	(224)	(290)	(194)	(484)
Securities sold under repurchase agreements	(3,083)	182	(2,901)	(585)	(254)	(839)
Other borrowings.....	(432)	1,945	1,513	(414)	(4)	(418)
Junior subordinated deferrable interest debentures.....						
	(230)	731	501	(252)	87	(165)
Total interest expense.....	<u>\$ (4,361)</u>	<u>\$ 3,173</u>	<u>\$ (1,188)</u>	<u>\$ (1,870)</u>	<u>\$ (356)</u>	<u>\$ (2,226)</u>
Net interest income.....	<u>\$ 1,895</u>	<u>\$ (9,547)</u>	<u>\$ (7,652)</u>	<u>\$ 12,602</u>	<u>\$ (7,221)</u>	<u>\$ 5,381</u>

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

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

The Company has established guidelines for acceptable volatility of projected net interest income on the income simulation analysis and the guidelines are reviewed at least annually. As of December 31, 2016, in rising rate scenarios of 150, 300 and 400 basis points, the guidelines established by management require that the net interest income not vary by more than plus or minus 15%, 15% and 20%, respectively. At December 31, 2016, the income simulations show that a rate shift of 150, 300 and 400 basis points in interest rates up will vary projected net interest income for the coming 12 month period by 1.00%, 3.92% and 6.01%, respectively. The basis point shift in interest rates is a hypothetical rate

scenario used to calibrate risk, and does not necessarily represent management's current view of future market developments. The Company believes that it is properly positioned for a potential interest rate increase or decrease.

### Allowance for Probable Loan Loss

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

	December 31,				
	2016	2015	2014	2013	2012
	(Dollars in Thousands)				
Loans accounted for on a non-accrual basis . . . .	\$ 36,858	\$ 47,320	\$ 63,559	\$ 62,823	\$ 71,768
Accruing loans contractually past due ninety days or more as to interest or principal payments. . . .	5,215	11,174	9,988	7,197	14,769

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

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

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

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

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

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

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

Loan commitments, consisting of unused commitments to lend, letters of credit, credit card lines and other approved loans, that have not been funded, were approximately \$2,262,717,000 and \$1,781,959,000 at December 31, 2016 and 2015, respectively. See Note 19 to the Consolidated Financial Statements.

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

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

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

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

	At December 31,									
	2016		2015		2014		2013		2012	
	Allowance	Percent of total	Allowance	Percent of total	Allowance	Percent of total	Allowance	Percent of total	Allowance	Percent of total
	(Dollars in Thousands)									
Commercial, Financial and Agricultural . . .	\$ 32,928	50.2 %	\$ 35,379	52.1 %	\$ 41,881	54.7 %	\$ 47,676	55.7 %	\$ 34,206	52.8 %
Real estate— Mortgage . . . . .	11,355	17.3	10,979	16.2	8,272	16.0	8,061	16.3	8,838	17.6
Real estate— Construction . . .	18,887	28.8	18,818	27.7	12,955	24.9	12,541	23.2	12,720	24.0
Consumer . . . . .	607	0.9	659	1.0	660	1.1	750	1.3	1,289	1.6
Foreign . . . . .	884	2.8	1,152	3.0	1,060	3.3	1,133	3.5	1,140	4.0
	<u>\$ 64,661</u>	<u>100.0 %</u>	<u>\$ 66,988</u>	<u>100.0 %</u>	<u>\$ 64,828</u>	<u>100.0 %</u>	<u>\$ 70,161</u>	<u>100.0 %</u>	<u>\$ 58,193</u>	<u>100.0 %</u>

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

The bank subsidiaries charge off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a “loss” by bank examiners. Commercial, financial and agricultural or real estate loans are generally considered by management to represent a loss, in whole or part, (i) when an exposure beyond any collateral coverage is apparent, (ii) when no further collection of the portion of the loan so exposed is anticipated based on actual results, (iii) when the credit enhancements, if any, are not adequate, and (iv) when the borrower’s financial condition would indicate so. Generally, unsecured consumer loans are charged off when 90 days past due. The increase in charge-offs for the year ended December 31, 2016 can be attributed to further deterioration in a previously identified and charged down relationship primarily secured by multiple pieces of transportation equipment. In March 2016, litigation against the management of the borrower was filed in the State of Nevada, resulting in a going concern issue with the borrower’s operations and the future use of the transportation equipment pledged as collateral on the relationship. As a result, management, in accordance with its credit review procedures, re-evaluated the collateral values on the equipment in light of the new circumstances and reduced the collateral values accordingly, resulting in a further charge-down of the relationship of approximately \$19.4 million, which is included in the losses charged to the allowance in the commercial category in the table detailing twelve months ended December 31, 2016 activity. The same relationship had been previously charged down in the years ended December 31, 2015 and 2014. Two large recoveries on loans charged off in prior years are included in the recoveries credited to the allowance in the table detailing activity for the year ended December 31, 2016. The recoveries occurred in the first and third quarters of 2016 in the amounts of \$4.4 million and \$6 million, respectively and are included in the Commercial and Commercial Real Estate: Other Construction and Land Development categories. The increase in charge-offs for the years ended December 31, 2015 and 2014 in the Commercial category can be attributed to a charge down of a relationship that is primarily secured by multiple pieces of transportation equipment. The relationship was charged down by \$13.5 million and \$8.5 million for the years ended December 31, 2015 and December 31, 2014, respectively.

The allowance for probable loan losses is a reserve established through a provision for probable loan losses charged to expense, which represents management’s best estimate of probable loan losses within the existing portfolio of loans. The Company’s allowance for probable loan loss methodology is based on guidance provided in Securities and Exchange Commission Staff Accounting Bulletin No. 102, “Selected Loan Loss Allowance Methodology and Documentation Issues” and includes allowance allocations calculated in accordance with ASC 310, “Receivables” and ASC 450, “Contingencies.” The reserve allocated to loans individually evaluated for impairment at December 31, 2015 decreased approximately \$10.0 million, primarily as a result of a charge down in the above described relationship secured by multiple pieces of transportation equipment. The reserve allocated to loans collectively evaluated for impairment at December 31, 2015 increased approximately \$12.0 million and can be attributed to an increase in the actual historical

charge-off experience in the commercial loan category of the calculation. The reserve allocated by categories shows an overall decrease of \$5.3 million from December 31, 2013 to December 31, 2014 and a \$12.0 million increase from December 31, 2012 to December 31, 2013. The decrease for the year ended December 31, 2014 compared to the year ended December 31, 2013 is partially due to a charge down in the above-described relationship secured by multiple pieces of transportation equipment. A specific reserve on the relationship of \$12.0 million was recognized in 2013 and created the increase in the reserve for probable loan losses for December 31, 2013 compared to December 31, 2012. The decrease in the reserve is mainly due to the continued workout of the impaired loans previously identified by the Company. Please refer to Note 4—Allowance for Probable Loan Losses in the accompanying Notes to the consolidated Financial Statements.

While management of the Company considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. It is the judgment of the Company's management that the allowance for probable loan losses at December 31, 2016 was adequate to absorb probable losses from loans in the portfolio at that date. See Critical Accounting Policies on page 23. Should any of the factors considered by management in evaluating the adequacy of the allowance for probable loan losses change, the Company's estimate of probable loan losses could also change, which could affect the level of future provisions for probable loan losses.

### Non-Interest Income

	Year Ended December 31, 2016	Year Ended December 31, 2015	Percent Increase (Decrease) 2016 vs. 2015	Year Ended December 31, 2014	Percent Increase (Decrease) 2015 vs. 2014
	(Dollars in Thousands)				
Service charges on deposit accounts . . . . .	\$ 73,581	\$ 78,825	(6.7)%	\$ 88,586	(11.0)%
Other service charges, commissions and fees					
Banking . . . . .	46,267	44,971	2.9	44,435	1.2
Non-banking . . . . .	7,006	7,223	(3.0)	7,463	(3.2)
Investment securities transactions, net. . . . .	(2,626)	(3,682)	(28.7)	1,283	(387.0)
Other investments, net. . . . .	23,827	16,969	40.4	22,023	(22.9)
Other income . . . . .	13,647	11,428	19.4	14,558	(21.5)
Total non-interest income . . . . .	<u>\$ 161,702</u>	<u>\$ 155,734</u>	<u>3.8 %</u>	<u>\$ 178,348</u>	<u>(12.7)%</u>

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



## Non-Interest Expense

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

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

## Effects of Inflation

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

## Financial Condition

### Investment Securities

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

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

The following tables set forth the contractual maturities of investment securities, based on amortized cost, at December 31, 2016 and the average yields of such securities, except for the totals, which reflect the weighted average yields. Actual maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

	Available for Sale Maturing							
	Within one year		After one but within five years		After five but within ten years		After ten years	
	Adjusted		Adjusted		Adjusted		Adjusted	
	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield
	(Dollars in Thousands)							
Residential mortgage-backed securities . . . . .	\$ 9	7.30 %	\$ 21,346	4.63 %	771,018	3.12 %	\$ 3,153,771	2.51 %
Obligations of states and political subdivisions . . . . .	—	—	—	—	1,218	4.76 %	243,404	4.61
Equity securities . . . . .	28,075	2.44	—	—	—	—	—	—
Other securities . . . . .	—	—	—	—	—	—	—	—
Total . . . . .	<u>\$ 28,084</u>	<u>2.44 %</u>	<u>\$ 21,346</u>	<u>4.63 %</u>	<u>\$ 772,236</u>	<u>3.12 %</u>	<u>\$ 3,397,175</u>	<u>2.66 %</u>

	Held to Maturity Maturing							
	Within one year		After one but within five years		After five but within ten years		After ten years	
	Adjusted		Adjusted		Adjusted		Adjusted	
	Cost	Yield	Cost	Yield	Cost	Yield	Cost	Yield
	(Dollars in Thousands)							
Other securities . . . . .	\$ 125	1.91 %	\$ 2,275	1.79 %	\$ —	— %	\$ —	— %
Total . . . . .	<u>\$ 125</u>	<u>1.91 %</u>	<u>\$ 2,275</u>	<u>1.74 %</u>	<u>\$ —</u>	<u>— %</u>	<u>\$ —</u>	<u>— %</u>

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

## Loans

The amounts of loans outstanding, by classification, at December 31, 2016, 2015, 2014, 2013 and 2012 are shown in the following table:

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

The following table shows the amounts of loans (excluding real estate mortgages and consumer loans) outstanding as of December 31, 2016, which based on remaining scheduled repayments of principal are due in the years indicated. Also, the amounts due after one year are classified according to the sensitivity to changes in interest rates:

	Maturing			
	Within one year	After one but within five years	After five years	Total
	(Dollars in Thousands)			
Commercial, financial and agricultural . . . . .	\$ 987,705	\$ 1,763,368	\$ 242,130	\$ 2,993,203
Real estate—construction . . . . .	764,377	824,007	128,491	1,716,875
Foreign . . . . .	108,424	44,783	14,013	167,220
Total . . . . .	<u>\$ 1,860,506</u>	<u>\$ 2,632,158</u>	<u>\$ 384,634</u>	<u>\$ 4,877,298</u>

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

## International Operations

On December 31, 2016, the Company had \$167,220,000 (1.4% of total assets) in loans outstanding to borrowers domiciled in foreign countries, which included primarily borrowers domiciled in Mexico. The loan policies of the Company's bank subsidiaries generally require that loans to borrowers domiciled in foreign countries be primarily secured by assets located in the United States or have credit enhancements, in the form of guarantees, from significant United

States corporations. The composition of such loans and the related amounts of allocated allowance for probable loan losses as of December 31, 2016 and 2015 is presented below.

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

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

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

## Deposits

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

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

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

Due within 3 months or less . . . . .	\$ 605,093
Due after 3 months and within 6 months . . . . .	390,668
Due after 6 months and within 12 months . . . . .	430,477
Due after 12 months . . . . .	160,057
	<u>\$ 1,586,265</u>

The Company offers a variety of deposit accounts having a wide range of interest rates and terms. The Company relies primarily on its high quality customer service, sales programs, customer referrals and advertising to attract and retain these deposits. Deposits provide the primary source of funding for the Company's lending and investment activities, and the interest paid for deposits must be managed carefully to control the level of interest expense. Deposits at December 31, 2016 were \$8,610,089,000, an increase of 0.9% from \$8,536,253,000 at December 31, 2015. The increase in deposits is

the result of the increased availability of deposits in the banking market. Even though the Company increased its deposits, the Company is still experiencing a substantial amount of competition for deposits at higher than market rates. As a result, the Company has attempted to maintain certain deposit relationships but has allowed certain deposits to leave as the result of aggressive pricing by competitors.

### Return on Equity and Assets

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

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

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

### Liquidity and Capital Resources

#### Liquidity

The maintenance of adequate liquidity provides the Company's bank subsidiaries with the ability to meet potential depositor withdrawals, provide for customer credit needs, maintain adequate statutory reserve levels and take full advantage of high-yield investment opportunities as they arise. Liquidity is afforded by access to financial markets and by holding appropriate amounts of liquid assets. The Company's bank subsidiaries derive their liquidity largely from deposits of individuals and business entities. Deposits from persons and entities domiciled in Mexico comprise a stable portion of the deposit base of the Company's bank subsidiaries. Deposits from persons and entities domiciled in Mexico comprise a stable portion of the deposit base of the Company's bank subsidiaries. Historically, the Mexico based deposits of the Company's bank subsidiaries have been a stable source of funding. Such deposits comprised approximately 28%, 27%, and 27% of the Company's bank subsidiaries' total deposits at each of the years ended December 31, 2016, 2015 and 2014, respectively. Other important funding sources for the Company's bank subsidiaries during 2016 and 2015 were borrowings from the FHLB, securities sold under repurchase agreements and large certificates of deposit, requiring management to closely monitor its asset/liability mix in terms of both rate sensitivity and maturity distribution. The borrowings from FHLB are primarily short term in nature and are renewed at maturity. The Company's bank subsidiaries have had a long-standing relationship with the FHLB and keep open unused lines of credit in order to fund liquidity needs. In the event that the FHLB bank indebtedness is not renewed, the repayment of the outstanding indebtedness would more than likely be repaid through proceeds generated from the sales of unpledged available for sale securities. The Company maintains a sizable, high quality investment portfolio to provide significant liquidity. These securities can be sold or sold under agreements to repurchase, to provide immediate liquidity. As in the past, the Company will continue to monitor the volatility and cost of funds in an attempt to match maturities of rate-sensitive assets and liabilities and respond accordingly to anticipated fluctuations in interest rates over reasonable periods of time.

#### Asset/Liability Management

The Company's fund management policy has as its primary focus the measurement and management of the banks' earnings at risk in the face of rising or falling interest rate forecasts. The earliest and most simplistic concept of earnings at risk measurement is the gap report, which is used to generate a rough estimate of the vulnerability of net interest income to changes in market rates as implied by the relative re-pricings of assets and liabilities. The gap report calculates the difference between the amounts of assets and liabilities re-pricing across a series of intervals in time, with emphasis typically placed on the one-year period. This difference, or gap, is usually expressed as a percentage of total assets.

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

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

The net interest rate sensitivity at December 31, 2016, is illustrated in the following table. This information reflects the balances of assets and liabilities whose rates are subject to change. As indicated in the table below, the Company is liability-sensitive during the early time periods and is asset-sensitive in the longer periods. The table shows the sensitivity of the statement of condition at one point in time and is not necessarily indicative of the position at future dates.

## INTEREST RATE SENSITIVITY

(Dollars in Thousands)

<u>December 31, 2016</u>	Rate/Maturity				<u>Total</u>
	3 Months or Less	Over 3 Months to 1 Year	Over 1 Year to 5 Years	Over 5 Years	
	(Dollars in Thousands)				
Rate sensitive assets					
Investment securities . . . . .	\$ 345,055	\$ 794,036	\$ 2,782,811	\$ 257,847	\$ 4,179,749
Loans, net of non-accruals . . . . .	<u>4,523,652</u>	<u>193,708</u>	<u>359,687</u>	<u>850,396</u>	<u>5,927,443</u>
Total earning assets . . . . .	<u>\$ 4,868,707</u>	<u>\$ 987,744</u>	<u>\$ 3,142,498</u>	<u>\$ 1,108,243</u>	<u>\$ 10,107,192</u>
Cumulative earning assets . . . . .	<u>\$ 4,868,707</u>	<u>\$ 5,856,451</u>	<u>\$ 8,998,949</u>	<u>\$ 10,107,192</u>	
Rate sensitive liabilities					
Time deposits . . . . .	\$ 935,068	\$ 1,086,586	\$ 226,558	\$ 98	\$ 2,248,310
Other interest bearing deposits . . . . .	3,203,728	—	—	—	3,203,728
Securities sold under repurchase agreements . . . . .	203,078	1,907	300,000	—	504,985
Other borrowed funds . . . . .	733,375	—	—	—	733,375
Junior subordinated deferrable interest debentures . . . . .	<u>160,416</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>160,416</u>
Total interest bearing liabilities . . . . .	<u>\$ 5,235,665</u>	<u>\$ 1,088,493</u>	<u>\$ 526,558</u>	<u>\$ 98</u>	<u>\$ 6,850,814</u>
Cumulative sensitive liabilities . . . . .	<u>\$ 5,235,665</u>	<u>\$ 6,324,158</u>	<u>\$ 6,850,716</u>	<u>\$ 6,850,814</u>	
Repricing gap . . . . .	\$ (366,958)	\$ (100,749)	\$ 2,615,940	\$ 1,108,145	\$ 3,256,378
Cumulative repricing gap . . . . .	(366,958)	(467,707)	2,148,233	3,256,378	
Ratio of interest-sensitive assets to liabilities . . . . .	0.93	0.91	5.97	11,308.60	1.48
Ratio of cumulative, interest-sensitive assets to liabilities . . . . .	0.93	0.93	1.31	1.48	

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

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

The Company has established guidelines for acceptable volatility of projected net interest income on the income simulation analysis and the guidelines are reviewed at least annually. As of December 31, 2016, in rising rate scenarios of 150, 300 and 400 basis points, the guidelines established by management require that the net interest income not vary by more than plus or minus 15%, 15% and 20%, respectively. At December 31, 2016, the income simulations show that a



rate shift of 150, 300 and 400 basis points in interest rates up will vary projected net interest income for the coming 12 month period by 1.0%, 3.92% and 6.01%, respectively. The basis point shift in interest rates is a hypothetical rate scenario used to calibrate risk, and does not necessarily represent management's current view of future market developments. The Company believes that it is properly positioned for a potential interest rate increase or decrease.

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

Principal sources of liquidity and funding for the Company are dividends from subsidiaries and borrowed funds, with such funds being used to finance the Company's cash flow requirements. The Company closely monitors the dividend restrictions and availability from the bank subsidiaries as disclosed in Note 20 to the Consolidated Financial Statements. At December 31, 2016, the aggregate amount legally available to be distributed to the Company from bank subsidiaries as dividends was approximately \$819,500,000, assuming that each bank subsidiary continues to be classified as "well-capitalized" under the applicable regulations in effect at December 31, 2016. The restricted capital (capital and surplus) of the bank subsidiaries was approximately \$959,844,000 as of December 31, 2016. The undivided profits of the bank subsidiaries were approximately \$1,779,344,000 as of December 31, 2016.

At December 31, 2016, the Company has outstanding \$733,375,000 in other borrowed funds and \$160,416,000 in junior subordinated deferrable interest debentures. In addition to borrowed funds and dividends, the Company has a number of other available alternatives to finance the growth of its existing banks as well as future growth and expansion.

## **Capital**

The Company maintains an adequate level of capital as a margin of safety for its depositors and shareholders. At December 31, 2016, shareholders' equity was \$1,724,667,000 compared to \$1,665,503,000 at December 31, 2015, an increase of \$59,164,000, or 3.6%. Shareholders' equity increased primarily due to the retention of earnings, offset by the payment of cash dividends to shareholders and repurchases of the Company's common stock in the form of treasury stock. The accumulated other comprehensive loss is not included in the calculation of regulatory capital ratios.

During 1990, the Federal Reserve Board ("FRB") adopted a minimum leverage ratio of 3% for the most highly rated bank holding companies and at least 4% to 5% for all other bank holding companies. The Company's leverage ratio (defined as shareholders' equity plus eligible trust preferred securities issued and outstanding less goodwill and certain other intangibles divided by average quarterly assets) was 13.91% at December 31, 2016 and 13.15% at December 31, 2015. The core deposit intangibles and goodwill of \$282,557,000 as of December 31, 2016, are deducted from the sum of core capital elements when determining the capital ratios of the Company.

The FRB has adopted risk-based capital guidelines which assign risk weightings to assets and off-balance sheet items. The guidelines also define and set minimum capital requirements (risk-based capital ratios). Under the final 1992 rules, all banks are required to have Tier 1 capital of at least 4.0% of risk-weighted assets and total capital of 8.0% of risk-weighted assets. Tier 1 capital consists principally of shareholders' equity plus trust preferred securities issued and outstanding less goodwill and certain other intangibles, while total capital consists of Tier 1 capital, certain debt instruments and a portion of the reserve for loan losses. In order to be deemed well-capitalized pursuant to the regulations, an institution must have a total risk-weighted capital ratio of 10%, a Tier 1 risk-weighted ratio of 8% and a Tier 1 leverage ratio of 5%. The Company had risk-weighted Tier 1 capital ratios of 18.68% and 18.69% and risk weighted total capital ratios of 19.47% and 19.54% as of December 31, 2016 and 2015, respectively, which are well above the minimum regulatory requirements and exceed the well-capitalized ratios (see Note 20 to Notes to Consolidated Financial Statements).

In July 2013, the Federal Deposit Insurance Corporation ("FDIC") and other regulatory bodies established a new, comprehensive capital framework for U.S. banking organizations, consisting of minimum requirements that increase both the quantity and quality of capital held by banking organizations. The final rules are a result of the implementation of the BASEL III capital reforms and various Dodd-Frank Act related capital provisions. Consistent with the Basel international

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

### **Junior Subordinated Deferrable Interest Debentures**

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

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

For financial reporting purposes, the Trusts are treated as investments of the Company and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders’ equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. At December 31, 2016 and December 31, 2015, the total \$160,416,000 and \$161,416,000, respectively of the Capital Securities outstanding qualified as Tier 1 capital.

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

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

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

### Contractual Obligations and Commercial Commitments

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

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

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

	<b>Amount of Commitment Expiration Per Period</b>				
	<b>(Dollars in Thousands)</b>				
<b>Commercial Commitments</b>	<b>Total</b>	<b>Less than One Year</b>	<b>One to Three Years</b>	<b>Three to Five Years</b>	<b>After Five Years</b>
Financial and Performance Standby Letters of Credit.....	\$ 88,504	\$ 82,834	\$ 5,486	\$ 184	\$ —
Commercial Letters of Credit.....	4,650	4,650	—	—	—
Credit Card Lines.....	18,531	18,531	—	—	—
Other Commercial Commitments.....	2,262,717	1,377,568	384,848	366,233	134,068
Total Commercial Commitments.....	<u>\$ 2,374,402</u>	<u>\$ 1,483,583</u>	<u>\$ 390,334</u>	<u>\$ 366,417</u>	<u>\$ 134,068</u>

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

### Critical Accounting Policies

The Company has established various accounting policies which govern the application of accounting principles in the preparation of the Company's consolidated financial statements. The significant accounting policies are described in the Notes to the Consolidated Financial Statements. Certain accounting policies involve significant subjective judgments

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

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

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

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

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

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

### Recent Accounting Standards Issued

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

### Preferred Stock, Common Stock and Dividends

The Company had issued and outstanding 65,989,631 shares of \$1.00 par value Common Stock held by approximately 2,062 holders of record at February 22, 2017. The book value of the Common Stock at December 31, 2016 was \$27.53 per share compared with \$26.11 per share at December 31, 2015. In connection with the Company's participation in the Troubled Asset Relief Program Capital Purchase Program (the "TARP Capital Purchase Program") in 2008, the US Treasury received a warrant (the "Warrant") to purchase 1,326,238 shares of the Company's common stock (the "Warrant Shares") at \$24.43 per share. The term of the Warrant is ten years and was immediately exercisable. The Warrant is included as a component of Tier 1 capital. On June 12, 2013, the U. S. Treasury sold the Warrant to a third party. As of February 22, 2017, the Warrant is still outstanding, but expires on December 23, 2018. Adjustments to the \$24.43 per share Exercise Price of the Warrant will be made if the Company pays cash dividends in excess of 33 cents per semi-annual period or makes certain other shareholder distributions before the Warrant expires on December 23, 2018.

The Common Stock is traded on the NASDAQ National Market under the symbol "IBOC." The following table sets forth the approximate high and low bid prices in the Company's Common Stock during 2016 and 2015, as quoted on the NASDAQ National Market for each of the quarters in the two year period ended December 31, 2016. Some of the quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions. The closing sales price of the Company's Common Stock was \$38.70 per share at February 22, 2017.

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

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

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

## Stock Repurchase Program

In April 2009, following receipt of the Treasury Department's consent, the Board of Directors re-established a formal stock repurchase program that authorized the repurchase of up to \$40 million of common stock within the following twelve months and on March 11, 2016, the Board of Directors extended the repurchase program and again authorized the repurchase of up to \$40 million of common stock during the twelve month period commencing on April 9, 2016, which repurchase cap the Board is inclined to increase over time. Stock repurchases may be made from time to time, on the open market or through private transactions. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. During the fourth quarter of 2016, the Company's Board of Directors adopted a Rule 10b5-1 plan and intends to adopt additional Rule 10b5-1 trading plans that will allow the Company to purchase its shares of common stock during certain trading blackout periods when the Company ordinarily would not be in the market due to trading restrictions in its internal trading policy. During the term of a 10b5-1 Plan, purchases of common stock are automatic to the extent the conditions of the 10b5-1 Plan's trading instructions are met. Shares repurchased in this program will be held in treasury for reissue for various corporate purposes, including employee stock option plans. As of February 22, 2017, a total of 9,240,788 shares had been repurchased under all programs at a cost of \$271,103,000. The Company is not obligated to repurchase shares under its stock repurchase program or to enter into additional Rule 10b5-1 plans. The timing, actual number and value of shares purchased will depend on many factors, including the Company's cash flow and the liquidity and price performance of its shares of common stock.

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

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly- Announced Program	Approximate Dollar Value of Shares Available for Repurchase(1)
October 1 – October 31, 2016. . . . .	—	\$ —	—	\$ 40,000,000
November 1 – November 30, 2016 . . . . .	—	—	—	40,000,000
December 1 – December 31, 2016. . . . .	159	40.88	—	39,993,500
Total . . . . .	<u>159</u>	<u>\$ 40.88</u>	<u>—</u>	

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

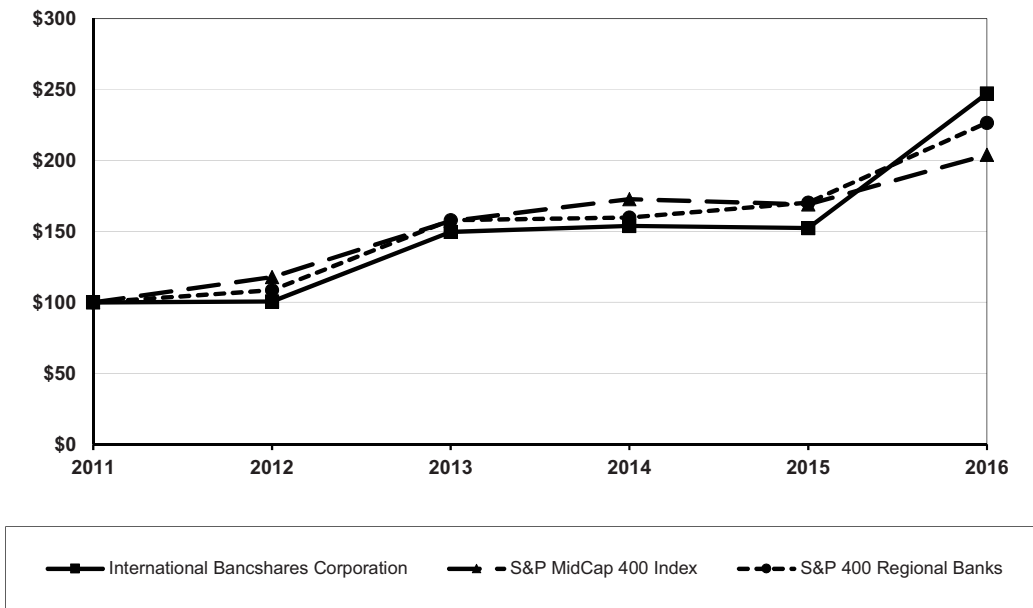
## Equity Compensation Plan Information

The following table sets forth information as of December 31, 2016, with respect to the Company's equity compensation plans:

Plan Category	(A) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(B) Weighted average exercise price of outstanding options, warrants and rights	(C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column A)
Equity Compensation plans approved by security holders. . . . .	800,502	\$ 19.24	266,392
Total . . . . .	<u>800,502</u>	<u>\$ 19.24</u>	<u>266,392</u>

**Stock Performance**

**COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN**



**Total Return To Shareholders  
(Includes reinvestment of dividends)**

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



RSM US LLP

## Report of Independent Registered Public Accounting Firm

To the Board of Directors Shareholders  
International Bancshares Corporation

We have audited the accompanying consolidated balance sheets of International Bancshares Corporation and Subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of International Bancshares Corporation and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), International Bancshares Corporation and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 27, 2017 expressed an unqualified opinion on the effectiveness of International Bancshares Corporation and subsidiaries' internal control over financial reporting.

**RSM US LLP**

Dallas, Texas  
February 27, 2017



**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Condition**

**December 31, 2016 and 2015**

**(Dollars in Thousands, Except Per Share Amounts)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Condition Continued**

**December 31, 2016 and 2015**

**(Dollars in Thousands, Except Per Share Amounts)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Income**

**Years ended December 31, 2016, 2015 and 2014**

**(Dollars in Thousands, Except Per Share Amounts)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Income, continued**

**Years ended December 31, 2016, 2015 and 2014**

**(Dollars in Thousands, Except Per Share Amounts)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Comprehensive Income**

**Years ended December 31, 2016, 2015, and 2014**

**(Dollars in Thousands)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Shareholders' Equity**

**Years ended December 31, 2016, 2015 and 2014**

**(in Thousands, except per share amounts)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

**Years ended December 31, 2016, 2015 and 2014**

**(Dollars in Thousands)**

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

**See accompanying notes to consolidated financial statements.**

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows (Continued)**

**Years ended December 31, 2016, 2015 and 2014**

**(Dollars in Thousands)**

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

**See accompanying notes to consolidated financial statements.**



# INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

### (1) Summary of Significant Accounting Policies

The accounting and reporting policies of International Bancshares Corporation (“Corporation”) and Subsidiaries (the Corporation and Subsidiaries collectively referred to herein as the “Company”) conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The following is a description of the more significant of those policies.

#### *Consolidation and Basis of Presentation*

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

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

The Company owns one insurance-related subsidiary, IBC Insurance Agency, Inc., a wholly owned subsidiary of IBC, the bank subsidiary. The insurance-related subsidiary does not conduct underwriting activities.

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

#### *Subsequent Events*

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

#### *Investment Securities*

The Company classifies debt and equity securities into one of these categories: held-to-maturity, available-for-sale, or trading. Such classifications are reassessed for appropriate classification at each reporting date. Securities that are intended and expected to be held until maturity are classified as “held-to-maturity” and are carried at amortized cost for financial statement reporting. Securities that are not positively expected to be held until maturity, but are intended to be held for an indefinite period of time are classified as “available-for-sale” or “trading” and are carried at their fair value. Unrealized holding gains and losses are included in net income for those securities classified as “trading”,

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

while unrealized holding gains and losses related to those securities classified as “available-for-sale” are excluded from net income and reported net of tax as other comprehensive income and in shareholders’ equity as accumulated other comprehensive income until realized. The Company did not maintain any trading securities during the three year period ended December 31, 2016.

Mortgage-backed securities held at December 31, 2016 and 2015 represent participating interests in pools of long-term first mortgage loans originated and serviced by the issuers of the securities. Mortgage-backed securities are either issued or guaranteed by the U.S. government or its agencies including the Federal Home Loan Mortgage Corporation (“Freddie Mac”), the Federal National Mortgage Association (“Fannie Mae”), the Government National Mortgage Association (“Ginnie Mae”) or other non-government entities. Investments in residential mortgage-backed securities issued by Ginnie Mae are fully guaranteed by the U. S. government. Investments in residential mortgage-backed securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. government, however, the Company believes that the quality of the bonds is similar to other AAA rated bonds with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in 2008 and because securities issued by others that are collateralized by residential mortgage-backed securities issued by Fannie Mae or Freddie Mac are rated consistently as AAA rated securities. Market interest rate fluctuations can affect the prepayment speed of principal and the yield on the security.

Premiums and discounts are amortized using the level yield or “interest method” over the terms of the securities. Declines in the fair value of held-to-maturity and available-for sale-securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to hold and the determination of whether the Company will more likely than not be required to sell the security prior to a recovery in fair value. If the Company determines that (1) it intends to sell the security or (2) it is more likely than not that it will be required to sell the security before it’s anticipated recovery, the other-than-temporary impairment that is recognized in earnings is equal to the difference between the fair value of the security and the Company’s amortized cost in the security. If the Company determines that it (1) does not intend to sell the security and (2) it will not be more likely than not required to sell the security before it’s anticipated recovery, the other-than-temporary impairment is segregated into its two components (1) the amount of impairment related to credit loss and (2) the amount of impairment related to other factors. The difference between the present value of the cash flows expected to be collected and the amortized cost is the credit loss recognized through earnings and an adjustment to the cost basis of the security. The amount of impairment related to other factors is included in other comprehensive income (loss). Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

#### *Provision and Allowance for Probable Loan Losses*

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

Management believes that the allowance for probable loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company’s bank subsidiaries’ allowances for probable loan losses. Such agencies may require the Company’s bank

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

subsidiaries to make additions or reductions to their U.S. generally accepted accounting principles (“GAAP”) allowances based on their judgments of information available to them at the time of their examination.

The bank subsidiaries charge off that portion of any loan which management considers to represent a loss as well as that portion of any other loan which is classified as a “loss” by bank examiners. Commercial, financial and agricultural or real estate loans are generally considered by management to represent a loss, in whole or part, (i) when an exposure beyond any collateral coverage is apparent, (ii) when no further collection of the portion of the loan so exposed is anticipated based on actual results, (iii) when the credit enhancements, if any, are not adequate, and (iv) when the borrower’s financial condition would indicate so. Generally, unsecured consumer loans are charged off when 90 days past due.

#### *Loans*

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

#### *Impaired Loans*

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

#### *Troubled Debt Restructured Loans*

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

#### *Non-Accrual Loans*

The non-accrual loan policy of the Company’s bank subsidiaries is to discontinue the accrual of interest on loans when management determines that it is probable that future interest accruals will be un-collectible. As it relates to consumer loans, management charges off those loans when the loan is contractually 90 days past due. Under special

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

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

#### *Other Real Estate Owned*

Other real estate owned is comprised of real estate acquired by foreclosure and deeds in lieu of foreclosure. Other real estate is carried at the lower of the recorded investment in the property or its fair value less estimated costs to sell such property (as determined by independent appraisal). Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for probable loan losses, if necessary. Any subsequent write-downs are charged against other non-interest expense through a valuation allowance. Other real estate owned totaled approximately \$42,204,000 and \$55,850,000 at December 31, 2016 and 2015, respectively. Other real estate owned is included in other assets.

#### *Bank Premises and Equipment*

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on straight-line and accelerated methods over the estimated useful lives of the assets. Repairs and maintenance are charged to operations as incurred and expenditures for renewals and betterments are capitalized.

#### *Other Investments*

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

#### *Income Taxes*

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

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

The Company evaluates uncertain tax positions at the end of each reporting period. The Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefit recognized in the financial statements from any such a position is measured based on the largest benefit that has a greater than fifty percent

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

likelihood of being realized upon ultimate settlement. As of December 31, 2016 and 2015, respectively, after evaluating all uncertain tax positions, the Company has recorded no liability for unrecognized tax benefits at the end of the reporting period. The Company would recognize any interest accrued on unrecognized tax benefits as other interest expense and penalties as other non-interest expense. During the years ended December 31, 2016, 2015 and 2014, the Company recognized no interest expense or penalties related to uncertain tax positions.

The Company files consolidated tax returns in the U.S. Federal jurisdiction and various state jurisdictions. The Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2013.

#### *Stock Options*

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

#### *Net Income Per Share*

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

#### *Goodwill and Identified Intangible Assets*

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill is tested for impairment at least annually or on an interim basis if an event triggering impairment may have occurred. As of October 1, 2016, after completing goodwill testing, the Company has determined that no goodwill impairment exists.

Identified intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability. The Company's identified intangible assets relate to core deposits and contract rights. As of December 31, 2016, the Company has determined that no impairment of identified intangibles exists. Identified intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. See Note 6—Goodwill and Other Intangible Assets.

#### *Impairment of Long-Lived Assets*

Long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying value of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying value of

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statement of condition and reported at the lower of the carrying value or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the statement of condition.

#### *Consolidated Statements of Cash Flows*

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

#### *Accounting for Transfers and Servicing of Financial Assets*

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

#### *Segments of an Enterprise and Related Information*

The Company operates as one segment. The operating information used by the Company's chief executive officer for purposes of assessing performance and making operating decisions about the Company is the consolidated financial statements presented in this report. The Company has four active operating subsidiaries, namely, the bank subsidiaries, otherwise known as International Bank of Commerce, Laredo, Commerce Bank, International Bank of Commerce, Zapata and International Bank of Commerce, Brownsville. The Company applies the provisions of ASC Topic 280, "Segment Reporting," in determining its reportable segments and related disclosures.

#### *Comprehensive Income (Loss)*

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

#### *Advertising*

Advertising costs are expensed as incurred.

#### *Reclassifications*

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

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

#### *New Accounting Standards*

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

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

In February 2015, the FASB issued Accounting Standards Update No. 2015-02 to ASC 810, “Consolidation.” The update amends existing standards regarding the evaluation of certain legal entities and their consolidation in the financial statements. The amendments modify the evaluation process to assess whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, eliminate the presumption that a general partner should consolidate a limited partnership, affect the consolidation analysis of entities that are involved in variable interest entities, particularly those that have fee arrangements and related party relationships and provides a scope exception for reporting entities with legal interests that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. The update is effective for interim and annual periods after December 15, 2015. The adoption of the update to existing standards did not have a significant impact to the Company’s consolidated financial statements.

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

In January 2016, the FASB issued Accounting Standards Update No. 2016-01 to ASC 825-10, “Financial Instruments – Overall.” The update amends existing standards regarding certain aspects of recognition and measurement of financial assets and financial liabilities. The amendments in the update establish the following guidance: (i) requires equity investments, except those accounted for under the equity method of accounting or those that result in consolidation

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

of the investee, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity securities without readily determinable fair values by requiring a qualitative assessment, (iii) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities, (iv) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (v) requires public business entities to use the exit price notion when measuring fair value for disclosure purposes, (vi) requires an entity to present separately, in other comprehensive income, the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option, (vii) requires separate presentation of financial assets and liabilities by measurement category and form of financial assets on the balance sheet or in the accompanying notes to the financial statements, and (viii) clarifies that an entity should evaluate the need to a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The update is effective for interim and annual periods beginning after December 15, 2017. The adoption of the update is not expected to have a significant impact to the Company's consolidated financial statements.

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

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

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 to ASC 326, "Financial Instruments – Credit Losses." The update amends existing standards for accounting for credit losses for financial assets. The update requires that the expected credit losses on the financial instruments held as of the end of the period being reported be measured based on historical experience, current conditions, and reasonable and supportable forecasts. The update also expands the required disclosures related to significant estimates and judgements used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's financial assets. The update also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The update is effective for interim and annual periods beginning after December 15, 2019. The Company is evaluating the potential impact of the update on the Company's consolidated financial statements.

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



**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Investment Securities**

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

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

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

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

The amortized cost and estimated fair value of investment securities at December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

	<b>Held to Maturity</b>		<b>Available for Sale</b>	
	<b>Amortized Cost</b>	<b>Estimated fair value</b>	<b>Amortized Cost</b>	<b>Estimated fair value</b>
(Dollars in Thousands)				
Due in one year or less . . . . .	\$ 125	\$ 125	\$ —	\$ —
Due after one year through five years . . . . .	2,275	2,275	—	—
Due after five years through ten years . . . . .	—	—	1,218	1,288
Due after ten years . . . . .	—	—	243,404	253,684
Residential mortgage-backed securities . . . . .	—	—	3,946,144	3,894,470
Equity securities . . . . .	—	—	28,075	27,907
Total investment securities . . . . .	<u>\$ 2,400</u>	<u>\$ 2,400</u>	<u>\$ 4,218,841</u>	<u>\$ 4,177,349</u>

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

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

The amortized cost and fair value of available for sale investment securities pledged to qualify for fiduciary powers, to secure public monies as required by law, repurchase agreements and short-term fixed borrowings was \$1,780,513,000 and \$1,754,763,000, respectively, at December 31, 2016.

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2016 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>
	<b>(Dollars in Thousands)</b>					
Available for sale:						
Residential mortgage-backed securities . . . . .	\$ 2,513,872	\$ (52,245)	\$ 396,695	\$ (17,675)	\$ 2,910,567	\$ (69,920)
Obligations of states and political subdivisions . . . . .	31,104	(433)	—	—	31,104	(433)
Equity securities . . . . .	14,066	(184)	5,452	(298)	19,518	(482)
	<u>\$ 2,559,042</u>	<u>\$ (52,862)</u>	<u>\$ 402,147</u>	<u>\$ (17,973)</u>	<u>\$ 2,961,189</u>	<u>\$ (70,835)</u>

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position, at December 31, 2015 were as follows:

	<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>
	<b>(Dollars in Thousands)</b>					
Available for sale:						
Residential mortgage-backed securities . . . . .	\$ 1,083,137	\$ (9,333)	\$ 1,454,550	\$ (37,224)	\$ 2,537,687	\$ (46,557)
Obligations of states and political subdivisions . . . . .	6,814	(19)	544	(6)	7,358	(25)
Equity securities . . . . .	5,041	(35)	5,540	(210)	10,581	(245)
	<u>\$ 1,094,992</u>	<u>\$ (9,387)</u>	<u>\$ 1,460,634</u>	<u>\$ (37,440)</u>	<u>\$ 2,555,626</u>	<u>\$ (46,827)</u>

The unrealized losses on investments in residential mortgage-backed securities are primarily caused by changes in market interest rates. Residential mortgage-backed securities are primarily securities issued by Freddie Mac, Fannie Mae and Ginnie Mae. The contractual cash obligations of the securities issued by Ginnie Mae are fully guaranteed by the U.S. government. The contractual cash obligations of the securities issued by Freddie Mac and Fannie Mae are not fully guaranteed by the U.S. government; however, the Company believes that the quality of the bonds is similar to other AAA rated bonds with limited credit risk, particularly given the placement of Fannie Mae and Freddie Mac into conservatorship by the federal government in early September 2008 and because securities issued by others that are collateralized by residential mortgage-backed securities issued by Fannie Mae and Freddie Mac are rated consistently as AAA rated securities. The decrease in fair value on residential mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae is due to market interest rates. The Company has no intent to sell and more likely than not be required to sell before a market price recovery or maturity of the securities; therefore, it is the conclusion of the Company that the investments in residential mortgage-backed securities issued by Freddie Mac, Fannie Mae and Ginnie Mae are not considered other-than-temporarily impaired. In addition, the Company has a small investment in non-agency residential mortgage-backed securities that have strong credit backgrounds and include additional credit enhancements to protect the Company from losses arising from high foreclosure rates. These securities have additional market volatility beyond economically induced interest rate events. It is the conclusion of the Company that the investments in non-agency residential mortgage-backed securities are other-than-temporarily impaired due to both credit and other than credit issues. An impairment charge of \$354,000 (\$230,100 after tax), was recorded in 2016 on the non-agency residential mortgage backed securities. Impairment charges of \$954,000 (\$620,100, after tax) and \$817,000 (\$531,050, after tax) were recorded in 2015 and 2014, respectively on the non-agency residential mortgage backed securities. The impairment charges represent the credit related impairment on the securities.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investments recognized in earnings for the twelve months ended December 31, 2016 (in Thousands):

Balance at December 31, 2015 . . . . .	\$	13,577
Impairment charges recognized during period . . . . .		354
Balance at December 31, 2016 . . . . .	\$	<u>13,931</u>

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investments recognized in earnings for the twelve months ended December 31, 2015 (in Thousands):

Balance at December 31, 2014 . . . . .	\$	12,623
Impairment charges recognized during period . . . . .		954
Balance at December 31, 2015 . . . . .	\$	<u>13,577</u>

The following table presents a reconciliation of credit-related impairment charges on available-for-sale investments recognized in earnings for the twelve months ended December 31, 2014 (in Thousands):

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

**(3) Loans**

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

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

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

#### (4) Allowance for Probable Loan Losses

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

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

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

The U.S. economy continues to face uncertainty, with particular attention being paid to continued depressed oil and gas prices, the unprecedented debt and trade deficit of the United States, possible interest rate movement, political changes, the continued impact of overseas markets on the U.S. and the negative impact on US exports and cross border trade between the U.S. and Mexico arising from the strength of the U.S. dollar. Although the Texas and Oklahoma economies continue to perform better than the U.S. economy as a whole, the same issues that are creating uncertainty in the U.S. economy may also negatively impact the economies of Texas and Oklahoma. Economic risk factors are minimized by the underwriting standards of the bank subsidiaries. The general underwriting standards encompass the following principles: (i) the financial strength of the borrower including strong earnings, a high net worth, significant liquidity and an acceptable debt to worth ratio, (ii) managerial and business competence, (iii) the ability to repay, (iv) for a new business, projected cash flows, (v) loan to value, (vi) in the case of a secondary guarantor, a guarantor financial statement, and (vii) financial and/or other character references. Although the underwriting standards reduce the risk of loss, unique risk factors exist in each type of loan in which the bank subsidiaries invest.

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

	December 31, 2016								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 December 31, . . . . .	\$ 21,431	\$ 13,920	\$ 19,769	\$ 1,248	\$ 3,509	\$ 5,321	\$ 638	\$ 1,152	\$ 66,988
Losses charge to allowance . . .	(32,959)	(16)	(1,890)	(180)	(70)	(331)	(414)	(41)	(35,901)
Recoveries credited to allowance . . . . .	7,110	6,099	119	—	21	278	69	19	13,715
Net losses charged to allowance	(25,849)	6,083	(1,771)	(180)	(49)	(53)	(345)	(22)	(22,186)
Provision (credit) charged to operations . . . . .	30,067	(6,114)	(1,267)	(262)	(1,005)	(1,552)	238	(246)	19,859
Balance at December 31, . . . . .	<u>\$ 25,649</u>	<u>\$ 13,889</u>	<u>\$ 16,731</u>	<u>\$ 806</u>	<u>\$ 2,455</u>	<u>\$ 3,716</u>	<u>\$ 531</u>	<u>\$ 884</u>	<u>\$ 64,661</u>
	December 31, 2015								
	Domestic						Foreign		
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31, . . . . .	\$ 22,352	\$ 12,955	\$ 18,683	\$ 846	\$ 3,589	\$ 4,683	\$ 660	\$ 1,060	\$ 64,828
Losses charge to allowance . . .	(24,802)	(695)	(492)	—	(157)	(275)	(704)	—	(27,125)
Recoveries credited to allowance . . . . .	3,135	141	963	—	30	431	170	10	4,880
Net losses charged to allowance	(21,667)	(554)	471	—	(127)	156	(534)	10	(22,245)
Provision (credit) charged to operations . . . . .	20,746	1,519	615	402	47	482	512	82	24,405
Balance at December 31, . . . . .	<u>\$ 21,431</u>	<u>\$ 13,920</u>	<u>\$ 19,769</u>	<u>\$ 1,248</u>	<u>\$ 3,509</u>	<u>\$ 5,321</u>	<u>\$ 638</u>	<u>\$ 1,152</u>	<u>\$ 66,988</u>

INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

	December 31, 2014								
	Domestic						Foreign		
	Commercial	Commercial real estate: other construction & land development	Commercial real estate: farmland & commercial	Commercial real estate: multifamily	Residential: first lien	Residential: junior lien	Consumer	Foreign	Total
	(Dollars in Thousands)								
Balance at December 31, . . . . .	\$ 22,433	\$ 12,541	\$ 24,467	\$ 776	\$ 3,812	\$ 4,249	\$ 750	\$ 1,133	\$ 70,161
Losses charge to allowance . . .	(19,110)	(680)	(1,893)	—	(351)	(661)	(719)	(51)	(23,465)
Recoveries credited to allowance . . . . .	2,979	72	107	—	49	242	210	50	3,709
Net losses charged to allowance	(16,131)	(608)	(1,786)	—	(302)	(419)	(509)	(1)	(19,756)
Provision (credit) charged to operations . . . . .	16,050	1,022	(3,998)	70	79	853	419	(72)	14,423
Balance at December 31, . . . . .	<u>\$ 22,352</u>	<u>\$ 12,955</u>	<u>\$ 18,683</u>	<u>\$ 846</u>	<u>\$ 3,589</u>	<u>\$ 4,683</u>	<u>\$ 660</u>	<u>\$ 1,060</u>	<u>\$ 64,828</u>

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

	<b>December 31, 2016</b>			
	<b>Loans Individually Evaluated For Impairment</b>		<b>Loans Collectively Evaluated For Impairment</b>	
	<b>Recorded Investment</b>	<b>Allowance</b>	<b>Recorded Investment</b>	<b>Allowance</b>
	<b>(Dollars in Thousands)</b>			
Domestic				
Commercial.....	\$ 22,412	\$ —	\$ 887,255	\$ 25,649
Commercial real estate: other construction & land development..	4,776	371	1,712,099	13,518
Commercial real estate: farmland & commercial .....	10,810	546	1,932,260	16,185
Commercial real estate: multifamily.....	552	—	139,914	806
Residential: first lien .....	6,836	44	415,068	2,411
Residential: junior lien.....	978	—	609,340	3,716
Consumer .....	1,295	—	53,873	531
Foreign.....	746	—	166,474	884
<b>Total .....</b>	<b>\$ 48,405</b>	<b>\$ 961</b>	<b>\$ 5,916,283</b>	<b>\$ 63,700</b>

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

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



**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

	<u>December 31, 2016</u>				
	<u>Recorded</u>	<u>Unpaid</u>	<u>Related</u>	<u>Average</u>	<u>Interest</u>
	<u>Investment</u>	<u>Principal</u>	<u>Allowance</u>	<u>Recorded</u>	<u>Recognized</u>
	<u>(Dollars in Thousands)</u>				
Loans with Related Allowance					
Domestic					
Commercial real estate: other construction & land development . . . . .	\$ 1,958	\$ 1,971	\$ 371	\$ 2,512	\$ —
Commercial real estate: farmland & commercial . . . . .	2,808	3,948	546	3,247	—
Residential: first lien . . . . .	62	62	44	62	—
Total impaired loans with related allowance . . . . .	<u>\$ 4,828</u>	<u>\$ 5,981</u>	<u>\$ 961</u>	<u>\$ 5,821</u>	<u>\$ —</u>

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

	December 31, 2015				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Recognized
(Dollars in Thousands)					
Loans with Related Allowance					
Domestic					
Commercial	\$ 4,016	\$ 4,156	\$ 1,704	\$ 3,758	\$ —
Commercial real estate: other construction & land development	167	169	100	893	—
Commercial real estate: farmland & commercial	4,003	4,309	202	444	92
Commercial real estate: multifamily	599	599	200	599	—
Total impaired loans with related allowance	<u>\$ 8,785</u>	<u>\$ 9,233</u>	<u>\$ 2,206</u>	<u>\$ 5,694</u>	<u>\$ 92</u>

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

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

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

While management of the Company considers that it is generally able to identify borrowers with financial problems reasonably early and to monitor credit extended to such borrowers carefully, there is no precise method of predicting loan losses. The determination that a loan is likely to be uncollectible and that it should be wholly or partially charged-off as a loss is an exercise of judgment. Similarly, the determination of the adequacy of the allowance for probable loan losses can be made only on a subjective basis. It is the judgment of the Company’s management that the allowance for probable loan losses at December 31, 2016 and December 31, 2015, was adequate to absorb probable losses from loans in the portfolio at that date.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

	<b>December 31, 2016</b>						
	<b>30 - 59 Days</b>	<b>60 - 89 Days</b>	<b>90 Days or Greater</b>	<b>90 Days or greater &amp; still accruing</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Total Portfolio</b>
(Dollars in Thousands)							
Domestic							
Commercial	\$ 4,081	\$ 829	\$ 21,123	\$ 392	\$ 26,033	\$ 883,634	\$ 909,667
Commercial real estate: other construction & land development	1,502	396	4,456	9	6,354	1,710,521	1,716,875
Commercial real estate: farmland & commercial	3,454	3,054	6,150	289	12,658	1,930,412	1,943,070
Commercial real estate: multifamily	44	—	552	—	596	139,870	140,466
Residential: first lien	5,615	1,350	4,143	3,756	11,108	410,796	421,904
Residential: junior lien	762	178	540	382	1,480	608,838	610,318
Consumer	910	95	413	387	1,418	53,750	55,168
Foreign	931	425	397	11	1,753	165,467	167,220
Total past due loans	<u>\$ 17,299</u>	<u>\$ 6,327</u>	<u>\$ 37,774</u>	<u>\$ 5,226</u>	<u>\$ 61,400</u>	<u>\$ 5,903,288</u>	<u>\$ 5,964,688</u>

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

The Company's internal classified report is segregated into the following categories: (i) "Special Review Credits," (ii) "Watch List—Pass Credits," or (iii) "Watch List—Substandard Credits." The loans placed in the "Special Review Credits" category reflect the Company's opinion that the loans reflect potential weakness which require monitoring on a more frequent basis. The "Special Review Credits" are reviewed and discussed on a regular basis with the credit department and the lending staff to determine if a change in category is warranted. The loans placed in the "Watch List—Pass Credits" category reflect the Company's opinion that the credit contains weaknesses which represent a greater degree of risk, which warrant "extra attention." The "Watch List—Pass Credits" are reviewed and discussed on a regular basis with the credit department and the lending staff to determine if a change in category is warranted. The loans placed in the "Watch List—Substandard Credits" classification are considered to be potentially inadequately protected by the current sound worth and debt service capacity of the borrower or of any pledged collateral. These credit obligations, even if apparently protected by collateral value, have shown defined weaknesses related to adverse financial, managerial, economic, market or political conditions which may jeopardize repayment of principal and interest. Furthermore, there is the possibility that some future loss could be sustained by the Company if such weaknesses are not corrected. For loans that are classified as impaired, management evaluates these credits in accordance with the provision of ASC 310-10,

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

“Receivables,” and, if deemed necessary, a specific reserve is allocated to the credit. The specific reserve allocated under ASC 310-10, is based on (i) the present value of expected future cash flows discounted at the loan’s effective interest rate; (ii) the loan’s observable market price; or (iii) the fair value of the collateral if the loan is collateral dependent. Substantially all of the Company’s loans evaluated as impaired under ASC 310-10 are measured using the fair value of collateral method. In limited cases, the Company may use other methods to determine the specific reserve of a loan under ASC 310-10 if such loan is not collateral dependent.

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

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

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

**(5) Bank Premises and Equipment**

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

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

**(6) Goodwill and Other Intangible Assets**

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

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

Fiscal year ending December 31:

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

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

**(7) Deposits**

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

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

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

**(8) Securities Sold Under Repurchase Agreements**

The Company's bank subsidiaries have entered into repurchase agreements with an investment banking firm and individual customers of the bank subsidiaries. The purchasers have agreed to resell to the bank subsidiaries identical securities upon the maturities of the agreements. Securities sold under repurchase agreements were mortgage-backed book



**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

Further information related to repurchase agreements at December 31, 2016 and 2015 is set forth in the following table:

	Collateral Securities		Repurchase Borrowing	
	Book Value of Securities Sold	Fair Value of Securities Sold	Balance of Liability	Weighted Average Interest Rate
	(Dollars in Thousands)			
December 31, 2016 term:				
Overnight agreements .....	\$ 295,282	\$ 292,286	\$ 190,915	0.15 %
1 to 29 days .....	10,250	10,148	9,863	0.50
30 to 90 days .....	2,315	2,317	2,300	0.33
Over 90 days .....	382,304	375,060	301,907	4.01
Total .....	\$ 690,151	\$ 679,811	\$ 504,985	2.46 %
December 31, 2015 term:				
Overnight agreements .....	\$ 316,041	\$ 317,799	\$ 250,702	0.15 %
1 to 29 days .....	10,199	10,114	9,798	0.50
30 to 90 days .....	4,388	4,356	4,320	0.31
Over 90 days .....	647,086	644,131	562,952	3.84
Total .....	\$ 977,714	\$ 976,400	\$ 827,772	2.66 %

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

**(9) Other Borrowed Funds**

Other borrowed funds include Federal Home Loan Bank borrowings, which are short and long-term fixed borrowings issued by the Federal Home Loan Bank of Dallas at the market price offered at the time of funding. These borrowings are secured by mortgage-backed investment securities and a portion of the Company's loan portfolio. The increase in other borrowed funds is a result of purchases of available-for-sale securities.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

**(10) Junior Subordinated Deferrable Interest Debentures**

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

For financial reporting purposes, the Trusts are treated as investments of the Company and not consolidated in the consolidated financial statements. Although the Capital Securities issued by each of the Trusts are not included as a component of shareholders' equity on the consolidated statement of condition, the Capital Securities are treated as capital for regulatory purposes. Specifically, under applicable regulatory guidelines, the Capital Securities issued by the Trusts qualify as Tier 1 capital up to a maximum of 25% of Tier 1 capital on an aggregate basis. Any amount that exceeds the 25% threshold would qualify as Tier 2 capital. At December 31, 2016 and December 31, 2015, the total \$160,416,000 and \$161,416,000, respectively, of the Capital Securities outstanding qualified as Tier 1 capital.

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

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

**(11) Earnings per Share (“EPS”)**

Basic EPS is calculated by dividing net income by the weighted average number of common shares outstanding. The computation of diluted EPS assumes the issuance of common shares for all dilutive potential common shares outstanding during the reporting period. The calculation of the basic EPS and the diluted EPS for the years ended December 31, 2016, 2015, and 2014 is set forth in the following table:

	<u>Net Income</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per Share</u> <u>Amount</u>
	(Dollars in Thousands, Except Per Share Amounts)		
December 31, 2016:			
Basic EPS			
Net income available to common shareholders . . . . .	\$ 133,932	65,967,989	\$ 2.03
Potential dilutive common shares and warrants . . . . .	—	<u>345,501</u>	
Diluted EPS . . . . .	<u>\$ 133,932</u>	<u>66,313,490</u>	\$ 2.02
December 31, 2015:			
Basic EPS			
Net income available to common shareholders . . . . .	\$ 136,726	66,411,193	\$ 2.06
Potential dilutive common shares and warrants . . . . .	—	<u>225,160</u>	
Diluted EPS . . . . .	<u>\$ 136,726</u>	<u>66,636,353</u>	\$ 2.05
December 31, 2014:			
Basic EPS			
Net income available to common shareholders . . . . .	\$ 153,151	66,872,500	\$ 2.29
Potential dilutive common shares . . . . .	—	<u>183,956</u>	
Diluted EPS . . . . .	<u>\$ 153,151</u>	<u>67,056,456</u>	\$ 2.28

**(12) Employees’ Profit Sharing Plan**

The Company has a deferred profit sharing plan for full-time employees with a minimum of one year of continuous employment. The Company’s annual contribution to the plan is based on a percentage, as determined by the Board of Directors, of income before income taxes, as defined, for the year. Allocation of the contribution among officers and employees’ accounts is based on length of service and amount of salary earned. Profit sharing costs of \$3,650,000, \$3,525,000 and \$3,510,000 were charged to income for the years ended December 31, 2016, 2015, and 2014, respectively.

**(13) International Operations**

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

**(14) Income Taxes**

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

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

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

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

**(15) Stock Options**

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

shareholders, which may be exercisable for a period of up to only five years. As of December 31, 2016, 198,675 shares were available for future grants under the 2012 Plan.

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

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

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

Stock-based compensation expense included in the consolidated statements of income for the years ended December 31, 2016, 2015 and 2014 was approximately \$1,082,000, \$1,172,000 and \$1,058,000, respectively. As of December 31, 2016, there was approximately \$2,322,000 of total unrecognized stock-based compensation cost related to non-vested options granted under the Company plans that will be recognized over a weighted average period of 1.7 years.

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

**(16) Long Term Restricted Stock Units**

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

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

The Plan authorizes the Company to issue Restricted Stock Units (“RSUs”) to officers, employees, consultants and advisors of the Company and its subsidiaries. The Plan provides that RSUs shall be issued by a committee of the Board appointed by the Board from time to time consisting of at least two (2) members of the Board, each of whom is both a non-employee director and an outside director. On December 18, 2009, the Board adopted resolutions creating the Long-Term Restricted Stock Unit Plan Committee to administer the Plan. RSUs issued under the Plan are not equity and are payable only in cash. The Plan provides for both the issuance of CPP-compliant long-term RSUs as well as RSUs that are not CPP-compliant.

Dennis E. Nixon, the Company’s President, Chairman of the Board and a director of the Company, was awarded CPP-compliant RSUs granted as of December 19, 2012 of \$425,000 for his performance in 2012. In order to meet the requirements of a CPP-compliant RSU, Mr. Nixon’s 2012 RSUs vested and were paid in December 2014 in the cash amount of \$572,746.

**(17) Commitments, Contingent Liabilities and Other Matters**

The Company leases portions of its banking premises and equipment under operating leases. Total rental expense for the years ended December 31, 2016, 2015 and 2014 were approximately \$5,870,000, \$6,200,000 and \$7,200,000, respectively. Future minimum lease payments due under non-cancellable operating leases at December 31, 2016 were as follows:

Fiscal year ending:

	<b>Total</b>
	<b>(in Thousands)</b>
2017 .....	\$ 3,078
2018 .....	2,772
2019 .....	2,726
2020 .....	2,551
2021 .....	1,633
Thereafter .....	88
Total .....	\$ 12,848

It is expected that certain leases will be renewed, as these leases expire. Aggregate future minimum rentals to be received under non-cancellable sub-leases greater than one year at December 31, 2016 were \$101,562,000.



## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

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

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

#### (18) Transactions with Related Parties

In the ordinary course of business, the subsidiaries of the Company make loans to directors and executive officers of the Corporation, including their affiliates, families and companies in which they are principal owners. In the opinion of management, these loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than normal risk of collectability or present other unfavorable features. The aggregate amounts receivable from such related parties amounted to approximately \$26,662,000 and \$31,975,000 at December 31, 2016 and 2015, respectively.

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

In the normal course of business, the bank subsidiaries are party to financial instruments with off-statement of condition risk to meet the financing needs of their customers. These financial instruments include commitments to their customers. These financial instruments involve, to varying degrees, elements of credit risk in excess of the amounts recognized in the consolidated statement of condition. The contract amounts of these instruments reflect the extent of involvement the bank subsidiaries have in particular classes of financial instruments. At December 31, 2016, the following financial amounts of instruments, whose contract amounts represent credit risks, were outstanding:

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

The Company enters into a standby letter of credit to guarantee performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved is represented by the contractual amounts of those instruments. Under the standby letters of credit, the Company is required to make payments to the beneficiary of the letters of credit upon request by the beneficiary so long as all performance criteria have been met. At December 31, 2016, the maximum potential amount of future payments is approximately \$88,504,000. At December 31, 2016, the fair value of these guarantees is not significant. Unsecured letters of credit totaled approximately \$40,738,000 and \$37,454,000 at December 31, 2016 and 2015, respectively.

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

The bank subsidiaries' exposure to credit loss in the event of nonperformance by the other party to the above financial instruments is represented by the contractual amounts of the instruments. The bank subsidiaries use the same

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

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

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

#### **(20) Capital Requirements**

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

On June 12, 2013, the U.S. Treasury sold the Warrant to a third party. As of February 20, 2016, the Warrant is still outstanding. Adjustments to the \$24.43 per share Exercise Price of the Warrant will be made if the Company pays cash dividends in excess of 33 cents per semi-annual period or makes certain other shareholder distributions before the Warrants expires on December 23, 2018.

Bank regulatory agencies limit the amount of dividends, which the bank subsidiaries can pay the Corporation, through IBC Subsidiary Corporation, without obtaining prior approval from such agencies. At December 31, 2016, the subsidiary banks could pay dividends of up to \$819,500,000 to the Corporation without prior regulatory approval and without adversely affecting their "well-capitalized" status under regulatory capital rules in effect at December 31, 2016. In addition to legal requirements, regulatory authorities also consider the adequacy of the bank subsidiaries' total capital in relation to their deposits and other factors. These capital adequacy considerations also limit amounts available for payment of dividends. The Company historically has not allowed any subsidiary bank to pay dividends in such a manner as to impair its capital adequacy.

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

Current quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios (set forth in the table on the following page) of Total and Tier 1 capital to

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2016, that the Company and each of the bank subsidiaries met all capital adequacy requirements to which they are subject.

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

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

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

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

As of December 31, 2016, the most recent notification from the Federal Deposit Insurance Corporation categorized all the bank subsidiaries as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as “well-capitalized,” the Company and the bank subsidiaries must maintain minimum Total risk-based, Tier 1 risk based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the categorization of the Company or any of the bank subsidiaries as well-capitalized.

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

The Company's and the bank subsidiaries' actual capital amounts and ratios for 2015 are also presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount (greater than or equal to)	Ratio (greater than or equal to)	Amount (greater than or equal to)	Ratio (greater than or equal to)
(Dollars in Thousands)						
As of December 31, 2015:						
Common Equity Tier 1 (to Risk Weighted Assets):						
Consolidated . . . . .	\$ 1,380,801	16.81 %	\$ 369,726	4.50 %	N/A	N/A
International Bank of Commerce, Laredo . . . . .	1,151,812	16.42	315,707	4.50	\$ 456,022	6.50 %
International Bank of Commerce, Brownsville . . . . .	154,141	26.26	26,418	4.50	38,159	6.50
International Bank of Commerce, Zapata . . . . .	66,153	35.71	8,336	4.50	12,042	6.50
Commerce Bank . . . . .	72,882	36.17	9,067	4.50	13,097	6.50
Total Capital (to Risk Weighted Assets):						
Consolidated . . . . .	\$ 1,605,419	19.54 %	\$ 657,291	8.00 %	N/A	N/A
International Bank of Commerce, Laredo . . . . .	1,213,377	17.30	561,258	8.00	\$ 701,572	10.00 %
International Bank of Commerce, Brownsville . . . . .	159,913	27.24	46,965	8.00	58,706	10.00
International Bank of Commerce, Zapata . . . . .	67,470	36.42	14,820	8.00	18,525	10.00
Commerce Bank . . . . .	74,204	36.83	16,119	8.00	20,149	10.00
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated . . . . .	\$ 1,535,443	18.69 %	\$ 492,968	6.00 %	N/A	N/A
International Bank of Commerce, Laredo . . . . .	1,151,812	16.42	420,943	6.00	\$ 561,258	8.00 %
International Bank of Commerce, Brownsville . . . . .	154,141	26.26	35,224	6.00	46,965	8.00
International Bank of Commerce, Zapata . . . . .	66,153	35.71	11,115	6.00	14,820	8.00
Commerce Bank . . . . .	72,882	36.17	12,089	6.00	16,119	8.00
Tier 1 Capital (to Average Assets):						
Consolidated . . . . .	\$ 1,535,443	13.15 %	\$ 466,897	4.00 %	N/A	N/A
International Bank of Commerce, Laredo . . . . .	1,151,812	12.09	381,105	4.00	476,381	5.00 %
International Bank of Commerce, Brownsville . . . . .	154,141	15.03	41,034	4.00	51,293	5.00
International Bank of Commerce, Zapata . . . . .	66,153	13.15	20,129	4.00	25,161	5.00
Commerce Bank . . . . .	72,882	12.94	22,521	4.00	28,151	5.00

### (21) Fair Value

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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 financial instruments reported on the consolidated statements of condition at their fair value as of December 31, 2016 by level within the fair value measurement hierarchy.

	Assets/Liabilities Measured at Fair Value <u>December 31, 2016</u>	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)
<i>Measured on a recurring basis:</i>				
Assets:				
Available for sale securities				
Residential mortgage-backed securities . . . . .	\$ 3,894,470	\$ —	\$ 3,876,865	\$ 17,605
States and political subdivisions . . . . .	254,972	—	254,972	—
Equity securities . . . . .	27,907	27,907	—	—
	<u>\$ 4,177,349</u>	<u>\$ 27,907</u>	<u>\$ 4,131,837</u>	<u>\$ 17,605</u>

The following table represents financial instruments reported on the consolidated balance sheets at their fair value as of December 31, 2015 by level within the fair value measurement hierarchy.

	Assets/Liabilities Measured at Fair Value <u>December 31, 2015</u>	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)
<i>Measured on a recurring basis:</i>				
Assets:				
Available for sale securities				
Residential mortgage - backed securities . . . . .	\$ 3,893,210	\$ —	\$ 3,871,981	\$ 21,229
States and political subdivisions . . . . .	277,705	—	277,705	—
Equity securities . . . . .	28,457	28,457	—	—
	<u>\$ 4,199,372</u>	<u>\$ 28,457</u>	<u>\$ 4,149,686</u>	<u>\$ 21,229</u>

Investment securities available-for-sale are classified within level 2 and level 3 of the valuation hierarchy, with the exception of certain equity investments that are classified within level 1. For investments classified as level 2 in the

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

fair value hierarchy, the Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Investment securities classified as level 3 are non-agency mortgage-backed securities. The non-agency mortgage-backed securities held by the Company are traded in inactive markets and markets that have experienced significant decreases in volume and level of activity, as evidenced by few recent transactions, a significant decline or absence of new issuances, price quotations that are not based on comparable securities transactions and wide bid-ask spreads among other factors. As a result of the inability to use quoted market prices to determine fair value for these securities, the Company determined that fair value, as determined by level 3 inputs in the fair value hierarchy, is more appropriate for financial reporting and more consistent with the expected performance of the investments. For the investments classified within level 3 of the fair value hierarchy, the Company used a discounted cash flow model to determine fair value. Inputs in the model included both historical performance and expected future performance based on information currently available.

Assumptions used in the discounted cash flow model as of December 31, 2016 and December 31, 2015 were applied separately to those portions of the bond where the underlying residential mortgage loans had been performing under original contract terms for at least the prior 24 months and those where the underlying residential mortgages had not been meeting the original contractual obligation for the same period. Unobservable inputs included in the model are estimates on future principal prepayment rates, and default and loss severity rates. For that portion of the bond where the underlying residential mortgage had been meeting the original contract terms for at least 24 months, the Company used the following estimates in the model: (i) a voluntary prepayment rate of 7%, (ii) a 1% default rate, (iii) a loss severity rate of 25%, and (iv) a discount rate of 13%. The assumptions used in the model for the rest of the bond included the following estimates: (i) a voluntary prepayment rate of 2%, (ii) a default rate of 4.5%, (iii) a loss severity rate that started at 60% for the first year (2012) then declines by 5% for the following five years (2013, 2014, 2015, 2016 and 2017) and remains at 25% thereafter (2018 and beyond), and (iv) a discount rate of 13%. The estimates used in the model to determine fair value are based on observable historical data of the underlying collateral. The model anticipates that the housing market will gradually improve and that the underlying collateral will eventually all perform in accordance with the original contract terms on the bond. Should the number of loans in the underlying collateral that default and go into foreclosure or the severity of the losses in the underlying collateral significantly change, the results of the model would be impacted. The Company will continue to evaluate the actual historical performance of the underlying collateral and will modify the assumptions used in the model as necessary.

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

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

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the period ended December 31, 2016 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Year ended December 31, 2016	Fair Value Measurements at Reporting Date Using			Net Provision (Credit) During Period
		(in Thousands)			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<i>Measured on a non-recurring basis:</i>					
Assets:					
Impaired loans . . . . .	\$ 38,794	\$ —	\$ —	\$ 38,794	\$ 19,699
Other real estate owned . . . . .	9,445	—	—	9,445	2,351

The following table represents financial instruments measured at fair value on a non-recurring basis as of and for the year ended December 31, 2015 by level within the fair value measurement hierarchy:

	Assets/Liabilities Measured at Fair Value Year ended December 31, 2015	Fair Value Measurements at Reporting Date Using			Net (Credit) Provision During Period
		(in Thousands)			
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<i>Measured on a non-recurring basis:</i>					
Assets:					
Impaired loans . . . . .	\$ 18,033	\$ —	\$ —	\$ 18,033	\$ (8,589)
Other real estate owned . . . . .	12,705	—	—	12,705	1,023

The Company's assets measured at fair value on a non-recurring basis are limited to impaired loans and other real estate owned. Impaired loans are classified within level 3 of the valuation hierarchy. The fair value of impaired loans is derived in accordance with FASB ASC 310, "Receivables". Impaired loans are primarily comprised of collateral-dependent commercial loans. Understanding that as the primary sources of loan repayments decline, the secondary repayment source comes into play and correctly evaluating the fair value of that secondary source, the collateral, becomes even more important. Re-measurement of the impaired loan to fair value is done through a specific valuation allowance included in the allowance for probable loan losses. The fair value of impaired loans is based on the fair value of the collateral, as determined through either an appraisal or evaluation process. The basis for the Company's appraisal and appraisal review process is based on regulatory guidelines and strives to comply with all regulatory appraisal laws, regulations and the Uniform Standards of Professional Appraisal Practice. All appraisals and evaluations are "as is" (the property's highest and best use) valuations based on the current conditions of the property/project at that point in time. The determination of the fair value of the collateral is based on the net realizable value, which is the appraised value less any closing costs, when applicable. As of December 31, 2016, the Company had approximately \$38,108,000 of impaired commercial collateral dependent loans, of which approximately \$26,162,000 had an appraisal performed within the immediately preceding twelve months and of which approximately \$6,836,000 had an evaluation performed within the immediately preceding twelve months. As of December 31, 2015, the Company had approximately \$51,021,000 of



## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

impaired commercial collateral dependent loans, of which approximately \$39,520,000 had an appraisal performed within the immediately preceding twelve months and of which approximately \$2,958,000 had an evaluation performed within the immediately preceding twelve months.

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

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

The fair value estimates, methods, and assumptions for the Company's financial instruments at December 31, 2016 and December 31, 2015 are outlined below.

#### *Cash and Cash Equivalents*

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

#### *Investment securities held-to-maturity*

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

#### *Investment Securities*

For investment securities, which include U.S. Treasury securities, obligations of other U.S. government agencies, obligations of states and political subdivisions and mortgage pass through and related securities, fair values are from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. See disclosures of fair value of investment securities in Note 2.

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

#### *Loans*

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

For variable rate performing loans, the carrying amount approximates the fair value. For fixed rate performing loans, except residential mortgage loans, the fair value is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. For performing residential mortgage loans, fair value is estimated by discounting contractual cash flows adjusted for prepayment estimates using discount rates based on secondary market sources or the primary origination market. Fixed rate performing loans are within Level 3 of the fair value hierarchy. At December 31, 2016, and December 31, 2015, the carrying amount of fixed rate performing loans was \$1,411,272,000 and \$1,383,836,000, respectively, and the estimated fair value was \$1,375,807,000 and \$1,362,248,000, respectively.

#### *Accrued Interest*

The carrying amounts of accrued interest approximate fair value.

#### *Deposits*

The fair value of deposits with no stated maturity, such as non-interest bearing demand deposit accounts, savings accounts and interest bearing demand deposit accounts, was equal to the amount payable on demand as of December 31, 2016 and December 31, 2015. The fair value of time deposits is based on the discounted value of contractual cash flows. The discount rate is based on currently offered rates. Time deposits are within Level 3 of the fair value hierarchy. At December 31, 2016 and December 31, 2015, the carrying amount of time deposits was \$2,248,310,000 and \$2,366,413,000, respectively, and the estimated fair value was \$2,247,648,000 and \$2,365,390,000, respectively.

#### *Securities Sold Under Repurchase Agreements*

Securities sold under repurchase agreements include both short and long-term maturities. Due to the contractual terms of the short-term instruments, the carrying amounts approximated fair value at December 31, 2016 and December 31, 2015. The fair value of the long-term instruments is based on established market spread using option adjusted spreads methodology. Long-term repurchase agreements are within level 3 of the fair value hierarchy. At December 31, 2016 and December 31, 2015, respectively, the carrying amount of long-term repurchase agreements was \$300,000,000 and \$560,000,000 and the estimated fair value was \$289,324,000 and \$527,198,600, respectively.

#### *Junior Subordinated Deferrable Interest Debentures*

The company currently has floating rate junior subordinated deferrable interest debentures outstanding. Due to the contractual terms of the floating rate junior subordinated deferrable interest debentures, the carrying amounts approximated fair value at December 31, 2016 and December 31, 2015.

#### *Other Borrowed Funds*

The company currently has short and long-term borrowings issued from the Federal Home Loan Bank (“FHLB”). Due to the contractual terms of the short-term borrowings, the carrying amounts approximated fair value at December 31,

## INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Continued)

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

#### *Commitments to Extend Credit and Letters of Credit*

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

#### *Limitations*

Fair value estimates are made at a point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

**Statements of Condition**

**(Parent Company Only)**

**December 31, 2016 and 2015**

**(Dollars in Thousands)**

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

**Statements of Income**

**(Parent Company Only)**

**Years ended December 31, 2016, 2015 and 2014**

**(Dollars in Thousands)**

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

**INTERNATIONAL BANCSHARES CORPORATION AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Continued)**

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

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

**Years ended December 31, 2016, 2015 and 2014  
(Dollars in Thousands)**

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

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

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

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

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



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

Distribution of Assets, Liabilities and Shareholders' Equity

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

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

**INTERNATIONAL BANCSHARES CORPORATION  
OFFICERS AND DIRECTORS**

**OFFICERS**

DENNIS E. NIXON  
Chairman of the Board and President

R. DAVID GUERRA  
Vice President

EDWARD J. FARIAS  
Vice President

IMELDA NAVARRO  
Treasurer

WILLIAM J. CUELLAR  
Auditor

MARISA V. SANTOS  
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HILDA V. TORRES  
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International Bank of Commerce

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Senior Vice President  
B.P. Newman Investment Company

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International Investments/Real Estate

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International Bank of Commerce  
Branch in McAllen, TX

DOUG HOWLAND  
Investments

IMELDA NAVARRO  
President  
International Bank of Commerce

PEGGY NEWMAN  
Investments

LARRY NORTON  
President  
Norton Stores, Inc.

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

LEONARDO SALINAS  
Investments

ANTONIO R. SANCHEZ, JR.  
Chairman of the Board  
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Investments





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