Southside Bancshares, Inc.

2016 ANNUAL REPORT

Dear Shareholders, Customers and Friends,

Last year on these pages, we shared with you not just a recap of the prior year's successes but a powerful vision for Southside Bank's future. We detailed the growth we expected to see in each of our markets; the development and implementation of the new and innovative technologies we expected to onboard; and the flexible, customer-centered, modern bank we were striving to become.

I am pleased to share with you that, as a result of our strategic plans and dedicated team, each of these initiatives is coming to fruition. Throughout this report, we have included the latest updates on our progress and ongoing plans.

Overall, 2016 was another extraordinary year for Southside. Executing on our strategic priorities and focusing on market opportunities were important components of our success.

These results were achieved under the leadership of my friend and mentor of over 32 years, Sam Dawson. Sam retired as Chief Executive Officer on December 31, 2016 after 42 years with Southside Bank. His accomplishments are measured not just in numbers, but also by the enduring legacy of the team he assembled to lead Southside into the future.

At the end of 2016, we:

- **Reported** record net income of \$49.3M, a 12.2% increase from 2015;
- **Grew** loans 5.1% to a record high of \$2.56B;
- **Increased** our cash dividend by 6%;
- **Produced** a return on average shareholders' equity of 10.54%;
- **Successfully contained** costs with an efficiency ratio declining to 54.08% for all of 2016 and 52% during the fourth quarter.

> Southside has always been and will remain a Texas community bank focused on improving the lives of the people we serve.
>
> – Lee R. Gibson, President and CEO

Southside's stock reached an all-time high in 2016, closing the year 64.7% higher than at the close of 2015. We took advantage of this increase in stock price to issue common stock in early December 2016, netting $76M of additional capital for future growth and potential acquisitions. These developments make us extremely optimistic about our prospects for 2017.

Our loan pipeline is solid, and we are hopeful loan growth during 2017 will be more consistent. Healthy asset quality, loan concentration levels below regulatory guidelines and additional capital provide a balance sheet well positioned to lend in the dynamic markets we serve.

The Dallas/Fort Worth and Austin economies remain very healthy, and the prospects for 2017 look promising. In fact, the DFW Metroplex is expected to lead the nation in total job growth this year, and Austin job growth projections remain solid for 2017. The East Texas economy, centered in Tyler, remains steady with low single-digit growth projected for 2017.

It appears 2017 has ushered in an administration that favors reducing the bank's regulatory burdens. It also seems as though we are entering a more net interest income, market-friendly environment. We would welcome both of these events and are fully prepared to leverage the latter.

Additionally, we are executing a comprehensive rebranding effort that will culminate with the grand reopening of our main branch in Tyler. You'll find a sneak peek of these innovations later in this report.

The first phase of the rebrand involved an intensive branding workshop where senior management collaborated with marketing to craft a new vision for Southside. Together, we agreed that the following vision embodies our higher calling as a brand:

To help the communities we serve attain and celebrate life's biggest milestones.

In order to achieve this aspirational vision, we also crafted a new mission statement which gives us a road map to deliver on this promise:

Bringing prosperity, security and wealth to the people and businesses of Texas.

We feel these sentiments not only play directly to our strengths as an institution but also speak powerfully to our core values. Southside has always been and will remain a Texas community bank focused on improving the lives of the people we serve. I am confident that the new direction we are taking through the rebrand will further solidify our stellar reputation, while positioning Southside as the bank of choice for the communities we serve.

On a more somber note, Southside lost three invaluable members of the board during 2016 with the passing of Pierre de Wet, Ben Sutton and Dr. Paul Powell. Each was not only a mentor but a treasured friend. Their memories will remain in our hearts forever.

And finally, I would like to extend my personal thanks to our incredible employees. None of Southside's success would be possible without the diligence and commitment of our team – each a vital part of the Southside Family.

Here's to a bright and prosperous future!

Lee R. Gibson

Lee R. Gibson
President and Chief Executive Officer

Financial HI

dollars in thousands,

Net Income **2015:** $43,997 | **2016:** $49,349

Per Share Data

Earnings per common share - basic

$1.65 2015

$1.86 2016

Earnings per common share - diluted

$1.65 2015

$1.86 2016

Book value per common share

2015: $16.66

2016: $18.16

Cash dividends paid per common share

2015: $1.00

2016: $1.01

Performance Ratios

Return on average assets

2015: 0.90%

2016: 0.94%

Return on average shareholders' equity

2015: 10.04%

2016: 10.54%

Dividend payout ratio

2015: 60.61%

2016: 54.30%

Net interest margin

2015: 3.40% | **2016:** 3.26%

GHLIGHTS

except per share amounts

Balance Sheet Data

Loans

$2,431,753

2015

$2,556,537

2016

Securities

2015: $2,244,788

2016: $2,417,087

Total assets

2015: $5,161,996 I **2016:** $5,563,767

Total deposits

$3,455,407
2015

$3,533,076
2016

Noninterest
bearing deposits

2015: $672,470 I **2016:** $704,013

Interest
bearing deposits

2015: $2,782,937 I **2016:** $2,829,063

Long-term obligations

$562,512

2015

$601,464

2016

Total shareholders' equity

2015 **$444,062**

2016 **$518,274**

Caring for OUR COMMUNITIES

Southside Bank is steadily moving forward, yet we've never forgotten the importance of giving back.

In 2016, Southside donated to over 350 nonprofit organizations, including United Way, American Cancer Society, Boys and Girls Clubs of America, Junior Achievement and Literacy Council. Additionally, our largest charitable commitment to date, Tyler Junior College's Promise Program, awards scholarships based on academic achievement, persistence and community service to area high school graduates.

But giving back involves much more than financial support. Our employees are encouraged to volunteer their time and talents to causes they believe in.

Southside believes helping the communities we serve is not just good for business — it's good for the soul.


Toy Drive for Children's Hospital
Complete control. Peace of mind.
SOUTHSIDE BANK


SOUTHSIDE BANK'S
BACK TO SCHOOL
SUPPLY DRIVE
SCHOOL SUPPLY DRIVE FOR DE ZAVALA ELEMENTARY


FRESH 15


SOUTHSIDE BANK


TOY DRIVE

Innovating for OUR CUSTOMERS

SOUTHSIDE BANK™

Southside has been a preeminent bank in East Texas for over 56 years with a growing presence in both North and Central Texas. As an esteemed institution, we've developed a reputation as a solid, reliable bank – one that Texans can count on.

We know that to stay relevant and responsive, innovation is just as important as reputation. That's why we have made a commitment to revitalizing Southside through a comprehensive rebranding effort, launching summer 2017.

It starts with a new logo – one that captures the spirit of Southside Bank – genuine, reputable, modern and insightful. The logo was developed through extensive research, testing and feedback from our customers and employees. The design creates energy and movement with an understated arrow pointing forward to a bright and prosperous future.

But a rebrand is so much more than just a new logo. We are reimagining everything our customers see, hear and think about Southside, from business cards to billboards and all touchpoints in between, cementing our reputation as an industry leader and giving us a true, competitive edge.

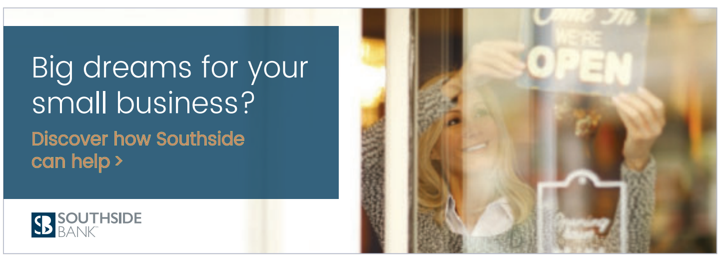
Southside will also embrace technology in new and exciting ways over the coming year. This includes an updated mobile app and website, the introduction of interactive teller machines and other systemic upgrades throughout the bank.

So far, the response to the rebrand has been overwhelmingly positive. This fresh, new look accurately reflects Southside's unique position in a crowded marketplace: combining modern convenience with traditional values.

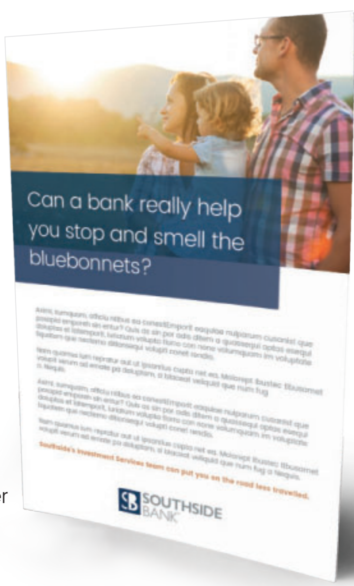
We think our new tagline sums it up perfectly. Southside offers *banking with a hometown touch™.*

Billboard

Mobile application



Web banner

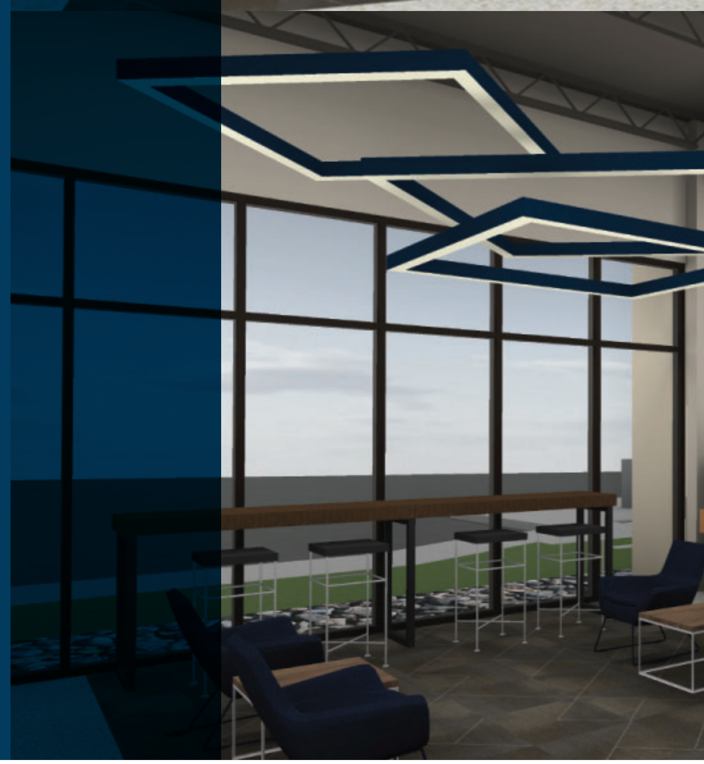


Flyer

Print ad

Southside's new branding is highlighted by compelling graphics, sophisticated composition and aspirational copy.

Revitalizing OUR FUTURE



A bold new approach to banking requires a bold new look for our branches. In late 2016, Southside embarked on a journey to begin updating the look and feel of all of our branches, starting with the flagship location at our corporate headquarters.

Our branches will be completely overhauled with a new color palette, inviting environments and industrial touches that will seamlessly integrate with our new branding. We believe the result will raise the bar on what consumers can expect from a Texas community bank.

"The newly remodeled branches will be modern, in

Renderings courtesy of Fitzpatrick Architects.

viting places our customers will want to visit often.

– Lee R. Gibson, President and CEO

Directors of Southside BANCSHARES, INC.

John (Bob) Garrett
Vice Chairman of the Board

Lawrence L. Anderson, MD

S. Elaine Anderson, CPA

Michael Bosworth (2017)

Herbert Buie

Alton Cade

Officers of Southside BA

Sam Dawson
CEO (2016) and Director

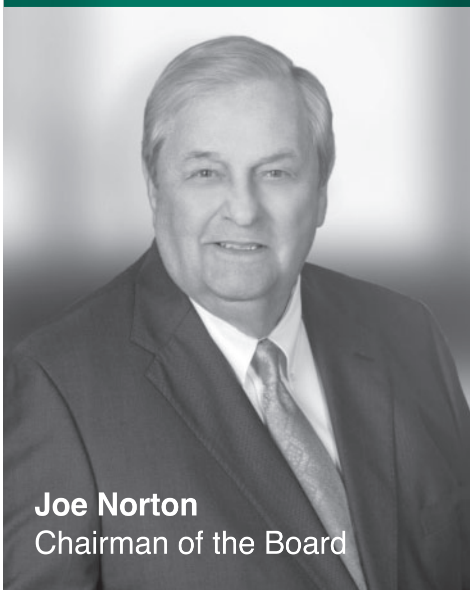
Lee R. Gibson, CPA
CEO (2017) and Director

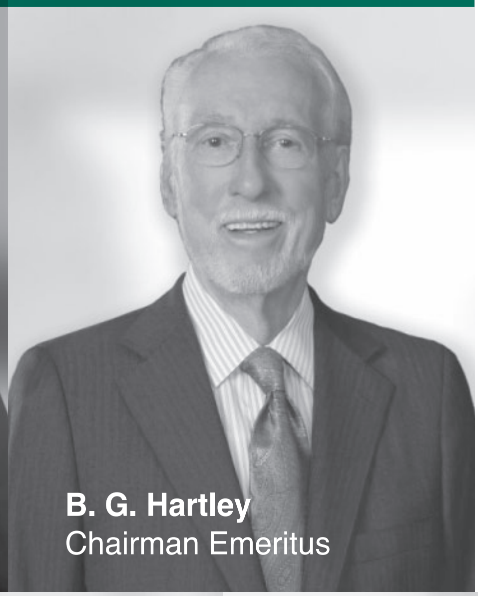
Sam Dawson
Chief Executive Officer (2016)

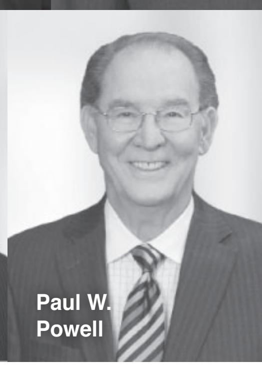
Lee R. Gibson, CPA
President and Chief Executive Officer (2017)

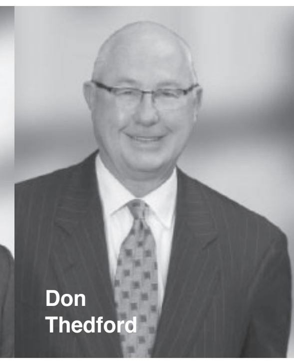
Julie Shamburger, CPA
Executive Vice President and Chief Financial Officer

Brian McCabe
Executive Vice President and Chief Information Officer









NCSHARES, INC.

Suni Davis, CPA
Chief Risk Officer

Anne Martinez
Executive Vice President
and Senior Loan Review Officer

Vonna Crowley, CRCM
Senior Vice President
and Compliance Officer

Sandi Hegwood, CPA, CIA
Senior Vice President
and Chief Audit Executive

April Pugh, CPA
Senior Vice President
and Controller

Katherine Clover, CPA, CIA
Vice President
and Senior Internal Auditor

Misty de Wet, CPA
Vice President
and Senior Internal Auditor

Susan Hill
Vice President
and Investor Relations

Mary McLarry
Secretary

Directors of Southside Bank

Tim Alexander*
Chief Lending Officer

S. Elaine Anderson, CPA
Retired Healthcare Executive
Healthcare Consultant

Lawrence L. Anderson, MD
Physician

Hoyt N. Berryman, Jr.*
Oil and Gas Investments

Michael Bosworth
President
Bosworth & Associates

Peter M. Boyd*
Senior Executive Vice President

Herbert C. Buie
President
Tyler Packing Co., Inc.

Alton Cade
Retired
Cade Building Materials

Patricia A. Callan
Principal
Callan Consulting

Tim Carter*
Regional President, North Texas

Bill Clawater*
Senior Executive Vice President
and Chief Credit Officer

Sam Dawson
Chief Executive Officer (2016)

John (Bob) Garrett
Vice Chairman of the Board
President, Fair Oil Company

Lee. R. Gibson, CPA
President and
Chief Executive Officer (2017)

George T. Hall*
Executive Vice President

B. G. Hartley
Chairman Emeritus

Melvin B. Lovelady, CPA
Investments
Financial Planning

Brian K. McCabe*
Executive Vice President
and Chief Information Officer

Tony Morgan, CPA
Founding Partner
Gollob Morgan Peddy

Joe Norton
Chairman of the Board
President, Norton Companies

Paul W. Powell†
Dean Emeritus
Truett Theological Seminary

John Sammons, Jr.
Chairman and CEO
Mid-States Services, Inc.

Julie Shamburger, CPA*
Executive Vice President
and Chief Financial Officer

William Sheehy
Retired Attorney

Preston L. Smith
PSI Production, Inc.

Ben Sutton*†
Independent
Petroleum Interests

Don Thedford
Don's TV & Appliance, Inc.

Lonny R. Uzzell*
Senior Executive Vice President

John F. Walker, MD*
Physician

H. Andy Wall*
Retired Banker

John B. White, III*
Investments

* Advisory Directors
† Deceased

Officers of Southside Bank

Sam Dawson
Chief Executive Officer (2016)

Lee R. Gibson, CPA
President and
Chief Executive Officer (2017)

Julie Shamburger, CPA
Executive Vice President
and Chief Financial Officer

Tim Alexander
Chief Lending Officer

East Texas

Senior Executive Vice Presidents

Peter Boyd
Bill Clawater
Lonny Uzzell

Executive Vice Presidents

Joel Adams
Doug Bolles
Pam Cunningham
Jared Green
Glen Greeney
George T. Hall
Jill Kinsley
Brian McCabe
Michael Phea
Greg Sims

North Texas

Regional President

Tim Carter

Executive Vice Presidents

T. L. Arnold
Faye Bond
Mark Cundiff
Deborah Wilkinson

Central Texas

Regional President

Jim Alfred

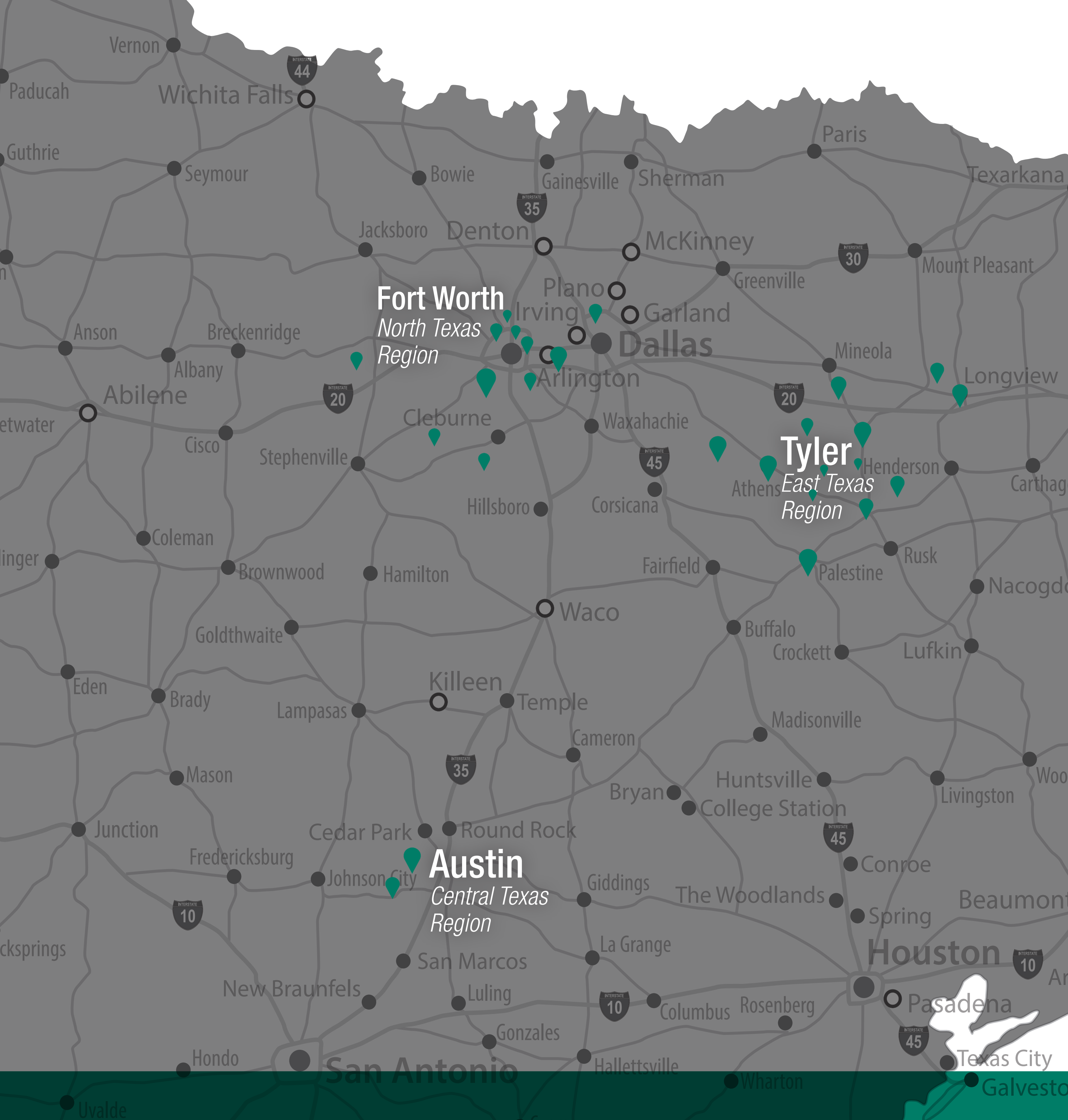
President, West Austin

John Miller

Executive Vice President

Dean Taylor

Southside Bank
LOCATIONS



East Texas

Athens	807 East Tyler Street	G
Bullard	213 North Doctor M. Roper Parkway	G
Chandler	703 State Highway 31 East	G
Gresham	16691 FM 2493	B
Gun Barrel City	901 West Main Street	B
Hawkins	1477 Beaulah Street	G
Jacksonville	1015 South Jackson Street	B
Lindale	2510 South Main Street	B
	521 South Main Street	G
Longview	2001 Judson Road	B
	1217 East Marshall Avenue	G
	2301 West Loop 281	G
Palestine	2107 South Loop 256	G
Tyler	1201 South Beckham Avenue	C/B
	1305 South Beckham Avenue	W
	1010 East First Street	M
	113 West Ferguson Street	B
	2121 West Gentry Parkway	B
	2111 West Gentry Parkway	M
	6201 South Broadway Avenue	B
	6019 South Broadway Avenue	M
	3815 State Highway 64 West	B
	6991 Old Jacksonville Highway	G
	2020 Roseland Boulevard	G
	20100 Highway 155 South	G
	113 NNW Loop 323	G
	100 Rice Road	G
	2734 East Fifth Street	G
	3828 Troup Highway	G
	6801 South Broadway Avenue	G
Whitehouse	901 Highway 110 North	B
	601 Highway 110 North	G

North Texas

Arlington	2831 West Park Row	B
	950 West Arbrook Boulevard	B
Cleburne	1204 West Henderson Street	B
Euless	2311 West Euless Boulevard	B
Flower Mound	2341 Justin Road (FM 407)	B
Fort Worth	9516 Clifford Street	B
	1320 South University Drive, Suite 106	B
	7800 White Settlement Road	B
	6001 Bryant Irvin Road	B
	1000 Pennsylvania Avenue	B
	2330 East Rosedale Street	B
Frisco	5665 Dallas Parkway, Suite 100	L
Granbury	1030 East Highway 377, Suite 138	B
Grapevine	1616 West Northwest Highway	B
Las Colinas	1401 Walnut Hill Lane	B
Watauga	8024 Denton Highway	B
Weatherford	318 South Main Street	B

Central Texas

Austin	8200 North Mopac Expressway, Suite 100	B
	1250 South Capital of Texas Hwy, Building 1, Suite 101	B

B Full-Service Branch | C Corporate Office | G Full-Service Branch in Grocery Store | L Loan Production | M Motor Bank | W Wealth Management

2016

10-K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016
or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From _______ to _______

Commission file number 0-12247

Southside Bancshares, Inc.

(Exact name of registrant as specified in its charter)

Texas	75-1848732
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1201 S. Beckham Avenue, Tyler, Texas	75701
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (903) 531-7111

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

Title of each class	Name of each exchange on which registered
COMMON STOCK, $1.25 PAR VALUE	**NASDAQ Global Select Market**

Securities registered pursuant to Section 12(g) of the Act:
NONE

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2016 was $750,576,483.

As of February 20, 2017, 28,574,789 shares of common stock of Southside Bancshares, Inc. were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Registrant's proxy statement to be filed for the Annual Meeting of Shareholders to be held May 10, 2017 are incorporated by reference into Part III of this Annual Report on Form 10-K. Other than those portions of the proxy statement specifically incorporated by reference pursuant to Items 10-14 of Part III hereof, no other portions of the proxy statement shall be deemed so incorporated.

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IMPORTANT INFORMATION ABOUT THIS REPORT

In this report, the words "the Company," "we," "us," and "our" refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries, including Southside Bank. The words "Southside" and "Southside Bancshares" refer to Southside Bancshares, Inc. The words "Southside Bank" and "the Bank" refer to Southside Bank. "FWBS" refers to Fort Worth Bancshares, Inc., a bank holding company acquired by Southside in 2007. "SFG" refers to SFG Finance, LLC (formerly Southside Financial Group, LLC) which was a wholly-owned subsidiary of the Bank until 2015. SFG is consolidated in our financial statements and was dissolved in April 2015. "Omni" refers to OmniAmerican Bancorp, Inc., a bank holding company acquired by Southside on December 17, 2014.

PART I

ITEM 1. BUSINESS

FORWARD-LOOKING INFORMATION

The disclosures set forth in this item are qualified by the section captioned "Cautionary Notice Regarding Forward-Looking Statements" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K and other cautionary statements set forth elsewhere in this report.

GENERAL

Southside Bancshares, Inc., incorporated in Texas in 1982, is a bank holding company for Southside Bank, a Texas state bank headquartered in Tyler, Texas that was formed in 1960. We operate through 60 banking centers, 17 of which are located in grocery stores, and 25 motor bank facilities.

At December 31, 2016, our total assets were $5.56 billion, total loans were $2.56 billion, total deposits were $3.53 billion, and total equity was $518.3 million. For the years ended December 31, 2016 and 2015, our net income was $49.3 million and $44.0 million and diluted earnings per common share were $1.86 and $1.65, respectively. We have paid a cash dividend every year since 1970 (including dividends paid by Southside Bank prior to the incorporation of Southside Bancshares).

We are a community-focused financial institution that offers a full range of financial services to individuals, businesses, municipal entities, and nonprofit organizations in the communities that we serve. These services include consumer and commercial loans, deposit accounts, trust services, safe deposit services and brokerage services.

Our consumer loan services include 1-4 family residential loans, home equity loans, home improvement loans, automobile loans and other installment loans. Commercial loan services include short-term working capital loans for inventory and accounts receivable, short and medium-term loans for equipment or other business capital expansion, commercial real estate loans and municipal loans. We also offer construction loans for 1-4 family residential and commercial real estate.

We offer a variety of deposit accounts with a wide range of interest rates and terms, including savings, money market, interest and noninterest bearing checking accounts and certificates of deposit ("CDs"). Our trust services include investment management, administration and advisory services, primarily for individuals and, to a lesser extent, partnerships and corporations. At December 31, 2016, our trust department managed approximately $1.01 billion of trust assets.

Our business strategy includes evaluating expansion opportunities through acquisitions of financial institutions in market areas that could complement our existing franchise. We generally seek merger partners that are culturally similar, have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. During 2014, we acquired OmniAmerican Bancorp, Inc., a bank holding company traded on the NASDAQ Global Market and the holding company for OmniAmerican Bank, a federal savings association, headquartered in Fort Worth, Texas. See "Note 2 - Acquisition" in the accompanying notes to consolidated financial statements included elsewhere in this report.

We and our subsidiaries are subject to comprehensive regulation, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Texas Department of Banking (the "TDB") and the Federal Deposit Insurance Corporation (the "FDIC") and are subject to numerous laws and regulations relating to internal controls, the extension of credit, making of loans to individuals, deposits, and all other facets of our operations.

Our administrative offices are located at 1201 South Beckham Avenue, Tyler, Texas 75701, and our telephone number is 903-531-7111. Our website can be found at *www.southside.com*. Our public filings with the Securities and Exchange Commission (the "SEC") may be obtained free of charge on either our website, *https://www.southside.com/about/investor-relations* under the topic Documents, or the SEC's website, *www.sec.gov,* as soon as reasonably practicable after filing with the SEC.

MARKET AREA

We are headquartered in Tyler, Texas. The Tyler metropolitan area has a population of approximately 210,000 and is located approximately 90 miles east of Dallas, Texas and 90 miles west of Shreveport, Louisiana.

We consider our primary market areas to be East Texas, the greater Fort Worth, Texas area and the greater Austin, Texas area. Our expectation is that our presence in all of the market areas we serve should grow in the future. In addition, we continue to explore new markets in which we believe we can expand successfully.

The principal economic activities in our market areas include retail, distribution, manufacturing, medical services, education, government and oil and gas industries. Additionally, the industry base includes conventions and tourism, as well as retirement relocation. These economic activities support a growing regional system of medical service, retail and education centers. Tyler, Longview, Fort Worth, Austin and Arlington are home to several nationally recognized health care systems that represent all major specialties.

Our 60 branches and 25 motor bank facilities are located in and around Tyler, Longview, Lindale, Gresham, Jacksonville, Bullard, Chandler, Hawkins, Palestine, Gun Barrel City, Athens, Whitehouse, Fort Worth, Arlington, Cleburne, Euless, Flower Mound, Frisco, Granbury, Grapevine, Irving, Watauga, Weatherford and Austin. Our advertising is designed to target the market areas we serve. The type and amount of advertising in each market area is directly attributable to our market share in that market area combined with overall cost.

Additionally, our customers may access various banking services through a network of over 70 automated teller machines ("ATMs") and ATMs owned by others, through debit cards, and through our automated telephone, internet and electronic banking products. These products allow our customers to apply for loans from their computers, access account information and conduct various other transactions from their telephones, smart phones and computers.

RECENT DEVELOPMENTS

During the year ended December 31, 2016, we opened a loan production office in Frisco. We also closed our Ft. Worth operations service center and one of our grocery store branches in Longview, both of which were leased.

On December 6, 2016, we entered into an underwriting agreement, pursuant to which we sold 2,185,000 shares of our common stock at a price of $36.50 per share. We received $76.0 million in net proceeds, after deducting underwriting discounts and costs. These net proceeds were used primarily for general corporate purposes, which included advances to the Bank to finance its activities.

THE BANKING INDUSTRY IN TEXAS

The banking industry is affected by general economic conditions such as interest rates, inflation, recession, unemployment and other factors beyond our control. During the last thirty years the Texas economy has continued to diversify, decreasing the overall impact of fluctuations in oil and gas prices; however, the oil and gas industry is still a significant component of the Texas economy. Since 2010, economic growth and business activity across a wide range of industries and regions in the U.S. has been slow and uneven. During a majority of that time economic growth and business activity in Texas exceeded the U.S. average. However in 2014, decisions by certain members of the Organization of Petroleum Exporting Countries ("OPEC") to maintain higher crude oil production levels, combined with increased production levels in the United States led to increased global oil supplies which has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2016, the price per barrel of crude oil was approximately $54 compared to approximately $98 as of December 31, 2013. A prolonged period of low oil prices could have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Texas. We cannot predict whether current economic conditions will improve, remain the same or decline.

COMPETITION

The activities we are engaged in are highly competitive. Financial institutions such as credit unions, fintech companies, consumer finance companies, insurance companies, brokerage companies and other financial institutions with varying degrees of regulatory restrictions compete vigorously for a share of the financial services market. Brokerage and insurance companies continue to become more competitive in the financial services arena and pose an ever-increasing challenge to banks. Legislative changes also greatly affect the level of competition we face. Federal legislation allows credit unions to use their expanded membership capabilities, combined with tax-free status, to compete more fiercely for traditional bank business. The tax-free status granted to credit unions provides them with a significant competitive advantage. Many of the largest banks operating in Texas, including some of the largest banks in the country, have offices in our market areas with capital resources, broader geographic markets, and legal lending limits substantially in excess of those available to us. We face competition from institutions that offer products and services we do not or cannot currently offer. Some institutions we compete with offer interest rate levels on loan and deposit products that we are unwilling to offer due to interest rate risk and overall profitability concerns. We expect the level of competition to continue to increase.

EMPLOYEES

At February 17, 2017, we employed approximately 679 full time equivalent persons. None of our employees are represented by any unions or similar groups, and we have not experienced any type of strike or labor dispute. We consider the relationship with our employees to be good.

SUPERVISION AND REGULATION

General

Banking is a complex, highly regulated industry. As a bank holding company under federal law, the Company is subject to regulation, supervision and examination by the Federal Reserve. In addition, under state law, as the parent company of a Texas-chartered state bank that is not a member of the Federal Reserve System, the Company is subject to supervision and examination by the TDB. As a Texas-chartered state bank, Southside Bank is subject to regulation, supervision and examination by the TDB, as its chartering authority, and by the FDIC, as its primary federal regulator and deposit insurer. This system of regulation and supervision applicable to us establishes a comprehensive framework for our operations and is intended primarily for the protection of bank depositors, the FDIC's Deposit Insurance Fund ("DIF") and the public, rather than our shareholders and creditors.

In addition to the system of regulation and supervision outlined above, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which is discussed in greater detail below, created the Consumer Financial Protection Bureau (the "Bureau"), a federal regulatory body with broad authority to regulate the offering and provision of consumer financial products and services. The Bureau officially came into being on July 21, 2011, and rulemaking authority for a range of consumer financial protection laws (such as the Truth in Lending Act, the Electronic Fund Transfer Act and the Real Estate Settlement Procedures Act, among others) transferred from the federal prudential banking regulators to the Bureau on that date. The Dodd-Frank Act gives the Bureau authority to supervise and examine depository institutions with more than $10 billion in assets for compliance with these federal consumer laws. The authority to supervise and examine depository institutions with $10 billion or less in assets for compliance with federal consumer laws will remain largely with those institutions' primary regulators. However, the Bureau may participate in examinations of these smaller institutions on a "sampling basis" and may refer potential enforcement actions against such institutions to their primary regulators. The Bureau will also have supervisory and examination authority over certain nonbank institutions that offer consumer financial products or services. The Dodd-Frank Act identifies a number of covered nonbank institutions, and also authorizes the Bureau to identify additional institutions that will be subject to its jurisdiction. Accordingly, the Bureau may participate in examinations of Southside Bank, and could supervise and examine other direct or indirect subsidiaries of the Company that offer consumer financial products or services.

The earnings of Southside Bank and, therefore, the earnings of the Company, are affected by general economic conditions, changes in federal and state laws and regulations and actions of various regulatory authorities, including those referenced above. Additional changes to the laws and regulations applicable to us are frequently proposed at both the federal and state levels. As a result of the Dodd-Frank Act, which was enacted on July 21, 2010, the regulatory framework under which we operate has changed and may continue to change substantially over the next several years. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, addressing, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, interchange fees, derivatives, lending limits, mortgage lending practices, registration of investment advisors and changes among the bank regulatory agencies. Among the provisions that have impacted or are likely to affect the operations of the Company and Southside Bank are the following:

- Creation of the Bureau with centralized authority, including supervisory, examination and enforcement authority, for consumer protection in the banking industry;

- New limitations on federal preemption;
- New prohibitions and restrictions on the ability of a banking entity and nonbank financial company to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund;
- Application of new regulatory capital requirements, including changes to leverage and risk-based capital standards and changes to the components of permissible tiered capital;
- Requirement that holding companies and their subsidiary banks be well capitalized and well managed in order to engage in activities permitted for financial holding companies;
- Changes to the assessment base for deposit insurance premiums;
- Permanently raising the FDIC's standard maximum deposit insurance amount to $250,000;
- Repeal of the prohibition on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts;
- Restrictions on compensation, including a prohibition on incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions and are deemed to be excessive, or that may lead to material losses;
- Requirement that sponsors of asset-backed securities retain a percentage of the credit risk underlying the securities; and
- Requirement that banking regulators remove references to and requirements of reliance upon credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness.

Some of these and other major changes could materially impact the profitability of our business, the value of assets we hold or the collateral available for our loans, require changes to business practices, or force us to discontinue businesses and expose us to additional costs, taxes, liabilities, enforcement actions and reputational risk. Many of these provisions became effective upon enactment of the Dodd-Frank Act, while others were subject to further study, rulemaking, and the discretion of regulatory bodies and have only recently taken effect or will take effect in the coming years. In light of these significant changes and the discretion afforded to federal regulators, we cannot fully predict the effect that compliance with the Dodd-Frank Act or any implementing regulations will have on the Company or Southside Bank's businesses or their ability to pursue future business opportunities. Additional regulations resulting from the Dodd-Frank Act may materially adversely affect the Company's business, financial condition or results of operations.

The likelihood, timing, and scope of any such change and the impact any such change may have on us are impossible to determine with any certainty. Also, additional changes to the laws and regulations applicable to us are frequently proposed at both the federal and state levels. We cannot predict whether new legislation or regulations will be enacted and, if enacted, the effect that it, or any regulations, would have on our business, financial condition or results of operations. Set forth below is a brief description of the significant federal and state laws and regulations to which we are currently subject. These descriptions do not purport to be complete and are qualified in their entirety by reference to the particular statutory or regulatory provision.

Holding Company Regulation

As a bank holding company regulated under the Bank Holding Company Act of 1956 ("BHCA"), as amended, the Company is registered with and subject to regulation, supervision and examination by the Federal Reserve. The Company is required to file annual and other reports with, and furnish information to, the Federal Reserve, which makes periodic inspections of the Company.

Permitted Activities. Under the BHCA, a bank holding company is generally permitted to engage in, or acquire direct or indirect control of more than five percent of the voting shares of any company engaged in, the following activities:

- banking or managing or controlling banks;
- furnishing services to or performing services for our subsidiaries; and
- any activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking, including:
    - factoring accounts receivable;
    - making, acquiring, brokering or servicing loans and usual related activities;
    - leasing personal or real property;
    - operating a nonbank depository institution, such as a savings association;
    - performing trust company functions;

- conducting financial and investment advisory activities;
- conducting discount securities brokerage activities;
- underwriting and dealing in government obligations and money market instruments;
- providing specified management consulting and counseling activities;
- performing selected data processing services and support services;
- acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions;
- performing selected insurance underwriting activities;
- providing certain community development activities (such as making investments in projects designed primarily to promote community welfare); and
- issuing and selling money orders and similar consumer-type payment instruments.

The Federal Reserve has the authority to order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when the Federal Reserve has reasonable cause to believe that the bank holding company's continued ownership, activity or control constitutes a serious risk to the financial safety, soundness or stability of it or any of its bank subsidiaries.

Under the BHCA, a bank holding company meeting certain eligibility requirements may elect to become a "financial holding company," which is a form of bank holding company with authority to engage in additional activities. Specifically, a financial holding company and companies under its control may engage in activities that are "financial in nature," as defined by the Gramm-Leach-Bliley Act ("GLBA") and Federal Reserve interpretations, and therefore may engage in a broader range of activities than those permitted for bank holding companies and their subsidiaries. Financial activities specifically include insurance brokerage and underwriting, securities underwriting and dealing, merchant banking, investment advisory and lending activities. Financial holding companies and their subsidiaries also may engage in additional activities that are determined by the Federal Reserve, in consultation with the U.S. Department of the Treasury, to be "financial in nature or incidental to" a financial activity or are determined by the Federal Reserve unilaterally to be "complementary" to financial activities.

In order to offer broker-dealer services through our subsidiary, Southside Securities, Inc., on February 8, 2011, we filed with the Federal Reserve Bank of Dallas a declaration of financial holding company status and were granted financial holding company status on March 22, 2011. Election of financial holding company status is not automatic and it was granted based upon consideration of a number of factors, including that all of our depository institution subsidiaries satisfy the Federal Reserve's "well capitalized" and "well managed" standards and have at least a satisfactory rating under the Community Reinvestment Act ("CRA") (discussed below). Now that we have succeeded in attaining financial holding company status, that status could be impacted by the condition of Southside Bank and/or other factors. For example, if Southside Bank ceases to be "well capitalized" or "well managed" under applicable regulatory standards, the Federal Reserve may, among other things, place limitations on our ability to conduct broader financial activities or, if the deficiencies persist, require us to divest Southside Bank. In addition, if Southside Bank were to receive a rating of less than satisfactory under the CRA, we would be prohibited from engaging in any additional activities other than those permissible for bank holding companies that are not financial holding companies. If we undertake expanded financial activities (that are not permissible for a bank holding company) and we fail to continue to meet any of the prerequisites for "financial holding company" status, including those described above, the financial holding company would be required to enter into an agreement with the Federal Reserve to comply with all applicable capital and management requirements. If we do not return to compliance within 180 days, the Federal Reserve may order the financial holding company to divest its Bank or the Company may discontinue or divest investments in companies engaged in activities permissible only for a bank holding company that has elected to be treated as a financial holding company. We began engaging in broker-dealer activities through Southside Securities, Inc. on June 16, 2011. In early 2013, to further concentrate on our primary business of banking, a management decision was made to close Southside Securities, Inc. We ceased engaging in broker-dealer activities through Southside Securities, Inc. in the second quarter of 2013. However, our financial holding company status has been maintained.

Capital Adequacy. Each of the federal banking agencies, including the Federal Reserve and the FDIC, has issued substantially similar risk-based and leverage capital guidelines applicable to the banking organizations they supervise. As a result of new regulations, we were required to begin complying with higher minimum capital requirements as of January 1, 2015. The new capital rules ("Updated Capital Rules"), which are discussed below, implement certain provisions of the Dodd-Frank Act and a separate, international regulatory capital initiative known as "Basel III." These Updated Capital Rules also make important changes to the "prompt corrective action" framework discussed below in *Bank Regulation - Prompt Corrective Action and Undercapitalization*.

The agencies' prior risk-based guidelines, applicable to the Company before January 1, 2015, defined a three-tier capital framework. Risk-based capital ratios were calculated by dividing, as appropriate, total capital and Tier 1 capital by risk-weighted assets. Assets and off-balance sheet exposures were assigned to one of four categories of risk weights, based primarily on relative credit risk. Under these prior risk-based capital requirements, the Company and Southside Bank were each generally required to maintain a minimum ratio of total capital to risk-weighted assets of at least 8% and a minimum ratio of Tier 1 capital to risk-weighted assets of at least 4%. To the extent we engaged in trading activities, we were required to adjust our risk-based capital ratios to take into consideration market risks that may result from movements in market prices of covered trading positions in trading accounts, or from foreign exchange or commodity positions, whether or not in trading accounts, including changes in interest rates, equity prices, foreign exchange rates or commodity prices.

Each of the federal bank regulatory agencies, including the Federal Reserve and the FDIC, also had established minimum leverage capital requirements for the banking organizations they supervise. These requirements provided that banking organizations that met certain criteria, including excellent asset quality, high liquidity, low interest rate exposure and good earnings, and that had received the highest regulatory rating must maintain a ratio of Tier 1 capital to total adjusted average assets of at least 3%. Institutions not meeting these criteria, as well as institutions with supervisory, financial or operational weaknesses, were expected to maintain a minimum Tier 1 capital to total adjusted average assets ratio equal to 100 to 200 basis points above this stated minimum. Holding companies experiencing internal growth or making acquisitions were expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. The Federal Reserve also considered a "tangible Tier 1 capital leverage ratio" (deducting all intangibles) and other indicators of capital strength in evaluating proposals for expansion or new activity.

The Updated Capital Rules, which became applicable to the Company and the Bank on January 1, 2015, made substantial changes to these previous standards. Among other things, the new regulations (i) introduced a new capital requirement known as "Common Equity Tier 1" ("CET1"), (ii) stated that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting certain requirements, (iii) defined CET1 to require that most deductions and adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) revised the scope of the deductions and adjustments from capital as compared to regulations that previously applied to the Company and other banking organizations.

The Updated Capital Rules also established the following minimum capital ratios: 4.5 percent CET1 to risk-weighted assets; 6.0 percent Tier 1 capital to risk-weighted assets; 8.0 percent total capital to risk-weighted assets; and 4.0 percent Tier 1 leverage ratio to average consolidated assets. In addition, the Updated Capital Rules also introduced a minimum "capital conservation buffer" equal to 2.5% of an organization's total risk-weighted assets, which exists in addition to these new required minimum CET1, Tier 1, and total capital ratios. The "capital conservation buffer," which must consist entirely of CET1, is designed to absorb losses during periods of economic stress. The Updated Capital Rules provide for a number of deductions from and adjustments to CET1, which include the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Certain regulatory capital ratios of the Company and Southside Bank, as of December 31, 2016, are shown in the following table.

	Capital Adequacy Ratios			
	Regulatory Minimums	Regulatory Minimums to be Well Capitalized	Southside Bancshares, Inc.	Southside Bank
Common Equity Tier 1 risk-based capital ratio	4.50%	6.50%	14.64%	17.98%
Tier 1 risk-based capital ratio	6.00%	8.00%	16.37%	17.98%
Total risk-based capital ratio	8.00%	10.00%	20.10%	18.60%
Leverage ratio	4.00%	5.00%	9.46%	10.40%

Under the previous capital framework, the effects of accumulated other comprehensive income items included in shareholders' equity under U.S. generally accepted accounting principles ("GAAP ") were excluded for the purposes of determining capital ratios. However, the effects of certain accumulated other comprehensive items are not excluded under the Updated Capital Rules. The Updated Capital Rules permitted most banking organizations, including the Company and Southside Bank, to make a one-time permanent election on the institution's first call report filed after January 1, 2015 to continue to exclude these items, which Southside Bank did in its March 31, 2015 call report.

Under the Updated Capital Rules, certain hybrid securities, such as trust preferred securities, do not qualify as Tier 1 capital. However, for bank holding companies like us that had assets of less than $15 billion as of December 31, 2009, trust preferred securities issued prior to May 19, 2010 can be treated as Tier 1 capital to the extent that they do not exceed 25% of Tier 1 capital after the application of capital deductions and adjustments.

In addition, reflecting the importance that regulators place on managing capital and other risks, in May 2012 the banking agencies also issued guidance on stress testing for banking organizations with more than $10 billion in total consolidated assets. This guidance outlines four "high-level" principles for stress testing practices that should be a part of a banking organization's stress-testing framework. Specifically, the guidance calls for the framework to (i) include activities and exercises that are tailored to and sufficiently capture the banking organization's exposures, activities and risks; (ii) employ multiple conceptually sound stress testing activities and approaches; (iii) be forward-looking and flexible; and (iv) be clear, actionable, well-supported, and used in the decision-making process. Moreover, the federal bank regulators have issued a series of guidance and rulemakings applicable to "large banks." While many of these do not currently apply to us due to our asset size, these issuances could impact industry capital standards and practices in many, potentially unforeseeable, ways.

Source of Strength. Federal Reserve policy and regulation require a bank holding company to act as a source of financial and managerial strength to its subsidiary banks. As a result, a bank holding company may be required to contribute additional capital to its subsidiaries in the form of capital notes or other instruments which qualify as capital under regulatory rules. Any loans from the holding company to its subsidiary banks likely will be unsecured and subordinated to the bank's depositors and perhaps to other creditors of the bank. Notably, the Dodd-Frank Act codified the Federal Reserve's "source of strength" policy; this statutory change became effective July 21, 2011. In addition to the foregoing requirements, the Dodd-Frank Act's provisions authorize the Federal Reserve and other federal banking regulators to require a company that directly or indirectly controls a bank to submit reports that are designed both to assess the ability of such company to comply with its "source of strength" obligations and to enforce the company's compliance with these obligations. As of December 31, 2016 the Federal Reserve and other federal banking regulators have not yet issued rules implementing this requirement.

In addition, if a bank holding company enters into bankruptcy or becomes subject to the orderly liquidation process established by the Dodd-Frank Act, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank would be assumed by the bankruptcy trustee or the FDIC, as appropriate, and entitled to a priority of payment. In addition, the FDIC provides that any insured depository institution generally will be liable for any loss incurred by the FDIC in connection with the default of, or any assistance provided by the FDIC to, a commonly controlled insured depository institution. Southside Bank is an FDIC-insured depository institution and thus subject to these requirements. See also *Bank Regulation - Prompt Corrective Action and Undercapitalization*.

Dividends. The principal source of our liquidity at the parent company level is dividends from Southside Bank. Southside Bank is subject to federal and state restrictions on its ability to pay dividends to the Company. We must pay essentially all of our operating expenses from funds we receive from Southside Bank. Therefore, shareholders may receive dividends from us only to the extent that funds are available after payment of our operating expenses. Consistent with its "source of strength" policy, the Federal Reserve discourages bank holding companies from paying dividends except out of operating earnings and prefers that dividends be paid only if, after the payment, the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition.

Among other things, the ability of banks and bank holding companies to pay dividends, and the contents of their respective dividend policies, could be impacted by a range of changes imposed by the Dodd-Frank Act, many of which will require implementing rules to become effective. See also *Bank Regulation - Dividends* for additional information.

Change in Control. Subject to certain exceptions, under the BHCA and the Change in Bank Control Act ("CBCA"), and the regulations promulgated thereunder, persons who intend to acquire direct or indirect control of a depository institution or a bank holding company are required to obtain the approval of the Federal Reserve prior to acquiring control. With respect to the Company, "control" is conclusively presumed to exist where an acquiring party directly or indirectly owns, controls or has the power to vote at least 25% of our voting securities. Under the Federal Reserve's CBCA regulations, a rebuttable presumption of control would arise with respect to an acquisition where, after the transaction, the acquiring party owns, controls or has the power to vote at least 10% (but less than 25%) of our voting securities. In certain cases, a company may also be presumed to have control under the BHCA if it acquires five percent or more of any class of voting securities.

On September 22, 2008, the Federal Reserve issued a policy statement on minority equity investments in banks and bank holding companies, that permits investors to (1) acquire up to 33 percent of the total equity of a target bank or bank holding company, subject to certain conditions, including that the acquiring investor does not acquire 15 percent or more of any class of voting securities, and (2) designate at least one director, without triggering the various regulatory requirements associated with control.

Acquisitions. The BHCA provides that a bank holding company must obtain the prior approval of the Federal Reserve (i) for the acquisition of more than five percent of the voting stock in any bank or bank holding company, (ii) for the acquisition of substantially all the assets of any bank or bank holding company, or (iii) in order to merge or consolidate with another bank holding company.

Regulatory Examination. Federal and state banking agencies require the Company and Southside Bank to prepare annual reports on financial condition and to conduct an annual audit of financial affairs in compliance with minimum standards and procedures. Southside Bank, and in some cases the Company and any nonbank affiliates, must undergo regular on-site examinations by the appropriate regulatory agency, which will examine for adherence to a range of legal and regulatory compliance responsibilities. A bank regulator conducting an examination has complete access to the books and records of the examined institution, and the results of the examination are confidential. The cost of examinations may be assessed against the examined organization as the agency deems necessary or appropriate. The FDIC has developed a method for insured depository institutions to provide supplemental disclosure of the estimated fair value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition or any other report.

Enforcement Authority. The Federal Reserve has broad enforcement powers over bank holding companies and their nonbank subsidiaries, as well as "institution-affiliated parties," including management, employees, agents, independent contractors and consultants, such as attorneys and accountants and others who participate in the conduct of the institution's affairs, and has authority to prohibit activities that represent unsafe or unsound banking practices or constitute knowing or reckless violations of laws or regulations. These powers may be exercised through the issuance of cease and desist orders, civil money penalties or other actions. Civil money penalties can be as high as $1,000,000 for each day the activity continues and criminal penalties for some financial institution crimes may include imprisonment for 20 years. Regulators have flexibility to commence enforcement actions against institutions and institution-affiliated parties, and the FDIC has the authority to terminate deposit insurance. When issued by a banking agency, cease and desist and similar orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions determined to be appropriate by the ordering agency. The federal banking agencies also may remove a director or officer from an insured depository institution (or bar them from the industry) if a violation is willful or reckless.

Bank Regulation

Southside Bank is a Texas-chartered commercial bank, the deposits of which are insured up to the applicable limits by the DIF of the FDIC. Southside Bank is not a member of the Federal Reserve System. The Bank is subject to extensive regulation, examination and supervision by the TDB, as its chartering authority, and by the FDIC, as its primary federal regulator and deposit insurer. In addition, the Bureau could participate in examinations of the Bank (as described above) in the near term regarding the Bank's offering of consumer financial products and services. The federal and state laws applicable to banks regulate, among other things, the scope of their business and investments, lending and deposit-taking activities, borrowings, maintenance of retained earnings and reserve accounts, distribution of earnings and payment of dividends.

Permitted Activities and Investments. Under the Federal Deposit Insurance Act ("FDIA"), the activities and investments of state nonmember banks are generally limited to those permissible for national banks, notwithstanding state law. With FDIC approval, a state nonmember bank may engage in activities not permissible for a national bank if the FDIC determines that the activity does not pose a significant risk to the DIF and that the bank meets its minimum capital requirements. Similarly, under Texas law, a state bank may engage in those activities permissible for national banks domiciled in Texas. The TDB may permit a Texas state bank to engage in additional activities so long as the performance of the activity by the bank would not adversely affect the safety and soundness of the bank.

On December 10, 2013, federal regulators, including the Federal Reserve and the FDIC, issued final rules to implement Section 619 of the Dodd-Frank Act, known as the "Volcker Rule," to prohibit insured depository institutions, such as Southside Bank, and their affiliates, such as the Company, from proprietary trading and acquiring certain interests in hedge or private equity funds. The final rules contain certain exemptions from the prohibition and permit the retention of certain ownership interests. Insured depository institutions were generally required to conform their activities and investments to the requirements by July 21, 2015, and for legacy investments in and relationships with a covered fund by July 21, 2016.

Brokered Deposits. Southside Bank also may be restricted in its ability to accept, renew or roll over brokered deposits, depending on its capital classification. Only "well-capitalized" banks are permitted to accept, renew or roll over brokered deposits. The FDIC may, on a case-by-case basis, permit banks that are adequately capitalized to accept brokered deposits if the

FDIC determines that acceptance of such deposits would not constitute an unsafe or unsound banking practice with respect to the bank. Undercapitalized banks generally may not accept, renew or roll over brokered deposits.

Loans to One Borrower. Under Texas law, without the approval of the TDB and subject to certain limited exceptions, the maximum aggregate amount of loans that Southside Bank is permitted to make to any one borrower is 25% of Tier 1 capital.

Insider Loans. Under Regulation O of the Federal Reserve, as made applicable to state nonmember banks by section 18(j)(2) of the FDIA, Southside Bank is subject to quantitative restrictions on extensions of credit to its executive officers and directors, the executive officers and directors of the Company, any owner of 10% or more of its stock or the stock of Southside Bancshares, Inc. and certain entities affiliated with any such persons. In general, any such extensions of credit must (i) not exceed certain dollar limitations, (ii) be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (iii) not involve more than the normal risk of repayment or present other unfavorable features. Additional restrictions are imposed on extensions of credit to executive officers. Certain extensions of credit also require the approval of a bank's board of directors.

Deposit Insurance and Assessments. The deposits of Southside Bank are insured by the DIF of the FDIC, up to the applicable limits established by law and are subject to the deposit insurance premium assessments of the DIF. The Dodd-Frank Act amended the statutory regime governing the DIF. Among other things, the Dodd-Frank Act established a minimum designated reserve ratio ("DRR") of 1.35 percent of estimated insured deposits (which the FDIC has set at 2.0 percent each year since 2010), required that the fund reserve ratio reach 1.35 percent by September 30, 2020 and directed the FDIC to amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Specifically, the Dodd-Frank Act requires the assessment base to be an amount equal to the average consolidated total assets of the insured depository institution during the assessment period, minus the sum of the average tangible equity of the insured depository institution during the assessment period and an amount the FDIC determines is necessary to establish assessments consistent with the risk-based assessment system found in the FDIA.

Furthermore, on February 7, 2011, the FDIC issued a final rule changing its assessment system from one based on domestic deposits to one based on the average consolidated total assets of a bank minus its average tangible equity during each quarter. This rule modified two adjustments added to the risk-based pricing system in 2009 (an unsecured debt adjustment and a brokered deposit adjustment), discontinued a third adjustment added in 2009 (the secured liability adjustment), and added an adjustment for long-term debt held by an insured depository institution where the debt is issued by another insured depository institution. Under these revisions to the DIF rules, the total base assessment rates will vary depending on the DIF reserve ratio. On April 26, 2016, the FDIC issued a final rule to refine the deposit insurance assessment system for small insured depository institutions that have been federally insured for at least five years. The rule, which became effective on July 1, 2016, revised the financial ratios method, updated the financial measures used, and eliminated risk categories for such banks.

In addition, all FDIC-insured institutions are required to pay a pro rata portion of the interest due on bonds issued by the Financing Corporation ("FICO") to fund the closing and disposal of failed thrift institutions by the Resolution Trust Corporation. FICO assessment rates, which are calculated off the assessment base established by the Dodd-Frank Act, are set quarterly. The rate was 0.580 (annual) basis points for the first quarter of 2016 and 0.560 (annual) basis points for the second, third and fourth quarters of 2016. It was 0.560 (annual) basis points for the first quarter of 2017. These assessments will continue until the FICO bonds mature in 2017 through 2019.

Capital Adequacy.

See *Holding Company Regulation - Capital Adequacy*.

Prompt Corrective Action and Undercapitalization. The Federal Deposit Insurance Corporation Improvement Act (the "FDICIA") established a system of prompt corrective action to resolve the problems of undercapitalized insured depository institutions. Under this system, the federal banking regulators are required to rate insured depository institutions on the basis of five capital categories as described below. The federal banking regulators are also required to take mandatory supervisory actions and are authorized to take other discretionary actions, with respect to insured depository institutions in the three undercapitalized categories, the severity of which will depend upon the capital category in which the insured depository institution is assigned. Generally, subject to a narrow exception, the FDICIA requires the banking regulator to appoint a receiver or conservator for an insured depository institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. The thresholds for each of these categories were recently revised pursuant to the Basel III Capital Rules, which are discussed above in "*Holding Company Regulation - Capital Adequacy*." These revised categories started to apply to Southside Bank on January 1, 2015.

Under the regulations, all insured depository institutions are assigned to one of the following capital categories:

- Well Capitalized - The insured depository institution exceeds the required minimum level for each relevant capital measure. Under the Updated Capital Rules, a well-capitalized insured depository institution is one (1) having a total risk-based capital ratio of 10 percent or greater, (2) having a Tier 1 risk-based capital ratio of 8 percent or greater, (3) having a

CET1 capital ratio of 6.5 percent or greater, (4) having a leverage capital ratio of 5 percent or greater and (5) that is not subject to any order or written directive to meet and maintain a specific capital level for any capital measure.

- Adequately Capitalized - The insured depository institution meets the required minimum level for each relevant capital measure. Under the Updated Capital Rules, an adequately-capitalized depository institution is one having (1) a total risk based capital ratio of 8 percent or more, (2) a Tier 1 capital ratio of 6 percent or more, (3) a CET1 capital ratio of 4.5 percent or more, and (4) a leverage ratio of 4 percent or more.
- Undercapitalized - The insured depository institution fails to meet the required minimum level for any relevant capital measure. Under the Updated Capital Rules, an undercapitalized depository institution is one having (1) a total capital ratio of less than 8 percent, (2) a Tier 1 capital ratio of less than 6 percent, (3) a CET1 capital ratio of less than 4.5 percent, or (4) a leverage ratio of less than 4 percent.
- Significantly Undercapitalized - The insured depository institution is significantly below the required minimum level for any relevant capital measure. Under the Updated Capital Rules, a significantly undercapitalized institution is one having (1) a total risk-based capital ratio of less than 6 percent (2) a Tier 1 capital ratio of less than 4 percent, (3) a CET1 ratio of less than 3 percent or (4) a leverage capital ratio of less than 3 percent.
- Critically Undercapitalized - The insured depository institution fails to meet a critical capital level set by the appropriate federal banking agency. A critically undercapitalized institution is one having a ratio of tangible equity to total assets that is equal to or less than 2 percent.

The prompt corrective action regulations permit the appropriate federal banking regulator to downgrade an institution to the next lower category if the regulator determines after notice and opportunity for hearing or response that (1) the institution is in an unsafe or unsound condition or (2) that the institution has received and not corrected a less-than-satisfactory rating for any of the categories of asset quality, management, earnings or liquidity in its most recent examination. Supervisory actions by the appropriate federal banking regulator depend upon an institution's classification within the five categories. Our management believes that we and our Bank subsidiary have the requisite capital levels to qualify as well-capitalized institutions under the FDICIA regulations.

If an institution fails to remain well capitalized, it will be subject to a variety of enforcement remedies that increase as the capital condition worsens. For instance, the FDICIA generally prohibits a depository institution from making any capital distribution, including payment of a dividend, or paying any management fee to its holding company if the depository institution would thereafter be undercapitalized as a result. Undercapitalized depository institutions are subject to restrictions on borrowing from the Federal Reserve System. In addition, adequately-capitalized depository institutions may not accept brokered deposits absent a waiver from the FDIC and undercapitalized depository institutions may not accept brokered deposits, are subject to growth limitations and are required to submit capital restoration plans for regulatory approval. A depository institution's holding company must guarantee any required capital restoration plan, up to an amount equal to the lesser of 5 percent of the depository institution's assets at the time it becomes undercapitalized or the amount of the capital deficiency when the institution fails to comply with the plan. Federal banking agencies may not accept a capital plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. If a depository institution fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized.

Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets and cessation of receipt of deposits from correspondent banks. Critically undercapitalized depository institutions are subject to appointment of a receiver or conservator.

In addition to the "prompt corrective action" directives, failure to meet capital guidelines may subject a banking organization to a variety of other enforcement remedies, including additional substantial restrictions on its operations and activities, termination of deposit insurance by the FDIC and, under certain conditions, the appointment of a conservator or receiver.

Standards for Safety and Soundness. The FDIA also requires the federal banking regulatory agencies to prescribe, by regulation or guideline, operational and managerial standards for all insured depository institutions relating to: (i) internal controls; (ii) information systems and internal audit systems; (iii) loan documentation; (iv) credit underwriting; (v) interest rate risk exposure; and (vi) asset quality. The agencies also must prescribe standards for asset quality, earnings, and stock valuation, as well as standards for compensation, fees and benefits. The federal banking agencies have adopted regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness ("Guidelines") to implement these required standards. The Guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Under the regulations, if the FDIC determines that Southside Bank fails to meet any standards prescribed by the Guidelines, it may require Southside Bank to submit an acceptable plan to achieve compliance, consistent with deadlines for the submission and review of such safety and soundness compliance plans. Notably, the Dodd-Frank Act contains separate requirements relating to compensation arrangements. Specifically, the Dodd-Frank Act requires federal banking regulators to issue regulations or guidelines to prohibit incentive-based compensation arrangements that encourage inappropriate risk taking by providing excessive compensation or that may lead to material loss at certain financial institutions with $1 billion or more in assets. A joint proposed rule was published in the Federal Register on April 14, 2011, and a second joint proposed rule was published on June 10, 2016; however, regulators have yet to issue the final rule on the topic.

Dividends. All dividends paid by Southside Bank are paid to the Company, as the sole shareholder of Southside Bank. The ability of Southside Bank, as a Texas state bank, to pay dividends is restricted under federal and state law and regulations. As an initial matter, the FDICIA and the regulations of the FDIC generally prohibit an insured depository institution from making a capital distribution (including payment of dividend) if, thereafter, the institution would not be at least adequately capitalized. Under Texas law, Southside Bank generally may not pay a dividend reducing its capital and surplus without the prior approval of the Texas Banking Commissioner. All dividends must be paid out of net profits then on hand, after deducting expenses, including losses and provisions for loan losses.

Southside Bank's general dividend policy is to pay dividends at levels consistent with maintaining liquidity and preserving applicable capital ratios and servicing obligations. Southside Bank's dividend policies are subject to the discretion of its board of directors and will depend upon such factors as future earnings, financial conditions, cash needs, capital adequacy, compliance with applicable statutory and regulatory requirements and general business conditions. The exact amount of future dividends paid by Southside Bank will be a function of its general profitability (which cannot be accurately estimated or assured), applicable tax rates in effect from year to year and the discretion of its board of directors.

As described above under *Holding Company Regulation - Dividends*, the ability of banks and bank holding companies to pay dividends, and the contents of their respective dividend policies, could be impacted by a range of changes imposed by the Dodd-Frank Act, many of which will require implementing rules to become effective.

Transactions with Affiliates. Southside Bank is subject to sections 23A and 23B of the Federal Reserve Act ("FRA") and the Federal Reserve's Regulation W, as made applicable to state nonmember banks by section 18(j) of the FDIA. Sections 23A and 23B of the FRA restrict a bank's ability to engage in certain transactions with its affiliates. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies controlled by such parent bank holding company are generally affiliates of the bank.

Specifically, section 23A places limits on the amount of "covered transactions," which include loans or extensions of credit to, and investments in or certain other transactions with, affiliates. It also limits the amount of any advances to third parties that are collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited to 10 percent of the bank's capital and surplus for any one affiliate and 20 percent for all affiliates. Additionally, within the foregoing limitations, each covered transaction must meet specified collateral requirements ranging from 100 to 130 percent of the loan amount, depending on the type of collateral. Further, banks are prohibited from purchasing low quality assets from an affiliate. Section 608 of the Dodd-Frank Act broadened the definition of "covered transactions" to include derivative transactions and the borrowing or lending of securities if the transaction will cause a bank to have credit exposure to an affiliate. The revised definition also includes the acceptance of debt obligations of an affiliate as collateral for a loan or extension of credit to a third party. Furthermore, reverse repurchase transactions are viewed as extensions of credit (instead of asset purchases) and thus become subject to collateral requirements. The expanded definition of "covered transactions" took effect on July 21, 2012.

Section 23B, among other things, prohibits a bank from engaging in certain transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with non-affiliated companies. Except for limitations on low quality asset purchases and transactions that are deemed to be unsafe or unsound, Regulation W generally excludes affiliated depository institutions from treatment as affiliates.

Anti-Tying Regulations. Under the BHCA and the Federal Reserve's regulations, a bank is prohibited from engaging in certain tying or reciprocity arrangements with its customers. In general, a bank may not extend credit, lease, sell property, or furnish any services or fix or vary the consideration for these products or services on the condition that either: (i) the customer obtain or provide some additional credit, property, or services from or to the bank, the bank holding company or subsidiaries thereof or (ii) the customer not obtain credit, property, or service from a competitor, except to the extent reasonable conditions are imposed to assure the soundness of the credit extended. A bank may, however, offer combined-balance products and may otherwise offer more favorable terms if a customer obtains two or more traditional bank products. Also, certain foreign transactions are exempt from the general rule.

Community Reinvestment Act. Under the CRA, Southside Bank has a continuing and affirmative obligation, consistent with safe and sound banking practices, to help meet the needs of our entire community, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for banks nor does it limit a bank's discretion to develop the types of products and services that it believes are best suited to its particular community.

On a periodic basis, the FDIC is charged with preparing a written evaluation of our record of meeting the credit needs of the entire community and assigning a rating - outstanding, satisfactory, needs to improve or substantial noncompliance. Banks are rated based on their actual performance in meeting community credit needs. The FDIC will take that rating into account in its evaluation of any application made by the bank for, among other things, approval of the acquisition or establishment of a branch or other deposit facility, an office relocation, a merger or the acquisition of shares of capital stock of another financial institution. A bank's CRA rating may be used as the basis to deny or condition an application. In addition, as discussed above, a bank holding company may not become a financial holding company unless each of its subsidiary banks has a CRA rating of at least "satisfactory." As of October 19, 2015, the most recent exam date, Southside Bank has a CRA rating of "outstanding."

Branch Banking. Pursuant to the Texas Finance Code, all banks located in Texas are authorized to branch statewide. Accordingly, a bank located anywhere in Texas has the ability, subject to regulatory approval, to establish branch facilities near any of our facilities and within our market area. If other banks were to establish branch facilities near our facilities, it is uncertain whether these branch facilities would have a material adverse effect on our business.

The Dodd-Frank Act substantially amended the legal framework that had previously governed interstate branching activities. Formerly, under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, a bank's ability to branch into a particular state was largely dependent upon whether the state "opted in" to de novo interstate branching. Many states did not "opt in," which resulted in branching restrictions in those states. The Dodd-Frank Act removed the "opt-in" concept and permits banks to engage in de novo branching outside of their home states, provided that the laws of the target state permit banks chartered in that state to branch within that state. Accordingly, de novo interstate branching by Southside Bank is subject to these new standards. All branching in which Southside Bank may engage remains subject to regulatory approval and adherence to applicable legal and regulatory requirements.

Consumer Protection Regulation. The activities of Southside Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected or contracted for by the banks are subject to state usury laws and federal laws concerning interest rates. Loan operations are also subject to federal laws and regulations applicable to credit transactions, such as:

- the Truth In Lending Act and Regulation Z, governing disclosures of credit terms to consumer borrowers;
- the Home Mortgage Disclosure Act and Regulation C, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- the Equal Credit Opportunity Act and Regulation B, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- the Fair Credit Reporting Act and Regulation V, governing the use and provision of information to consumer reporting agencies;
- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- the guidance of the various federal agencies charged with the responsibility of implementing such federal laws.

Deposit and other operations also are subject to:

- the Truth in Savings Act and Regulation DD, governing disclosure of deposit account terms to consumers;
- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- the Electronic Fund Transfer Act and Regulation E, which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of ATMs and other electronic banking services, which the Bureau has expanded to include a new compliance regime that governs consumer-initiated cross border electronic transfers.

Many of the foregoing laws and regulations have recently changed and are subject to further change resulting from the provisions in the Dodd-Frank Act and other developments. The Bureau recently issued a proposed rule, which was published in the Federal Register on May 24, 2016 that would impose limitations on the use of pre-dispute arbitration agreements by covered providers of consumer financial products and services; a final rule has not yet been issued.

In addition to numerous new disclosure requirements, the Dodd-Frank Act imposed new standards for mortgage loan originations on all lenders, including banks, in an effort to encourage lenders to verify a borrower's ability to repay. The Bureau issued a rule, which took effect on January 10, 2014, to implement this "ability-to-repay" requirement and provide lenders with protection from liability for "qualified mortgages," as required by the Dodd-Frank Act. The rule has impacted our residential mortgage lending practices, and the residential mortgage market generally. Most significantly, the new "qualified mortgage" standards generally limit the total points and fees that financial institutions and/or a broker may charge on conforming and jumbo loans to 3 percent of the total loan amount. Also, the Dodd-Frank Act, in conjunction with the Federal Reserve's final rule on loan originator compensation issued August 16, 2010 and effective April 1, 2011, prohibits certain compensation payments to loan originators and steering consumers to loans not in their interest because it will result in greater compensation for a loan originator. In addition, the Bureau recently issued additional rules pertaining to loan originator compensation, and that established qualification, registration and licensing requirements for loan originators. These standards will result in a myriad of new system, pricing, and compensation controls in order to ensure compliance and to decrease repurchase requests and foreclosure defenses. In addition, the Dodd-Frank Act generally requires lenders or securitizers to retain an economic interest in the credit risk relating to loans the lender sells and other asset-backed securities that the securitizer issues if the loans have not complied with the ability to repay standards. The final rule, which took effect on December 24, 2015 for residential mortgage-backed securitizations, generally requires the securitizer to retain not less than 5 percent of the credit risk.

The Bureau has also established a series of mechanisms to collect, track and make public consumer complaints, including complaints against individual financial institutions and is using this, and other information it has gathered, in connection with a variety of initiatives to address issues in markets for consumer financial products and services. The Bureau also has broad authority to prohibit unfair, deceptive and abusive acts and practices ("UDAAP") and to investigate and penalize financial institutions that violate this prohibition.

We cannot predict the effect that being regulated by a new, additional regulatory authority focused on consumer financial protection, or any new implementing regulations or revisions to existing regulations that may result from the establishment of this new authority, will have on our businesses. Additional regulations resulting from the Dodd-Frank Act may materially adversely affect our business, financial condition or results of operations. In addition, Southside Bank also may be subject to certain state laws and regulations designed to protect consumers.

Commercial Real Estate Lending. Lending operations that involve concentration of commercial real estate loans are subject to enhanced scrutiny by federal banking regulators. The regulators have issued guidance with respect to the risks posed by commercial real estate lending concentrations. Real estate loans generally include land development, construction loans, land and lot loans to individuals, loans secured by multi-family property and nonfarm nonresidential real property where the primary source of repayment is derived from rental income associated with the property. The guidance prescribes the following guidelines for examiners to help identify institutions that are potentially exposed to concentration risk and may warrant greater supervisory scrutiny:

- total reported loans for construction, land development and other land represent 100 percent or more of the institution's total capital, or
- total commercial real estate loans represent 300 percent or more of the institution's total capital and the outstanding balance of the institution's commercial real estate loan portfolio has increased by 50 percent or more during the prior 36 months.

In October 2009, the federal banking agencies issued additional guidance on real estate lending that emphasizes these considerations.

In addition, the Dodd-Frank Act contains provisions that may impact our business by reducing the amount of our commercial real estate lending and increasing the cost of borrowing, including rules relating to risk retention of securitized assets. Section 941 of the Dodd-Frank Act requires, among other things, a loan originator or a securitizer of asset-backed securities to retain a percentage of the credit risk of securitized assets. The banking agencies have jointly issued a final rule to implement these requirements, which became effective on December 24, 2016 for classes of asset-backed securities other than residential mortgage-backed securitizations.

Anti-Money Laundering. Southside Bank is subject to the regulations of the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Department of the Treasury, which implement the Bank Secrecy Act, as amended by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA PATRIOT Act"). The USA PATRIOT Act gives the federal government the power to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. Title III of the USA PATRIOT Act includes measures intended to encourage information sharing among banks, regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including state-chartered banks like Southside Bank.

The USA PATRIOT Act and the related FinCEN regulations impose certain requirements with respect to financial institutions, including the following:

- establishment of anti-money laundering programs, including adoption of written procedures and an ongoing employee training program, designation of a compliance officer and auditing of the program;
- establishment of a program specifying procedures for obtaining information from customers seeking to open new accounts, including verifying the identity of customers within a reasonable period of time;

- establishment of enhanced due diligence policies, procedures and controls designed to detect and report money laundering, for financial institutions that administer, maintain or manage private bank accounts or correspondent accounts for non-U.S. persons;
- prohibitions on correspondent accounts for foreign shell banks and compliance with recordkeeping obligations with respect to correspondent accounts of foreign banks;
- filing of suspicious activities reports if a bank believes a customer may be violating U.S. laws and regulations; and
- requirements that bank regulators consider bank holding company or bank compliance in connection with merger or acquisition transactions.

Bank regulators routinely examine institutions for compliance with these obligations and have been active in imposing cease and desist and other regulatory orders and money penalty sanctions against institutions found to be violating these obligations. In addition, FinCEN issued a final rule, which was published in the Federal Register on May 11, 2016 that requires subject to certain exclusions and exemptions, covered financial institutions to identify and verify the identity of beneficial owners of legal entity customers, beginning on May 11, 2018.

The Federal Bureau of Investigation can send bank regulatory agencies lists of the names of persons suspected of involvement in terrorist activities. Southside Bank can be requested to search its records for any relationships or transactions with persons on those lists and required to report any identified relationships or transactions.

OFAC. The U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") is responsible for helping to ensure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC publishes, and routinely updates, lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts, including the Specially Designated Nationals List. If we find a name on any transaction, account or wire transfer that is on an OFAC list, we must undertake certain specified activities, which could include blocking or freezing the account or transaction requested, and we must notify the appropriate authorities.

Privacy and Data Security. Under federal law, financial institutions are generally prohibited from disclosing consumer information to non-affiliated third parties unless the consumer has been given the opportunity to object and has not objected to such disclosure. Financial institutions are further required to disclose their privacy policies to customers annually. To the extent state laws are more protective of consumer privacy, financial institutions must comply with state law privacy provisions.

In addition, federal and state banking agencies have prescribed standards for maintaining the security and confidentiality of consumer information. Southside Bank is subject to such standards, as well as standards for notifying consumers in the event of a security breach. Under existing federal law, Southside Bank must disclose its privacy policy for collecting and protecting confidential customer information to consumers, permit consumers to "opt out" of having nonpublic customer information disclosed to non-affiliated third parties, with some exceptions, and allow customers to opt out of receiving marketing solicitations based on information about the customer received from another subsidiary. On October 28, 2014, the Bureau amended the annual privacy notice requirement to permit a financial institution to provide the annual privacy notice through posting the annual notice on its website if the financial institution meets certain conditions. On December 4, 2015, the GLBA was amended to provide additional circumstances under which a financial institution is not required to provide an annual notice. States may adopt more extensive privacy protections. Southside Bank is similarly required to have an information security program to safeguard the confidentiality and security of customer information and to ensure proper disposal. Customers must be notified when unauthorized disclosure involves sensitive customer information that may be misused.

Regulatory Examination.

See *Holding Company Regulation - Regulatory Examination.*

Enforcement Authority. Southside Bank and its "institution-affiliated parties," including management, employees, agents, independent contractors and consultants, such as attorneys and accountants and others who participate in the conduct of the institution's affairs, are subject to potential civil and criminal penalties for violations of law, regulations or written orders of a government agency. Violations can include failure to timely file required reports, filing false or misleading information or submitting inaccurate reports. Civil penalties may be as high as $1,000,000 a day for such violations, and criminal penalties for some financial institution crimes may include imprisonment for 20 years. Regulators have flexibility to commence enforcement actions against institutions and institution-affiliated parties, and the FDIC has the authority to terminate deposit insurance. When issued by a banking agency, cease and desist orders may, among other things, require affirmative action to correct any harm resulting from a violation or practice, including restitution, reimbursement, indemnifications or guarantees against loss. A financial institution may also be ordered to restrict its growth, dispose of certain assets, rescind agreements or contracts, or take other actions determined to be appropriate by the ordering agency. The federal banking agencies also may remove a director or officer from an insured depository institution (or bar them from the industry) if a violation is willful or reckless.

Governmental Monetary Policies. The commercial banking business is affected not only by general economic conditions but also by the monetary policies of the Federal Reserve. Changes in the discount rate on member bank borrowings, control of borrowings, open market operations, the imposition of and changes in reserve requirements against member banks, deposits and assets of foreign branches, the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates and the placing of limits on interest rates which member banks may pay on time and savings deposits are some of the instruments of monetary policy available to the Federal Reserve. These monetary policies influence to a significant extent the overall growth of all bank loans, investments and deposits and the interest rates charged on loans or paid on time and savings deposits. In response to the financial crisis, the Federal Reserve established several innovative programs to stabilize certain financial institutions and to ensure the availability of credit, which the Federal Reserve has begun to modify as a result of improving economic conditions. The nature of future monetary policies and the effect of such policies on Southside Bank's future business and earnings, therefore, cannot be predicted accurately.

Evolving Legislation and Regulatory Action. Proposals for new statutes and regulations are frequently circulated at both the federal and state levels, and may include wide-ranging changes to the structures, regulations and competitive relationships of financial institutions. We cannot predict whether new legislation or regulations will be enacted and, if enacted, the effect that it, or any regulations, would have on our business, financial condition or results of operations.

Other Regulatory Matters. The Company and its affiliates are subject to oversight by the SEC, the NASDAQ Stock Market, various state securities regulators and other regulatory authorities. The Company and its subsidiaries have from time to time received requests for information from regulatory authorities in various states, including state attorneys general, securities regulators and other regulatory authorities, concerning their business practices. Such requests are considered incidental to the normal conduct of business.

ITEM 1A. RISK FACTORS

Set forth below are the material risks and uncertainties that, if they were to occur, could materially and adversely affect our business, financial condition, results of operations and the trading price of our common stock. Additional risks and uncertainties that management is not aware of or focused on or that management currently deems immaterial may also impair our financial condition and business operations.

RISKS RELATED TO OUR BUSINESS

We continue to face market volatility, which could adversely impact our results of operations and access to capital.

The capital and credit markets experienced volatility and disruption from 2008 to 2010. While volatility in, and disruption of, these markets no longer remain at unprecedented levels, any future escalated levels of market volatility and disruption could produce downward pressure on stock prices and credit capacity without regard to an issuer's underlying financial strength. If levels of market disruption and volatility worsen, there can be no assurance that we will not experience adverse effects, which may be material, on our ability to access capital and on our results of operations and financial condition, including our liquidity position.

Our earnings are subject to interest rate risk.

Our earnings and cash flows are largely dependent upon our net interest income. Net interest income is the difference between interest income earned on interest earning assets such as loans and securities and interest expense paid on interest bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, interest rates, the yield curve, or market risk spreads, or a prolonged inverted yield curve could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and borrowings, but such changes could also affect:

- our ability to originate loans and obtain deposits;
- our ability to retain deposits in a rising rate environment;
- net interest rate spreads and net interest rate margins;
- our ability to enter into instruments to hedge against interest rate risk;
- the fair value of our financial assets and liabilities; and
- the average duration of our loan and mortgage-backed securities portfolio.

If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations. See the section captioned "Net Interest Income" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report for further discussion related to our management of interest rate risk.

We are subject to the risk that our U.S. agency mortgage-backed securities ("MBS") could prepay faster than we have projected.

We have and continue to purchase MBS at premiums due to the low interest rate environment. Our prepayment assumptions take into account Bloomberg consensus speeds, current trends and past experience. If actual prepayments exceed our projections, the amortization expense associated with these MBS will increase, thereby decreasing our net income. The increase in amortization expense and the corresponding decrease in net income could have a material adverse effect on our financial condition and results of operations.

We are subject to credit quality risks and our credit policies may not be sufficient to avoid losses.

We are subject to the risk of losses resulting from the failure of borrowers, guarantors and related parties to pay us the interest and principal amounts due on their loans. Although we maintain well-defined credit policies and credit underwriting and monitoring and collection procedures, these policies and procedures may not prevent losses, particularly during periods in which the local, regional or national economy suffers a general decline. If borrowers fail to repay their loans, our financial condition and results of operations would be adversely affected.

Our interest rate risk, liquidity, fair value of securities and profitability are dependent upon the successful management of our balance sheet strategy.

We implemented a balance sheet strategy for the purpose of enhancing overall profitability by maximizing the use of our capital. The effectiveness of our balance sheet strategy, and therefore our profitability, may be adversely affected by a number of factors, including reduced net interest margin and spread, adverse changes in the market liquidity and fair value of our investment securities and U.S. agency MBS, incorrect modeling results due to the unpredictable nature of MBS prepayments, the length of interest rate cycles and the slope of the interest rate yield curve. In addition, we may not be able to obtain wholesale funding to profitably and properly fund our balance sheet strategy. If our balance sheet strategy is flawed or poorly implemented, we may incur significant losses. See the section captioned "Balance Sheet Strategy" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report for further discussion related to our balance sheet strategy.

We have a high concentration of loans secured by real estate and a decline in the real estate market, for any reason, could result in losses and materially and adversely affect our business, financial condition, results of operations and future prospects.

A significant portion of our loan portfolio is dependent on real estate. In addition to the importance of the financial strength and cash flow characteristics of the borrower, loans are also often secured with real estate collateral. At December 31, 2016, approximately 76.8% of our loans have real estate as a primary or secondary component of collateral. The real estate in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. Beginning in the third quarter of 2007 and continuing until 2010, there was significant deterioration in the credit markets, beginning with a decline in the sub-prime mortgage lending market, which later extended to the markets for collateralized mortgage obligations, MBS and the lending markets generally. This decline resulted in restrictions in the resale markets during 2011 and 2012 for non-conforming loans and had an adverse effect on retail mortgage lending operations in many markets. Beginning in 2014, the price per barrel of crude oil began to decline significantly from a high during 2014 of over $100 to approximately $54 as of December 31, 2016. A prolonged period of low oil prices could have a negative impact on energy-dominant states such as Texas, including the real estate values in such states. A further decline in the credit markets generally could adversely affect our financial condition and results of operations if we are unable to extend credit or sell loans in the secondary market. An adverse change in the economy affecting real estate values generally or in our primary markets specifically could significantly impair the value of collateral underlying certain of our loans and our ability to sell the collateral at a profit or at all upon foreclosure. Furthermore, it is likely that, in a declining real estate market, we would be required to further increase our allowance for loan losses. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values or to increase our allowance for loan losses, our profitability and financial condition could be adversely impacted.

Our allowance for probable loan losses may be insufficient.

We maintain an allowance for probable loan losses, which is a reserve established through a provision for probable loan losses charged to expense. This allowance represents management's best estimate of probable losses that may exist within our existing loan portfolio. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions; and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for probable loan losses inherently involves a high degree of subjectivity and requires management to make significant estimates and assumptions regarding current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting the value of properties used as collateral for loans, problems affecting the credit of borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for probable loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for probable loan losses or the recognition of further loan charge-offs (in accordance with GAAP), based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for probable loan losses, we may need additional provisions to increase the allowance for probable loan losses. Any increases in the allowance for probable loan losses will result in a decrease in net income and capital, and may have a material adverse effect on our financial condition and results of operations. See the section captioned "Loan Loss Experience and Allowance for Loan Losses" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report for further discussion related to our process for determining the appropriate level of the allowance for probable loan losses.

We may be adversely affected by declining crude oil prices.

Beginning in 2014, decisions by certain members of OPEC to maintain higher crude oil production levels combined with increased production levels in the United States led to increased global oil supplies which has resulted in significant declines in market oil prices. Decreased market oil prices have compressed margins for many U.S. and Texas-based oil producers, particularly those that utilize higher-cost production technologies such as hydraulic fracking and horizontal drilling, as well as oilfield service providers, energy equipment manufacturers and transportation suppliers, among others. As of December 31, 2016, energy loans comprised approximately 1.09% of our loan portfolio. Energy production and related industries represent a significant part of the economies in our primary markets. As of December 31, 2016, the price per barrel of crude oil was approximately $54 compared to a high of over $100 in 2014. If oil prices remain at these low levels for an extended period, we could experience weaker loan demand from the energy industry and increased losses within our energy portfolio. A prolonged period of low oil prices could also have a negative impact on the U.S. economy and, in particular, the economies of energy-dominant states such as Texas, which in turn could have a material adverse effect on our business, financial condition and results of operations.

If we fail to maintain an effective system of disclosure controls and procedures, including internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud, which could have a material adverse effect on our business, results of operation and financial condition. In addition, current and potential shareholders could lose confidence in our financial reporting, which could harm the trading price of our common stock.

Management regularly monitors, reviews and updates our disclosure controls and procedures, including our internal control over financial reporting. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, assurances that the controls will be effective. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

Failure to achieve and maintain an effective internal control environment could prevent us from accurately reporting our financial results, preventing or detecting fraud, or providing timely and reliable financial information pursuant to our reporting obligations, which could have a material adverse effect on our business, financial condition, and results of operations. Further, ineffective internal controls could cause our investors to lose confidence in our financial information, which could affect the trading price of our common stock.

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

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. There is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental remediation may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures that require us to perform an environmental review before initiating any foreclosure action on nonresidential real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

Our profitability depends significantly on economic conditions in the State of Texas.

Our success depends primarily on the general economic conditions of the State of Texas and the specific local markets within Texas in which we operate. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers primarily in the State of Texas and the local markets in which we operate within Texas. The local economic conditions in these areas have a significant impact on the demand for our products and services, as well as the ability of our customers to repay loans, the value of the collateral securing our loans and the stability of our deposit funding sources. Moreover, virtually all of the securities in our municipal bond portfolio were issued by political subdivisions and agencies within the State of Texas. A significant decline in general economic conditions, caused by inflation, recession, crude oil prices, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, plant or business closings or downsizing, changes in securities markets or other factors could impact these local economic conditions and, in turn, have a material adverse effect on our financial condition and results of operations.

General political or economic conditions in the United States could adversely affect our financial condition and results of operations.

The state of the economy and various economic factors, including inflation, recession, unemployment, interest rates, declining oil prices and the level of U.S. debt, as well as governmental action and uncertainty resulting from U.S. and global political trends, may directly and indirectly, have a destabilizing effect on our financial condition and results of operations. An unfavorable or uncertain national or regional political or economic environment could drive losses beyond those which are provided for in our allowance for loan losses and result in the following consequences:

- increases in loan delinquencies;
- increases in nonperforming assets and foreclosures;
- decreases in demand for our products and services, which could adversely affect our liquidity position;

- decreases in the value of the collateral securing our loans, especially real estate, which could reduce customers' borrowing power;
- decreases in the credit quality of our non-U.S. Government and non-U.S. agency investment securities, corporate and municipal securities;
- an adverse or unfavorable resolution of the Fannie Mae or Freddie Mac receivership; and
- decreases in the real estate values subject to ad-valorem taxes by municipalities that impact such municipalities' ability to repay their debt, which could adversely affect our municipal loans or debt securities.

Any of the foregoing could adversely affect our financial condition and results of operation.

We operate in a highly competitive industry and market area.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets we operate. Additionally, various out-of-state banks have entered or have announced plans to enter the market areas in which we currently operate. We also face competition from many other types of financial institutions, including, without limitation, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes, continued consolidation and recent trends in the credit and mortgage lending markets. Banks, securities firms and insurance companies can be affiliated under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for nonbanks to offer certain products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Our competitors may have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

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

From time to time, we may implement new delivery systems, such as internet banking, or offer new products and services within existing lines of business. In developing and marketing new delivery systems and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on our business, results of operations and financial condition.

We rely on dividends from our bank subsidiary for most of our revenue.

Southside Bancshares, Inc. is a separate and distinct legal entity from its subsidiaries. We receive substantially all of our revenue from dividends from our subsidiary, Southside Bank. These dividends are the principal source of funds to pay dividends on our common stock to our shareholders and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that Southside Bank and certain of our nonbank subsidiaries may pay to us. In addition, Southside Bancshares, Inc.'s right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event Southside Bank is unable to pay dividends to Southside Bancshares, Inc., we may not be able to service debt, pay obligations or pay dividends to our shareholders. The inability to receive dividends from Southside Bank could have a material adverse effect on Southside Bancshares, Inc.'s business, financial condition and results of operations. See the section captioned "Supervision and Regulation" in "Item 1. Business" and "Note 14 – Shareholders' Equity" to our consolidated financial statements included in this report.

You may not receive dividends on our common stock.

Although we have historically declared quarterly cash dividends on our common stock, we are not required to do so and may reduce or cease to pay common stock dividends in the future. If we reduce or cease to pay common stock dividends, the market price of our common stock could be adversely affected.

As noted above, our ability to pay dividends depends primarily upon the receipt of dividends or other capital distributions from Southside Bank. Southside Bank's ability to pay dividends to us is subject to, among other thing, its earnings, financial condition and need for funds, as well as federal and state governmental policies and regulations applicable to us and Southside Bank, including the statutory requirement that we serve as a source of financial strength for Southside Bank, which limit the amount that may be paid as dividends without prior regulatory approval. Additionally, if Southside Bank's earnings are not sufficient to pay dividends to us while maintaining adequate capital levels, we may not be able to pay dividends to our shareholders. See "Supervision and Regulation — Holding Company Regulation — Dividends" included in this report.

Funding to provide liquidity may not be available to us on favorable terms or at all.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. The liquidity of Southside Bank is necessary to make loans and leases, and to repay deposit liabilities as they become due or are demanded by customers. Liquidity policies and limits are established by our board of directors. Management and our asset liability committee regularly monitor the overall liquidity position of Southside Bank and the Company to ensure that various alternative strategies exist to cover unanticipated events that could affect liquidity. Management and our asset liability committee also establish policies and monitor guidelines to diversify Southside Bank's funding sources to avoid concentrations in excess of board-approved policies from any one market source. Funding sources include federal funds purchased, securities sold under repurchase agreements, noncore deposits, and short- and long-term debt. Southside Bank is also a member of the Federal Home Loan Bank ("FHLB") System, which provides funding through advances to members that are collateralized with U.S. Treasury securities, MBS, CMBS and loans.

We maintain a portfolio of securities that can be used as a secondary source of liquidity. Other sources of liquidity include sales or securitizations of loans, our ability to acquire additional national market, noncore deposits, additional collateralized borrowings such as FHLB advances, the issuance and sale of debt securities and the issuance and sale of preferred or common securities in public or private transactions. Southside Bank also can borrow from the Federal Reserve's discount window.

We have historically had access to a number of alternative sources of liquidity, but if there is an increase in volatility in the credit and liquidity markets similar to 2008, there is no assurance that we will be able to obtain such liquidity on terms that are favorable to us, or at all. The cost of out-of-market deposits may exceed the cost of deposits of similar maturity in our local market area, making such deposits unattractive sources of funding; financial institutions may be unwilling to extend credit to banks because of concerns about the banking industry and the economy generally and there may not be a viable market for raising equity capital.

If we were unable to access any of these funding sources when needed, we might be unable to meet customers' needs, which could adversely impact our financial condition, results of operations, cash flows and liquidity, and level of regulatory-qualifying capital.

Acquisitions and potential acquisitions may disrupt our business and dilute shareholder value.

We occasionally evaluate merger and acquisition opportunities and conduct due diligence activities related to possible transactions with other financial institutions and financial services companies. As a result, merger or acquisition discussions and, in some cases, negotiations may take place and future mergers or acquisitions involving cash, debt or equity securities may occur at any time. Acquisitions typically involve the payment of a premium over book and fair values, and, therefore, some dilution of our tangible book value and net income per common share may occur in connection with any future transaction. Furthermore, failure to realize expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits and synergies from an acquisition could have a material adverse effect on our financial condition and results of operations.

The value of our goodwill and other intangible assets may decline in the future.

As of December 31, 2016, we had $96.1 million of goodwill and other intangible assets. A significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates or a significant and sustained decline in the price of our common stock may necessitate taking charges in the future related to the impairment of our goodwill and other intangible assets. If we were to conclude that a future write-down of goodwill and other intangible assets is necessary, we would record the appropriate charge, which could have a material adverse effect on our business, financial condition and results of operations.

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

The process we use to estimate our probable loan losses and to measure the fair value of our financial instruments, as well as the processes used to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, depend upon the use of analytical and forecasting models. These models reflect assumptions that may not be accurate, particularly in times of market stress or other unforeseen circumstances. Even if these assumptions are adequate, the models may prove to be inadequate or inaccurate because of other flaws in their design or their implementation. If the models we use for interest rate risk and asset-liability management are inadequate, we may incur increased or unexpected losses upon changes in market interest rates or other market measures. If the methodology we use for determining our probable loan losses are inadequate, our allowance for loan losses may not be sufficient to support future charge-offs. If the models we use to measure the fair value of financial instruments are inadequate, the fair value of such financial instruments may fluctuate unexpectedly or may not accurately reflect what we could realize upon sale or settlement of such financial instruments. Any such failure in our analytical or forecasting models could have a material adverse effect on our business, financial condition and results of operations.

We may not be able to attract and retain skilled personnel.

Our success depends, in large part, on our ability to attract and retain key personnel. Competition for the best personnel in most activities we engage in can be intense, and we may not be able to hire personnel or to retain them. The unexpected loss of services of one or more of our key personnel could have a material adverse impact on our business because of their skills, knowledge of our market, relationships in the communities we serve, years of industry experience and the difficulty of promptly finding qualified replacement personnel. Although we have employment agreements with certain of our executive officers, there is no guarantee that these officers and other key personnel will remain employed with the Company.

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

We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that we can prevent any such failures, interruptions, cyber security breaches or other security breaches or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

We continually encounter technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers and even if we implement such products and services, we may incur substantial costs in doing so. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business, financial condition and results of operations.

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

Severe weather, natural disasters, climate change, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. For example, because of our location and the location of the market areas we serve, severe weather is more likely than in other areas of the country. Although management has established disaster recovery policies and procedures, there can be no assurance of the effectiveness of such policies and procedures, and the occurrence of any such event could have a material adverse effect on our business, financial condition and results of operations.

RISKS ASSOCIATED WITH THE BANKING INDUSTRY

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

Southside Bancshares, Inc., primarily through Southside Bank, and certain of its nonbank subsidiaries, is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect our lending practices, capital structure, investment practices and dividend policy and growth, among other things. The statutory and regulatory framework under which we operate has changed substantially as the result of the enactment of the Dodd-Frank Act. The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial services industry, addressing, among other things, systemic risk, capital adequacy, deposit insurance assessments, consumer financial protection, as implemented through the Bureau, interchange fees, derivatives, lending limits, mortgage lending practices, registration of investment advisors and changes among bank regulatory authorities. In addition, Congress and federal and state regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit deposit fees and other types of fees we charge, limit the types of financial services and products we may offer and/or increase the ability of nonbanks to offer competing financial services and products, among other things. While we cannot predict the impact of regulatory changes that may arise out of the current financial and economic environment, any regulatory changes or increased regulatory scrutiny could increase costs directly related to complying with new regulatory requirements. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputational damage, which could have a material adverse effect on our business, financial condition and results of operations. While our policies and procedures are designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned "Supervision and Regulation" in "Item 1. Business" and "Note 14 – Shareholders' Equity" to our consolidated financial statements included in this report.

We may become subject to increased regulatory capital requirements.

The capital requirements applicable to Southside Bancshares, Inc. and Southside Bank are subject to change as a result of the Dodd-Frank Act, the international regulatory capital initiative known as Basel III and any other future government actions. In particular, the Dodd-Frank Act eliminates Tier 1 capital treatment for most trust preferred securities after a three-year phase-in period that began January 1, 2013 for institutions that exceed $15 billion in assets. Furthermore, each of the federal banking agencies, including the Federal Reserve and the FDIC, has issued substantially similar risk-based and leverage capital guidelines applicable to the banking organizations they supervise. As a result of new regulations, we were required to begin complying with higher minimum capital requirements as of January 1, 2015. The Updated Capital Rules implement certain provisions of the Dodd-Frank Act and Basel III. These Updated Capital Rules also make important changes to the prompt corrective action framework. For additional discussion relating to capital adequacy refer to "Item 1. Business - Supervision and Regulation - Capital Adequacy" in this report. The Company believes it will continue to meet the new capital guidelines, however complying with any higher Updated Capital Rules mandated by the Dodd-Frank Act or Basel III may affect our operations, including our asset portfolios and financial performance.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties and inaccuracies in such information, including as a result of fraud, could adversely impact our business, financial condition and results of operations.

In deciding whether to extend credit or enter into other transactions with third parties, we rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors or property appraisers, as to the accuracy and completeness of that information. Such information could turn out to be inaccurate, including as a result of fraud on behalf of our customers, counterparties or other third parties. In times of increased economic stress we are at increased risk of fraud losses. We cannot assure you that our underwriting and operational controls will prevent or detect such fraud or that we will not experience fraud losses or incur costs or other damages related to such fraud. Our customers may also experience fraud in their businesses which could adversely affect their ability to repay their loans or make use of our services. Our exposure and the exposure of our customers to fraud may increase our financial risk and reputation risk as it may result in unexpected loan losses that exceed those that have been provided for in our allowance for loan losses. Reliance on inaccurate or misleading information from our customers, counterparties and other third parties, including as a result of fraud, could have a material adverse impact on our business, financial condition and results of operations.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices insufficient to recover the full amount of the loan or derivative exposure due to us. There is no assurance that any such losses would not materially and adversely affect our results of operations or earnings.

We are subject to claims and litigation pertaining to fiduciary responsibility.

From time to time, customers make claims and take legal action pertaining to our performance of our fiduciary responsibilities. Whether customer claims and legal actions related to our performance of our fiduciary responsibilities are merited, defending claims is costly and diverts management's attention, and if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect our market perception and products and services as well as impact customer demand for those products and services. Any financial liability or reputational damage resulting from claims and legal actions could have a material adverse effect on our business, financial condition and results of operations.

RISKS ASSOCIATED WITH OUR COMMON STOCK

Our stock price can be volatile.

Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price can fluctuate significantly in response to a variety of factors including, among other things:

- actual or anticipated variations in our results of operations, financial conditions or asset quality;
- recommendations by securities analysts;
- operating and stock price performance of other companies that investors deem comparable to us;
- news reports relating to trends, concerns and other issues in the financial services industry;
- perceptions in the marketplace regarding us and/or our competitors;
- perceptions in the marketplace regarding the impact of the change in price per barrel of crude oil on the Texas economy;
- new technology used, or services offered, by competitors;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving us or our competitors;
- failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- future issuances of our common stock or other securities;
- additions or departures of key personnel;
- changes in government regulations; and
- geopolitical conditions such as acts or threats of terrorism or military conflicts.

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results.

The trading volume in our common stock is less than that of other larger financial services companies.

Although our common stock is listed for trading on the NASDAQ Global Select Market, the trading volume for our common stock is low relative to other larger financial services companies, and you are not assured liquidity with respect to transactions in our common stock. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of our common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

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

On September 19, 2016, we issued $100 million of 5.50% fixed to floating subordinated notes, which mature in September 2026. On September 4, 2003, we issued $20.6 million of floating rate junior subordinated debentures in connection with a $20.0 million trust preferred securities issuance by our subsidiary, Southside Statutory Trust III. These junior subordinated debentures mature in September 2033. On August 8 and 10, 2007, we issued $23.2 million and $12.9 million, respectively, of fixed to floating rate junior subordinated debentures in connection with $22.5 million and $12.5 million, respectively, trust preferred securities issuances by our subsidiaries Southside Statutory Trust IV and V, respectively. Trust IV matures October 2037 and Trust V matures September 2037. As part of the acquisition of Fort Worth Bancshares, Inc. on October 10, 2007, we assumed $3.6 million of floating rate junior subordinated debentures issued to Magnolia Trust Company I in connection with $3.5 million of trust preferred securities issued in 2005 that matures in 2035.

We conditionally guarantee payments of the principal and interest on the trust preferred securities. Our subordinated notes and the junior subordinated debentures are senior to our shares of common stock. We must make payments on the junior subordinated debentures (and the related trust preferred securities) before any dividends can be paid on our common stock and, in the event of bankruptcy, dissolution or liquidation, the holders of the debentures must be satisfied before any distributions can be made to the holders of common stock. We have the right to defer distributions on our debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid to holders of common stock.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this "Risk Factors" section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire our common stock, you may lose some or all of your investment.

Provisions of our certificate of formation and bylaws, as well as state and federal banking regulations, could delay or prevent a takeover of us by a third party.

Our certificate of formation and bylaws could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include, among others, requiring advance notice for raising business matters or nominating directors at shareholders' meetings and staggered board elections.

Any individual, acting alone or with other individuals, who are seeking to acquire, directly or indirectly, 10.0% or more of our outstanding common stock must comply with the Change in Bank Control Act, which requires prior notice to the Federal Reserve for any acquisition. Additionally, any entity that wants to acquire 5.0% or more of our outstanding common stock, or otherwise control us, may need to obtain the prior approval of the Federal Reserve under the BHCA of 1956, as amended. As a result, prospective investors in our common stock need to be aware of and comply with those requirements, to the extent applicable. These provisions may discourage potential acquisition proposals and could delay or prevent a change in control, including under circumstances in which our shareholders might otherwise receive a premium over the market price of our share.

We may issue additional securities, which could dilute your ownership percentage.

In certain situations, our board of directors has the authority, without any vote of our shareholders, to issue shares of our authorized but unissued stock. In the future, we may issue additional securities, through public or private offerings, to raise additional capital or finance acquisitions. Any such issuance would dilute the ownership of current holders of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

The primary executive offices of Southside are located at 1201 South Beckham Avenue, Tyler, Texas 75701. Southside owns four buildings at this site which houses a banking center, executive offices, back office support areas, and trust services. Additional executive offices are located at 1320 South University Drive, Fort Worth, Texas 76107 in the University Center II professional office building owned by Southside. University Center II is a 10-story building in which Southside occupies one floor and space on two additional floors. As of December 31, 2016, Southside operated 60 banking centers including traditional full service branches, full service branches within grocery stores, motor banks, trust services, and/or loan production or other financial services offices. These banking centers are located in the state of Texas in the Dallas/Fort Worth, East Texas, and Austin regions. Of the 60 banking centers, 37 were owned and 23 were leased. Southside also owns 70 ATM's located throughout our market area and a technology center located in Tyler, Texas.

ITEM 3. LEGAL PROCEEDINGS

We are party to legal proceedings arising in the normal conduct of business. Management believes that such litigation is not material to our financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

MARKET INFORMATION

Our common stock trades on the NASDAQ Global Select Market under the symbol "SBSI." Set forth below are the high and low sales prices on the NASDAQ Global Select Market for each full quarterly period from January 1, 2015 to December 31, 2016. During 2016 and 2015, we declared and paid a 5% stock dividend. Stock prices listed below have been adjusted to give retroactive recognition to such stock dividends.

	2016		2015	
Sales Price Per Share	High	Low	High	Low
First quarter	$ 25.47	$ 18.67	$ 27.66	$ 23.50
Second quarter	31.28	23.62	28.34	24.94
Third quarter	33.17	30.25	28.30	23.25
Fourth quarter	38.51	31.54	27.52	22.88

See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources" for a discussion of our common stock repurchase program.

SHAREHOLDERS

There were approximately 1,500 holders of record of our common stock, the only class of equity securities currently issued and outstanding, as of February 20, 2017.

DIVIDENDS

Cash dividends declared and paid were $1.01 and $1.00 per share for the years ended December 31, 2016 and 2015, respectively. Stock dividends of 5% were also declared and paid during both of the years ended December 31, 2016 and 2015. We have paid a cash dividend at least once every year since 1970 (including dividends paid by Southside Bank prior to the incorporation of Southside Bancshares). Future dividends will depend on our earnings, financial condition and other factors that our board of directors considers to be relevant. In addition, we must make payments on our junior subordinated debentures before any dividends can be paid on the common stock. For additional discussion relating to restrictions that limit our ability to pay dividends refer to "Item 1. Business – Supervision and Regulation" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources." The cash dividends were paid quarterly each year as listed below.

Cash Dividends Per Share	2016	2015
First quarter	$ 0.23	$ 0.23
Second quarter	0.24	0.23
Third quarter	0.24	0.23
Fourth quarter	0.30	0.31
Total	$ 1.01	$ 1.00

ISSUER SECURITY REPURCHASES

On January 28, 2016, our board of directors approved a common stock repurchase plan. The board authorized the repurchase, from time to time, of up to five percent of the issued and outstanding common stock, or approximately 1.27 million shares, in open market purchases and privately negotiated transactions at prevailing market prices. During the year ended December 31, 2016, we purchased 443,426 shares of common stock at an average price of $23.00 pursuant to the 2016 Common Stock Repurchase Plan. We did not purchase any of our common stock during the quarter ended December 31, 2016.

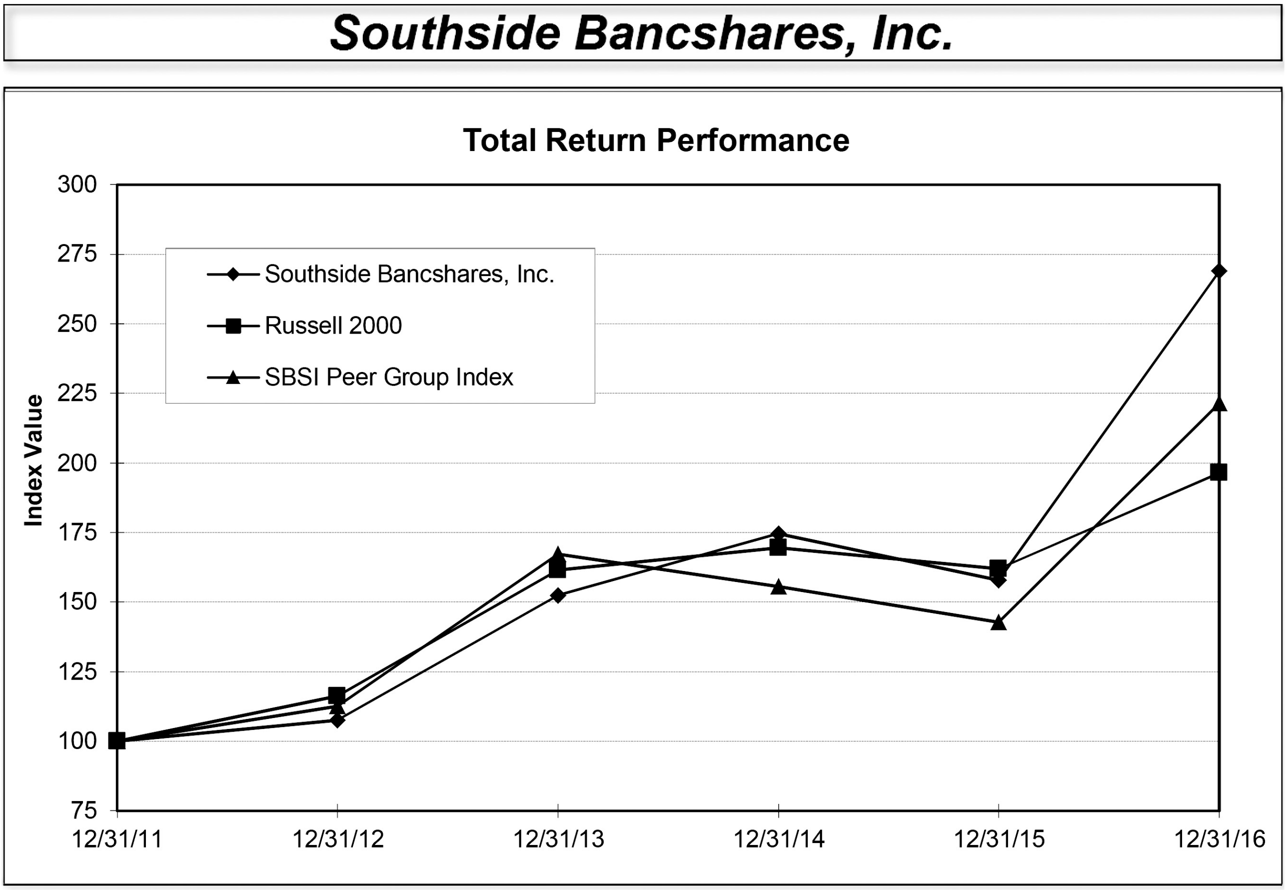
Our board continually evaluates the Company's needs and those of Southside Bank and may, at their discretion, initiate, modify or discontinue an authorized repurchase plan. In December 2016, the board discontinued the 2016 Common Stock Repurchase Plan.

RECENT SALES OF UNREGISTERED SECURITIES

There were no equity securities sold by us during the years ended December 31, 2016, 2015, or 2014 that were not registered under the Securities Act of 1933.

FINANCIAL PERFORMANCE

The following performance graph does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Company filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates the performance graph by reference therein.



	Period Ending					
Index	**12/31/11**	**12/31/12**	**12/31/13**	**12/31/14**	**12/31/15**	**12/31/16**
Southside Bancshares, Inc.	100.00	107.55	152.25	174.56	157.82	268.87
Russell 2000	100.00	116.35	161.52	169.43	161.95	196.45
SBSI Peer Group Index*	100.00	112.56	167.18	155.50	142.77	221.43

**Peer group index includes Cullen/Frost Bankers, Inc.(CFR), First Financial Bankshares, Inc.(FFIN), International Bancshares Corporation (IBOC), Prosperity Bancshares, Inc. (PB), Texas Capital Bancshares, Inc. (TCBI).*

Source : SNL Financial, an offering of S&P Global Market Intelligence

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial data regarding our results of operations and financial position for, and as of the end of, each of the fiscal years in the five-year period ended December 31, 2016. This information should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8. Financial Statements and Supplementary Data," as set forth in this report.

	As of and for the Years Ended December 31,				
	2016	2015	2014 (1)	2013	2012
	(in thousands, except per share data)				
Balance Sheet Data:					
Securities available for sale, at estimated fair value	$ 1,479,600	$ 1,460,492	$ 1,448,708	$ 1,177,687	$ 1,424,067
Securities held to maturity, at carrying value	$ 937,487	$ 784,296	$ 642,319	$ 667,121	$ 246,547
Loans, net of allowance for loan losses	$ 2,538,626	$ 2,412,017	$ 2,167,841	$ 1,332,396	$ 1,242,392
Total assets	$ 5,563,767	$ 5,161,996	$ 4,807,176	$ 3,445,574	$ 3,237,309
Deposits	$ 3,533,076	$ 3,455,407	$ 3,374,417	$ 2,527,808	$ 2,351,897
Long-term obligations	$ 601,464	$ 562,512	$ 660,278	$ 559,571	$ 429,314
Shareholders' equity	$ 518,274	$ 444,062	$ 425,243	$ 259,518	$ 257,763
Income Statement Data:					
Interest income	$ 168,913	$ 154,532	$ 123,778	$ 119,602	$ 116,020
Interest expense	$ 29,348	$ 19,854	$ 16,956	$ 17,968	$ 26,895
Provision for loan losses	$ 9,780	$ 8,343	$ 14,938	$ 8,879	$ 10,736
Deposit service income	$ 20,702	$ 20,112	$ 15,280	$ 15,560	$ 15,433
Net gain on sale of securities available for sale	$ 2,836	$ 3,660	$ 2,830	$ 8,472	$ 17,966
Noninterest income	$ 39,411	$ 37,895	$ 24,489	$ 35,245	$ 40,021
Noninterest expense	$ 109,522	$ 112,954	$ 97,704	$ 81,713	$ 76,107
Net income	$ 49,349	$ 43,997	$ 20,833	$ 41,190	$ 34,695
Per Share Data:					
Earnings per common share:					
Basic	$ 1.86	$ 1.65	$ 0.99	$ 1.99	$ 1.65
Diluted	$ 1.86	$ 1.65	$ 0.99	$ 1.99	$ 1.65
Cash dividends paid per common share	$ 1.01	$ 1.00	$ 0.96	$ 0.91	$ 1.11
Book value per common share	$ 18.16	$ 16.66	$ 16.00	$ 12.51	$ 12.43

(1) We completed the acquisition of Omni on December 17, 2014. Accordingly, our balance sheet data as of December 31, 2014 reflects the effects of the acquisition of Omni. Income statement data with respect to Omni includes only the results of Omni's operations for December 17 - December 31, 2014.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides a comparison of our results of operations for the years ended December 31, 2016, 2015, and 2014 and financial condition as of December 31, 2016 and 2015. This discussion should be read in conjunction with the financial statements and related notes included elsewhere in this report. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements of other than historical fact that are contained in this document and in written material, press releases and oral statements issued by or on behalf of Southside Bancshares, Inc., a bank holding company, may be considered to be "forward-looking statements" within the meaning of and subject to the protections of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date. These statements may include words such as "expect," "estimate," "project," "anticipate," "appear," "believe," "could," "should," "may," "might," "will," "would," "seek," "intend," "probability," "risk," "goal," "target," "objective," "plans," "potential," and similar expressions. Forward-looking statements are statements with respect to our beliefs, plans, expectations, objectives, goals, anticipations, assumptions, estimates, intentions and future performance, and are subject to significant known and unknown risks and uncertainties, which could cause our actual results to differ materially from the results discussed in the forward-looking statements. For example, discussions of the effect of our expansion, trends in asset quality and earnings from growth, and certain market risk disclosures are based upon information presently available to management and are dependent on choices about key model characteristics and assumptions and are subject to various limitations. See "Item 1. Business" and this "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." By their nature, certain of the market risk disclosures are only estimates and could be materially different from what actually occurs in the future. As a result, actual income gains and losses could materially differ from those that have been estimated. Other factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to, the following:

- general economic conditions, either globally, nationally, in the State of Texas, or in the specific markets in which we operate, including, without limitation, the deterioration of the commercial real estate, residential real estate, construction and development, energy, oil and gas, credit and liquidity markets, which could cause an adverse change in our net interest margin, or a decline in the value of our assets, which could result in realized losses;
- current or future legislation, regulatory changes or changes in monetary or fiscal policy that adversely affect the businesses in which we are engaged, including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the Federal Reserve's actions with respect to interest rates, the capital requirements promulgated by the Basel Committee on Banking Supervision ("Basel Committee") and other regulatory responses to current economic conditions;
- adverse changes in the status or financial condition of the Government-Sponsored Enterprises (the "GSEs") impacting the GSEs' guarantees or ability to pay or issue debt;
- adverse changes in the credit portfolio of other U.S. financial institutions relative to the performance of certain of our investment securities;
- economic or other disruptions caused by acts of terrorism in the United States, Europe or other areas;
- changes in the interest rate yield curve such as flat, inverted or steep yield curves, or changes in the interest rate environment that impact interest margins and may impact prepayments on the mortgage-backed securities ("MBS") portfolio;
- increases in our nonperforming assets;
- our ability to maintain adequate liquidity to fund operations and growth;
- the failure of our assumptions underlying allowance for loan losses and other estimates;
- the effectiveness of our derivative financial instruments and hedging activities to manage risk;
- unexpected outcomes of, and the costs associated with, existing or new litigation involving us;
- changes impacting our balance sheet and leverage strategy;
- risks related to actual U.S. agency MBS prepayments exceeding projected prepayment levels;
- risks related to U.S. agency MBS prepayments increasing due to U.S. Government programs designed to assist homeowners to refinance their mortgage that might not otherwise have qualified;

- our ability to monitor interest rate risk;
- risks related to the price per barrel of crude oil;
- significant increases in competition in the banking and financial services industry;
- changes in consumer spending, borrowing and saving habits;
- technological changes, including potential cyber-security incidents;
- execution of future acquisition, reorganization or disposition transactions, including the risk that the anticipated benefits of such transactions are not realized;
- our ability to increase market share and control expenses;
- the effect of changes in federal or state tax laws;
- the effect of compliance with legislation or regulatory changes;
- the effect of changes in accounting policies and practices;
- credit risks of borrowers, including any increase in those risks due to changing economic conditions;
- the inability of Southside Bank to pay dividends; and
- risks related to loans secured by real estate, including the risk that the value and marketability of collateral could decline.

All written or oral forward-looking statements made by us or attributable to us are expressly qualified by this cautionary notice. We disclaim any obligation to update any factors or to announce publicly the result of revisions to any of the forward-looking statements included herein to reflect future events or developments, unless otherwise required by law.

CRITICAL ACCOUNTING ESTIMATES

Our accounting and reporting estimates conform with U.S. generally accepted accounting principles ("GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. We consider our critical accounting policies to include the following:

Allowance for Losses on Loans. The allowance for losses on loans represents our best estimate of probable losses inherent in the existing loan portfolio. The allowance for losses on loans is increased by the provision for losses on loans charged to expense and reduced by loans charged-off, net of recoveries. The provision for losses on loans is determined based on our assessment of several factors: reviews and evaluations of specific loans, changes in the nature and volume of the loan portfolio, current economic conditions and the related impact on specific borrowers and industry groups, historical loan loss experience, the level of classified and nonperforming loans and the results of regulatory examinations.

The allowance for loan loss is based on the most current review of the loan portfolio and is a result of multiple processes. The servicing officer has the primary responsibility for updating significant changes in a customer's financial position. Each officer prepares status updates on any credit deemed to be experiencing repayment difficulties which, in the officer's opinion, would place the collection of principal or interest in doubt. Our internal loan review department is responsible for an ongoing review of our loan portfolio with specific goals set for the loans to be reviewed on an annual basis.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If full collection of the loan balance appears unlikely at the time of review, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $150,000 or more is updated on a quarterly basis in order to properly determine the necessary allowance and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

Loans are considered impaired if, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The measurement of loss on impaired loans is generally based on the fair value of expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement, except that all collateral-dependent loans are measured for impairment based on fair value of the collateral. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation.

Changes in the financial condition of individual borrowers, economic conditions, historical loss experience and the conditions of the various markets in which collateral may be sold all may affect the required level of the allowance for losses on loans and the associated provision for loan losses.

The allowance for loan losses related to purchase credit impaired ("PCI") loans is based on an analysis that is performed quarterly to estimate the expected cash flows for each loan deemed PCI. To the extent that the expected cash flows from a PCI loan have decreased since the acquisition date, we establish or increase the allowance for loan losses.

For acquired loans that are not deemed credit impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value. Subsequent to the purchase date, the methods utilized to estimate the required allowance for loan losses for these loan is similar to originated loans. The remaining differences between the purchase price and the unpaid principal balance at the date of acquisition are recorded in interest income over the economic life of the loan.

As of December 31, 2016, our review of the loan portfolio indicated that a loan loss allowance of $17.9 million was appropriate to cover probable losses in the portfolio.

Refer to "Part II - Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Loan Loss Experience and Allowance for Loan Losses" and "Note 6 – Loans and Allowance for Probable Loan Losses" to our consolidated financial statements included in this report for a detailed description of our estimation process and methodology related to the allowance for loan losses.

Estimation of Fair Value. The estimation of fair value is significant to a number of our assets and liabilities. In addition, GAAP requires disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values for securities are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of yield curves. Fair values for most investment securities and MBS are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or estimates from independent pricing services. Where there are price variances outside certain ranges from different pricing services for specific securities, those pricing variances are reviewed with other market data to determine which of the price estimates is appropriate for that period.

Impairment of Investment Securities and Mortgage-backed Securities. Investment securities and MBS classified as available for sale ("AFS") are carried at fair value and the impact of changes in fair value are recorded on our consolidated balance sheet as an unrealized gain or loss in "Accumulated other comprehensive (loss) income," a separate component of shareholders' equity. Securities classified as AFS or held to maturity ("HTM") are subject to our review to identify when a decline in value is other-than-temporary. When it is determined that a decline in value is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and to other comprehensive income for the noncredit portion unless there is no ability or intent to hold to recovery. Factors considered in determining whether a decline in value is other-than-temporary include : (1) whether the decline is substantial, the duration of the decline and the reasons for the decline in value; (2) whether the decline is related to a credit event, a change in interest rate or a change in the market discount rate; (3) the financial condition and near-term prospects of the issuer; and (4) whether we have a current intent to sell the security and whether it is not more likely than not that we will be required to sell the security before the anticipated recovery of its amortized cost basis. For certain assets, we consider expected cash flows of the investment in determining if impairment exists.

Defined Benefit Pension Plan. The plan obligations and related assets of our defined benefit pension plan (the "Plan") and the OmniAmerican Bank Defined Benefit Plan (the "Acquired Plan") are presented in "Note 11 - Employee Benefits" to our consolidated financial statements included in this report. Effective December 31, 2005, entry into the Plan by new employees was frozen. Effective December 31, 2006, employee benefits under the Acquired Plan were frozen. In addition, no new participants may be added to the Acquired Plan. Assets in both plans, consist primarily of marketable equity and debt instruments, and are valued using observable market quotations. Obligations and annual pension expense of both plans are determined by independent actuaries and through the use of a number of assumptions that are reviewed by management. Key assumptions in measuring the obligations of both plans include the discount rate and the estimated future return on the assets in both plans. The rate of salary increases is another key assumption used in measuring the Plan obligation. The rate of salary increases is not required to measure the obligations of the Acquired Plan since the benefits are frozen.

In determining the discount rate, we utilized a cash flow matching analysis to determine a range of appropriate discount rates for our defined benefit pension and restoration plans. In developing the cash flow matching analysis, we had our actuaries construct a portfolio of high quality noncallable bonds to match as closely as possible the timing of future benefit payments of the plans at December 31, 2016. We utilized a bond selection-settlement approach that selects a portfolio of bonds from a universe of high quality corporate bonds rated Aa by at least half of the rating agencies available. Based on this cash flow matching analysis, we were able to determine an appropriate discount rate.

The expected long-term rate of return assumption reflects the average return expected based on the investment strategies and asset allocation of the assets invested to provide for the liabilities of both plans. We considered broad equity and bond indices, long-term return projections, and actual long-term historical performance when evaluating the expected long-term rate of return assumption. Salary increase assumptions for the Plan are based upon historical experience and anticipated future management actions. Material changes in pension benefit costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the number of participants in the plans, changes in the level of benefits provided, changes in the discount rates, changes in the expected long-term rate of return, changes in the level of contributions to the plans and other factors.

NON-GAAP FINANCIAL MEASURES

Certain non-GAAP measures are used by management to supplement the evaluation of our performance. These include the following fully-taxable equivalent measures: tax-equivalent net interest income, tax-equivalent net interest margin, and tax-equivalent net interest spread, which include the effects of taxable-equivalent adjustments using a federal income tax rate of 35% to increase tax-exempt interest income to a tax-equivalent basis. Whenever we present a non-GAAP financial measure in an SEC filing, we are also required to present the most directly comparable financial measure calculated and presented in accordance with GAAP and reconcile the differences between the non-GAAP financial measure and such comparable GAAP measure. Tax-equivalent adjustments are reported in notes 2 and 3 to the Average Balances with Average Yields and Rates tables under Results of Operations.

Tax-equivalent net interest income, net interest margin and net interest spread. Net interest income on a tax-equivalent basis is a non-GAAP measure that adjusts for the tax-favored status of net interest income from loans and investments. We believe this measure to be the preferred industry measurement of net interest income and it enhances comparability of net interest income arising from taxable and tax-exempt sources. The most directly comparable financial measure calculated in accordance with GAAP is our net interest income. Net interest margin on a tax-equivalent basis is net interest income on a tax-equivalent basis divided by average interest-earning assets on a tax-equivalent basis. The most directly comparable financial measure calculated in accordance with GAAP is our net interest margin. Net interest spread on a tax-equivalent basis is the difference in the average yield on average interest-earning assets on a tax equivalent basis and the average rate paid on average interest-bearing liabilities. The most directly comparable financial measure calculated in accordance with GAAP is our net interest spread.

These non-GAAP financial measures should not be considered an alternative to GAAP-basis financial statements, and other bank holding companies may define or calculate these or similar measures differently.

OVERVIEW

OPERATING RESULTS

During the year ended December 31, 2016, our net income increased $5.4 million, or 12.2%, to $49.3 million, from $44.0 million for the same period in 2015. The increase was primarily the result of a $14.4 million increase in interest income, a $3.4 million decrease in noninterest expense, and a $1.5 million increase in noninterest income, partially offset by a $9.5 million increase in interest expense, a $3.0 million increase in income tax expense and a $1.4 million increase in provision for loan losses. Noninterest expense decreased primarily due to cost containment efforts and cost synergies as Omni was fully integrated in 2016. Earnings per diluted share increased $0.21, or 12.7%, to $1.86 for the year ended December 31, 2016, from $1.65 for the same period in 2015.

During the year ended December 31, 2015, our net income increased $23.2 million, or 111.2%, to $44.0 million, from $20.8 million for the same period in 2014. The increase in net income was primarily attributable to an increase in net interest income of $27.9 million and an increase in noninterest income of $13.4 million, combined with a decrease in the provision for loan losses. These items were partially offset by an increase in noninterest expense and income tax expense. Noninterest expense increased primarily due to expenses associated with the acquisition of Omni which are reflected primarily in salaries and employee benefits as well as occupancy expense. Earnings per diluted share increased to $1.65 for the year ended December 31, 2015, from $0.99 for the same period in 2014.

FINANCIAL CONDITION

Our total assets increased $401.8 million, or 7.8%, to $5.56 billion at December 31, 2016 from $5.16 billion at December 31, 2015 primarily as a result of the increase in our loans and investment and mortgage-backed securities ("MBS") portfolio. Loans increased $124.8 million, or 5.1%, to $2.56 billion compared to $2.43 billion at December 31, 2015. The net increase in our loans was comprised of increases of $310.8 million of commercial real estate loans and $10.5 million of municipal loans, which were partially offset by decreases of $65.3 million of commercial loans, $58.1 million of construction loans, $54.9 million of loans to individuals, and $18.2 million of 1-4 family residential loans. Our securities portfolio increased by $172.3 million, or 7.7%, to $2.42 billion compared to $2.24 billion at December 31, 2015. The increase in our securities was comprised of approximately $141.5 million of investment securities, comprised primarily of U.S. Treasury and Texas municipal securities, and to a lesser extent an increase of $30.8 million of MBS. Cash and cash equivalents increased $88.7 million, or 109.5%, to $169.7 million, compared to $81.0 million at December 31, 2015, primarily as a result of the proceeds from the subordinated debt offering during September 2016. The increase in loans and securities was funded primarily by FHLB advances, deposits, and proceeds from the issuance of the subordinated debt during September 2016.

Our nonperforming assets at December 31, 2016 decreased to $15.1 million, and represented 0.27% of total assets, compared to $32.5 million, or 0.63% of total assets at December 31, 2015. Nonaccruing loans decreased $12.2 million to $8.3 million and the ratio of nonaccruing loans to total loans decreased to 0.32% at December 31, 2016 compared to 0.84% at December 31, 2015. Restructured loans at December 31, 2016 decreased to $6.4 million compared to $11.1 million at December 31, 2015. Other Real Estate Owned ("OREO") decreased to $339,000 at December 31, 2016 from $744,000 at December 31, 2015. Repossessed assets decreased to $49,000 at December 31, 2016 from $64,000 at December 31, 2015.

Our deposits increased $77.7 million to $3.53 billion at December 31, 2016 from $3.46 billion at December 31, 2015. The increase in our deposits during 2016 was primarily the result of an increase in public fund deposits. During 2016, our non-interest bearing deposits increased $31.5 million, and interest bearing deposits increased $46.1 million. Our public fund deposits increased $76.8 million and our brokered deposits decreased $49.8 million during 2016. Total FHLB advances increased $162.0 million to $1.31 billion at December 31, 2016, from $1.15 billion at December 31, 2015. Short-term FHLB advances increased $221.1 million to $866.5 million at December 31, 2016 from $645.4 million at December 31, 2015. Long-term FHLB advances decreased $59.2 million to $443.1 million at December 31, 2016 from $502.3 million at December 31, 2015. On September 19, 2016, the Company issued $100.0 million aggregate principal amount of fixed-to-floating rate subordinated notes. The unamortized discount and debt issuance costs deducted from the subordinated notes issued totaled approximately $1.9 million at December 31, 2016. Other borrowings at December 31, 2016 and 2015 totaled $67.3 million and $62.7 million, respectively, and at December 31, 2016 consisted of $7.1 million of short-term borrowings and $60.2 million of long-term debt compared to $2.4 million of short-term borrowings and $60.2 million of long-term debt at December 31, 2015.

Assets under management in our trust department increased 15.54%, during 2016 and were approximately $1.01 billion at December 31, 2016 compared to $878.3 million at December 31, 2015.

Shareholders' equity at December 31, 2016 totaled $518.3 million compared to $444.1 million at December 31, 2015. The increase is primarily comprised of $76.0 million in net proceeds from the issuance of 2,185,000 shares of common stock, net income of $49.3 million recorded for the year ended December 31, 2016, net issuance of common stock under employee stock plans of $1.6 million, stock compensation expense of $1.5 million, and $1.4 million of common stock issued under our dividend reinvestment plan. These increases were partially offset by cash dividends paid of $26.0 million, an increase in accumulated other comprehensive loss of $19.8 million, and the repurchase of $10.2 million of our common stock. The increase in accumulated other comprehensive loss is comprised primarily of an increase of $23.5 million, net of tax, in the unrealized loss on securities, net of reclassification adjustments, partially offset by an increase of $4.6 million, net of tax in the unrealized gain on effective cash flow hedge interest rate swap derivatives and the reclassification adjustments included in net income, and a decrease of $936,000, net of tax, related to the change in the funded status of our defined benefit plan. See "Note 4 – Accumulated Other Comprehensive Loss" to our consolidated financial statements included in this report.

Economic conditions in our market areas have continued to perform generally better than many other parts of the country. There continues to be some economic headwinds including a decline in oil prices, however despite these headwinds, many economists predict the national economy and the economy in markets we serve will continue to grow at a slow to modest pace in 2017.

Key financial indicators management follows include, but are not limited to, numerous interest rate sensitivity and interest rate risk indicators, credit risk, operations risk, liquidity risk, capital risk, regulatory risk, competition risk, yield curve risk, U.S. Agency MBS prepayment risk, and economic risk indicators.

BALANCE SHEET STRATEGY

We utilize wholesale funding and securities to enhance our profitability and balance sheet composition by determining acceptable levels of credit, interest rate and liquidity risk consistent with prudent capital management. This balance sheet strategy consists of borrowing a combination of long- and short-term funds from the FHLB and, when determined appropriate, issuing brokered CDs. These funds are invested primarily in U.S. Agency MBS, and to a lesser extent, long-term municipal securities and U.S. Treasury securities. Although U.S. Agency MBS often carry lower yields than traditional mortgage loans and other types of loans we make, these securities generally (i) increase the overall quality of our assets because of either the implicit or explicit guarantees of the U.S. Government, (ii) are more liquid than individual loans and (iii) may be used to collateralize our borrowings or other obligations. While the strategy of investing a substantial portion of our assets in U.S. Agency MBS and municipal securities has historically resulted in lower interest rate spreads and margins, we believe the lower operating expenses and reduced credit risk, combined with the managed interest rate risk of this strategy, have enhanced our overall profitability over the last several years. At this time, we utilize this balance sheet strategy with the goal of enhancing overall profitability by maximizing the use of our capital.

Risks associated with the asset structure we maintain include a lower net interest rate spread and margin when compared to our peers, changes in the slope of the yield curve, which can reduce our net interest rate spread and margin, increased interest rate risk, the length of interest rate cycles, changes in volatility spreads associated with the MBS and municipal securities, the unpredictable nature of MBS prepayments and credit risks associated with the municipal securities. See "Part I - Item 1A. Risk Factors – Risks Related to Our Business" in this report for a discussion of risks related to interest rates. Our asset structure, net interest spread and net interest margin require us to closely monitor our interest rate risk. An additional risk is the change in fair value of the AFS securities portfolio as a result of changes in interest rates. Significant increases in interest rates, especially long-term interest rates, could adversely impact the fair value of the AFS securities portfolio, which could also significantly impact our equity capital. Due to the unpredictable nature of MBS prepayments, the length of interest rate cycles, and the slope of the interest rate yield curve, net interest income could fluctuate more than simulated under the scenarios modeled by our Asset/Liability Committee ("ALCO") and described under "Item 7A. Quantitative and Qualitative Disclosures about Market Risk" in this report.

Determining the appropriate size of the balance sheet is one of the critical decisions any bank makes. Our balance sheet is not merely the result of a series of micro-decisions, but rather the size is controlled based on the economics of assets compared to the economics of funding. The current low interest rate environment and investment and economic landscape requires that we monitor the interest rate sensitivity of the assets driving our growth and closely align ALCO objectives accordingly.

The management of our securities portfolio as a percentage of earning assets is guided by the current economics associated with increasing the securities portfolio, changes in our overall loan and deposit levels, and changes in our wholesale funding levels. If adequate quality loan growth is not available to achieve our goal of enhancing profitability by maximizing the use of capital, as described above, then we may purchase additional securities, if appropriate, which may cause securities as a percentage of earning assets to increase. Should we determine that increasing the securities portfolio or replacing the current securities maturities and principal payments is not an efficient use of capital, we may decrease the level of securities through proceeds from maturities, principal payments on MBS or sales. Our balance sheet strategy is designed such that our securities portfolio should help mitigate financial performance associated with potential business cycles that include slower loan growth and higher credit costs.

During the year ended December 31, 2016, we primarily sold U.S. Agency collateralized mortgage obligations ("CMO") along with some U.S. Agency mortgage pass-throughs, U.S. Agency commercial mortgage-backed securities ("CMBS"), Texas municipal securities and U.S. Treasury securities that resulted in an overall gain on the sale of AFS securities of $2.8 million. As long-term interest rates declined significantly during the first half of the year, we elected to marginally reduce the duration of the securities portfolio by selling U.S. Treasury securities and selected lower yielding long-term CMBS. During the third quarter, long-term interest rates fluctuated and we elected to take some gains by selling selected lower yielding long-term CMBS, lower yielding MBS and low balance, short duration MBS. The CMOs we sold during the year had a poor risk reward due to ongoing prepayment concerns as a result of the lower long term interest rate environment. During the fourth quarter we sold approximately $45 million of our lowest yielding U.S. Treasury securities at a loss of approximately $2.7 million. During the year we primarily purchased premium CMOs with favorable expected returns in relation to risk, U.S. Agency CMBS and Texas municipals.

Our investment securities and U.S. Agency MBS increased from $2.24 billion at December 31, 2015, to $2.42 billion at December 31, 2016. The increase was primarily due to increased Texas municipal securities and U.S. Agency mortgage pass-throughs.

At December 31, 2016, securities as a percentage of assets decreased slightly to 43.4%, compared to 43.5% at December 31, 2015. The size of the securities portfolio increased during the last half of the year to offset the interest expense associated with the sub-debt issued. As we see additional growth in the loan portfolio, the securities portfolio will gradually be reduced. Our balance sheet management strategy is dynamic and will be continually reevaluated as market conditions warrant. As interest rates, yield curves, MBS prepayments, funding costs, security spreads and loan and deposit portfolios change, our determination of the proper types, amount and maturities of securities to own as well as funding needs and funding sources will continue to be reevaluated. Should the economics of purchasing securities decrease, we may allow this part of the balance sheet to shrink through run-off or security sales. However, should the economics become more attractive, we may strategically increase the securities portfolio and the balance sheet.

With respect to liabilities, we continue to utilize a combination of FHLB advances and deposits to achieve our strategy of minimizing cost while achieving overall interest rate risk objectives as well as the liability management objectives of the ALCO. FHLB funding is the primary wholesale funding source we are currently utilizing.

Our FHLB borrowings increased 14.1%, or $162.0 million, to $1.31 billion at December 31, 2016 from $1.15 billion at December 31, 2015, due primarily to the increase in securities. During the year ended December 31, 2016, our long-term FHLB advances decreased $59.2 million, to $443.1 million from $502.3 million at December 31, 2015. In June 2016 we prepaid $63.0 million of FHLB advances with an average rate of 1.43%. This represented some of our higher priced advances maturing through January 2017. We paid prepayment fees of $148,000 associated with prepaying these advances. During the fourth quarter of 2015 and continuing into the first half of 2016, we entered into various variable rate advance agreements with the FHLB. At December 31, 2016, these agreements had a total notional value of $250.0 million with rates ranging from one-month LIBOR plus 0.17% to one-month LIBOR plus 0.278%. In addition, we entered into various interest rate swap contracts that are treated as cash flow hedges that effectively converted the variable rate advances to fixed interest rates ranging from 0.932% to 1.647% and original terms ranging from four years to nine years. The cash flows of the swaps are expected to be effective in hedging the variability in expected future cash flows attributable to fluctuations in the one-month LIBOR interest rate.

On September 19, 2016, the Company issued $100.0 million aggregate principal amount of fixed-to-floating rate subordinated notes that mature on September 30, 2026. This debt initially bears interest at a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a floating rate equal to three-month LIBOR plus 429.7 basis points. The proceeds from the sale of the subordinated notes were used for general corporate purposes, which included advances to Southside Bank to finance its activities. The unamortized discount and debt issuance costs deducted from the subordinated notes totaled approximately $1.9 million at December 31, 2016.

Our brokered CDs decreased from $85.3 million at December 31, 2015 to $35.5 million at December 31, 2016, or 58.4%. At December 31, 2016, approximately $29.8 million of our brokered CDs were non-callable with a weighted average cost of 66 basis points and remaining maturities of one to fifteen months. The remaining $5.7 million were long-term brokered CDs that mature within three years and have short-term calls that we control.

During 2016, increases in FHLB advances resulted in an increase in our total wholesale funding as a percentage of deposits, not including brokered deposits, to 38.5% at December 31, 2016 from 36.6% at December 31, 2015.

RESULTS OF OPERATIONS

Our results of operations are dependent primarily on net interest income, which is the difference between the interest income earned on assets (loans and investments) and interest expense due on our funding sources (deposits and borrowings) during a particular period. Results of operations are also affected by our noninterest income, provision for loan losses, noninterest expenses and income tax expense. General economic and competitive conditions, particularly changes in interest rates, changes in interest rate yield curves, prepayment rates of MBS and loans, repricing of loan relationships, government policies and actions of regulatory authorities also significantly affect our results of operations. Future changes in applicable law, regulations or government policies may also have a material impact on us.

NET INTEREST INCOME

Net interest income is one of the principal sources of a financial institution's earnings stream and represents the difference or spread between interest and fee income generated from interest earning assets and the interest expense paid on deposits and borrowed funds. Fluctuations in interest rates or interest rate yield curves, as well as repricing characteristics and volume and changes in the mix of interest earning assets and interest bearing liabilities, materially impact net interest income.

	Years Ended December 31,		
	2016	2015	2014
		(in thousands)	
Interest income			
Loans	$ 106,564	$ 96,417	$ 70,598
Investment securities – taxable	1,057	1,587	615
Investment securities – tax-exempt	22,654	22,468	24,038
Mortgage-backed securities	37,450	33,661	28,207
FHLB stock and other investments	798	298	181
Other interest earning assets	390	101	139
Total interest income	168,913	154,532	123,778
Interest expense			
Deposits	14,255	10,162	7,953
Short-term obligations	4,152	1,250	624
Long-term obligations	10,941	8,442	8,379
Total interest expense	29,348	19,854	16,956
Net interest income	$ 139,565	$ 134,678	$ 106,822

Net interest income for the year ended December 31, 2016 increased $4.9 million, or 3.6%, compared to the same period in 2015 and increased $27.9 million, or 26.1%, for the year ended December 31, 2015 compared to the same period in 2014. The increase in net interest income was due to the increase in interest income of $14.4 million, or 9.3%, which was primarily a result of the increase in the interest income on loans, compared to the same period in 2015, which included a $1.3 million recovery of interest income on the payoff of a long-time nonaccrual loan during the first quarter of 2016 and an increase in interest income on mortgage-backed securities of $3.8 million, partially offset by the increase in interest expense of $9.5 million on deposits and short- and long-term obligations, compared to the same period in 2015. For the year ended December 31, 2016, our net interest spread and net interest margin decreased to 3.14% and 3.26% from 3.31% and 3.40%, respectively, for the same period in 2015. The overall increase in net interest income during 2015 was primarily due to increases in interest income on loans and mortgage-backed securities, partially offset by increases in interest expense on deposits and short-term obligations. For the year ended December 31, 2015, our net interest spread decreased to 3.31% from 3.63%, and our net interest margin decreased to 3.40% from 3.77% compared to the same period in 2014.

During the year ended December 31, 2016, total interest income increased $14.4 million, or 9.3%, compared to the same period in 2015, and during the year ended December 31, 2015, increased $30.8 million, or 24.8%, compared to the same period in 2014. The increase in total interest income for the year ended December 31, 2016 was the result of an increase in average interest earning assets of $369.8 million, or 8.3%, from $4.46 billion for 2015 to $4.83 billion for 2016, and an increase in the average yield on average interest earning assets from 3.84% for the year ended December 31, 2015 to 3.87% for the year ended December 31, 2016. The increase in the yield on interest earning assets during the year ended December 31, 2016 is reflective of an increase in the yield on MBS.

The increase in total interest income for the year ended December 31, 2015 was the result of an increase in average interest earning assets of $1.20 billion, or 36.6%, from $3.26 billion to $4.46 billion from 2014 to 2015, while partially offset by a decrease in the average yield on average interest earning assets from 4.29% for the year ended December 31, 2014 to 3.84% for the year ended December 31, 2015. The decrease in the yield on interest earning assets during the year ended December 31, 2015 is reflective of a decrease in the average yield on loans and MBS.

During the year ended December 31, 2016, average loans increased $228.4 million, or 10.3%, to $2.45 billion from $2.22 billion, compared to the same period in 2015. During the year ended December 31, 2015, average loans increased $803.6 million, or 56.6%, from $1.42 billion to $2.22 billion, compared to the same period in 2014. The increase in average loans during 2016 was primarily a result of continued loan growth in our market areas. The increase in average loans during 2015 was primarily a result of strong loan growth in our market areas and loans acquired in the acquisition of Omni. Commercial real estate loans and municipal loans represent a large part of this increase for both years. The average yield on loans decreased slightly from 4.52% for the year ended December 31, 2015 to 4.51% for the year ended December 31, 2016, due to the mix of the loan portfolio. Interest income on loans increased $10.1 million, or 10.5%, for the year ended December 31, 2016 compared to the same period in 2015 as a result of an increase in the average balance which more than offset the decrease in the average yield. A $1.3 million recovery of interest income on the payoff of a long-time nonaccrual loan during the first quarter of 2016 also attributed to the increase in interest income. The average yield on loans decreased from 5.24% for the year ended December 31, 2014 to 4.52% for the year ended December 31, 2015. Interest income on loans increased $25.8 million, or 36.6%, for the year ended December 31, 2015 compared to the same period in 2014 as a result of an increase in the average balance, which more than offset the decrease in the average yield. Due to the competitive loan pricing environment, we anticipate that we may be required to continue to offer lower interest rate loans that compete with those offered by other financial institutions in order to retain quality loan relationships. Offering lower interest rate loans could impact the overall yield on loans and, therefore, profitability.

For the year ended December 31, 2016, average investment securities and MBS increased $93.7 million, or 4.4%, to $2.24 billion from $2.15 billion compared to the same period in 2015 and increased $396.9 million, or 22.7%, from $1.75 billion to $2.15 billion for the year ended December 31, 2015, compared to the same period in 2014. At December 31, 2016, all of our MBS were fixed rate securities. The overall yield on average investment securities and MBS increased to 3.35% during the year ended December 31, 2016 from 3.27% during the same period in 2015 and decreased to 3.27% during the year ended December 31, 2015 from 3.72% during the same period in 2014. The increase in the average yield during 2016 is primarily the result of an increase in the average yield on MBS due to less prepayments compared to the same period in 2015. The decrease in the average yield during 2015 primarily reflects an overall higher interest rate environment during 2014, the purchase of lower yielding securities compared to those securities paying off, maturing or sold and the addition of Omni's securities portfolio at fair value in a low interest rate environment. Interest income on investment securities and MBS increased $3.4 million in 2016, or 6.0%, due to increases in both average balance and average yield. A decrease in long-term interest rate levels combined with lower credit spreads could negatively impact our net interest margin in the future due to increased prepayments. Interest income on investment securities and MBS increased $4.9 million, or 9.2%, in 2015 as the increase in the average balance more than offset the decrease in the average yield.

Average FHLB stock and other investments increased $9.5 million, or 20.4%, to $56.1 million, for the year ended December 31, 2016, compared to $46.6 million for 2015 and increased $17.9 million, or 62.4%, to $46.6 million for the year ended December 31, 2015, compared to $28.7 million for 2014. The increase is primarily due to the increase in average FHLB advances during both 2016 and 2015 and the corresponding requirement to hold stock associated with those advances. We are required as a member of FHLB to own a specific amount of stock that changes as the level of our FHLB advances and asset size change. The FHLB stock is a variable instrument with the rate typically tied to the federal funds rate. Interest income from our FHLB stock and other investments increased $500,000, or 167.8%, during 2016, and increased $117,000, or 64.6%, during 2015. The increase in interest income in 2016 was due to increases in both the average balance and the average yield on FHLB stock and other investments. The increase in interest income in 2015 was due to increases in the average balance of FHLB stock and other investments.

Average interest earning deposits and federal funds sold increased $36.6 million, or 92.5%, to $76.1 million for the year ended December 31, 2016, compared to $39.5 million for 2015. Interest income from interest earning deposits and federal funds sold increased $289,000 in 2016, or 286.1%, as a result of an increase in both average balance and yield compared to 2015. Average interest earning deposits decreased $15.3 million, or 27.9%, to $39.5 million, for the year ended December 31, 2015, compared to $54.9 million for 2014. Interest income from interest earning deposits decreased $38,000, or 27.3%, for the year ended December 31, 2015, compared to 2014, as a result of the decrease in the average balance.

During the year ended December 31, 2016, our average loans and securities increased compared to the same period in 2015. As a result, the mix of our average interest earning assets changed as our average total securities as a percentage of total average interest earning assets totaled 47.5% during 2016 compared to 49.1% during 2015 and 54.4% during 2014. Average loans were 50.9% of average total interest earning assets during 2016 compared to 50.0% during 2015 and 43.9% during 2014. Other interest earning asset categories averaged 1.6% of average interest earning assets during 2016 compared to 0.9% during 2015 and 1.7% during 2014.

Total interest expense increased $9.5 million, or 47.8%, during the year ended December 31, 2016. The increase in interest expense for 2016 was attributable to an increase in average interest bearing liabilities of $311.3 million, or 8.4%, from $3.71 billion to $4.02 billion and in the average rate paid on interest bearing liabilities for the year ended December 31, 2016, to 0.73%, from 0.53% for the same period in 2015. The increase in average interest bearing liabilities was primarily the result of the increase in deposits and FHLB advances, and to a lesser extent, the issuance of the subordinated notes.

Total interest expense increased $2.9 million, or 17.1%, during the year ended December 31, 2015, as compared to 2014. The increase in interest expense for 2015 was attributable to an increase in average interest bearing liabilities of $1.13 billion, or 43.6%, from $2.59 billion to $3.71 billion, which was partially offset by the decrease in the average rate paid on interest bearing liabilities for the year ended December 31, 2015, to 0.53%, from 0.66% for the same period in 2014. The increase in average interest bearing liabilities was primarily the result of the increase in deposits and FHLB advances to fund the increase in loans and securities, as well as the deposits and FHLB advances acquired in the acquisition of Omni.

The following table sets forth our deposit averages by category (dollars in thousands):

COMPOSITION OF DEPOSITS

	Years Ended December 31,					
	2016		2015		2014	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Interest Bearing Demand Deposits	$ 1,681,422	0.36%	$ 1,648,416	0.27%	$ 1,231,711	0.29%
Savings Deposits	244,826	0.11%	232,385	0.10%	121,453	0.11%
Time Deposits	941,716	0.85%	845,882	0.65%	610,178	0.70%
Total Interest Bearing Deposits	2,867,964	0.50%	2,726,683	0.37%	1,963,342	0.41%
Noninterest Bearing Demand Deposits	693,929	N/A	679,346	N/A	576,770	N/A
Total Deposits	$ 3,561,893	0.40%	$ 3,406,029	0.30%	$ 2,540,112	0.31%

Total average interest bearing deposits increased $141.3 million, or 5.2%, and the average rate paid increased from 0.37% for the year ended December 31, 2015, to 0.50% for the year ended December 31, 2016. For the year ended December 31, 2015 average interest bearing deposits increased $763.3 million, or 38.9%, while the average rate paid decreased to 0.37% from 0.41% compared to the same period in 2014. Interest expense for interest bearing deposits increased $4.1 million, or 40.3%, for the year ended December 31, 2016, compared to the same period in 2015 due to the increase in the average balance and average rate paid. Interest expense for interest bearing deposits increased $2.2 million, or 27.8%, for the year ended December 31, 2015, compared to the same period in 2014 due to the increase in the average balance which more than offset the decrease in the average rate paid.

Average time deposits increased $95.8 million, or 11.3%, and the average rate paid increased 20 basis points for the year ended December 31, 2016. Average time deposits increased $235.7 million, or 38.6%, while the average rate paid decreased five basis points for the year ended December 31, 2015. Average interest bearing demand deposits increased $33.0 million, or 2.0%, and $416.7 million, or 33.8%, for the years ended December 31, 2016 and December 31, 2015, respectively. The average rate paid increased nine basis points for the year ended December 31, 2016 and decreased two basis points for the year ended December 31, 2015. Average savings deposits increased $12.4 million, or 5.4%, and the average rate paid increased one basis point for the year ended December 31, 2016. Average savings deposits increased $110.9 million, or 91.3%, while the average rate paid decreased one basis point for the year ended December 31, 2015. Average noninterest bearing demand deposits increased $14.6 million, or 2.1%, during 2016 and $102.6 million, or 17.8%, during 2015. The latter three categories, which are considered the lowest cost deposits, comprised 73.6% of total average deposits during the year ended December 31, 2016 compared to 75.2% during 2015 and 76.0% during 2014. The increase in our average total deposits during 2016 was primarily the result of increases in public fund deposits. The increase in our average total deposits during 2015 was primarily the result of our acquisition of Omni in December of 2014.

At December 31, 2016, total brokered CDs were $35.5 million compared to $85.3 million at December 31, 2015. This represented a decrease of $49.8 million, or 58.4%, from 2015. Total brokered CDs increased $61.8 million, or 264.0%, in 2015 from $23.4 million at December 31, 2014. At December 31, 2016, approximately $29.8 million of our brokered CDs were non-callable with maturities of one to fifteen months. The remaining $5.7 million were long-term CDs that mature within three years and have short-term calls that we control. We utilize long-term callable brokered CDs because the brokered CDs better match overall ALCO objectives at the time of issuance by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. At December 31, 2016, brokered CDs represented 1.0% of deposits compared to 2.5% of deposits at December 31, 2015 and 0.8% at December 31, 2014. Our wholesale funding policy currently allows maximum brokered CDs of $180 million; however, this amount could be increased to match changes in ALCO objectives. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.

Average short-term interest bearing liabilities, consisting primarily of FHLB advances, federal funds purchased and repurchase agreements were $570.3 million, an increase of $185.6 million, or 48.2%, for the year ended December 31, 2016, compared to the same period in 2015. Average short-term interest bearing liabilities increased primarily to fund the increase in loans and securities. For the year ended December 31, 2015, the increase was $320.5 million, or 499.6%, to $384.7 million compared to the same period in 2014. Interest expense associated with short-term interest bearing liabilities increased $2.9 million, or 232.2%, and the average rate paid increased 41 basis points to 0.73% for the year ended December 31, 2016, compared to 0.32% for the same period in 2015. Interest expense associated with short-term interest bearing liabilities increased $626,000, or 100.3%, while the average rate paid decreased 65 basis points to 0.32% for the year ended December 31, 2015, compared to 0.97% for the same period in 2014. The increase in the interest expense during 2016 was due to both the increase in the average balance and the average rate paid. The increase in the interest expense during 2015 was due to the increase in the average balance and was partially offset by a decrease in the average rate paid.

Average long-term interest bearing liabilities, consisting of FHLB advances, decreased $43.4 million, or 8.0%, during the year ended December 31, 2016, to $497.2 million as compared to $540.6 million at December 31, 2015, primarily due to a shift from long-term FHLB advances to short-term FHLB advances to fund the increase in loans and securities. Average long-term interest bearing liabilities increased $43.3 million, or 8.7%, during the year ended December 31, 2015, from $497.3 million at December 31, 2014. Interest expense associated with long-term FHLB advances increased $620,000, or 8.9%, and the average rate paid increased 24 basis points to 1.53% for the year ended December 31, 2016 compared to 1.29% for the same period in 2015. The increase in interest expense was due to the increase in the average rate paid which more than offset the decrease in the average balance. Interest expense associated with long-term FHLB advances increased $32,000, or 0.5%, while the average rate paid decreased 11 basis points to 1.29% for the year ended December 31, 2015 compared to 1.40% for the same period in 2014. The increase in interest expense was due to the increase in the average balance which more than offset the decrease in the average rate paid. FHLB advances are collateralized by FHLB stock, nonspecified loans and securities.

Average subordinated notes, consisting of $100.0 million aggregate principal amount of fixed-to-floating rate subordinated notes due 2026 issued on September 19, 2016, was $27.9 million at December 31, 2016. The $100.0 million aggregate principal amount of subordinated notes initially bears interest at a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a floating rate equal to three-month LIBOR plus 429.7 basis points. Interest expense associated with the subordinated notes was $1.6 million with an average yield of 5.84% for the year ended December 31, 2016.

Average long-term debt, consisting of our junior subordinated debentures, was $60.2 million for the years ended December 31, 2016, 2015, and 2014. The interest rate on the $20.5 million of long-term debentures issued to Southside Statutory Trust III adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points. The interest rate on the $23.2 million of long-term debentures issued to Southside Statutory Trust IV adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points. The interest rate on the $12.9 million of long-term debentures issued to Southside Statutory Trust V adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points. The interest rate on the $3.6 million of long-term debentures issued to Magnolia Trust Company I adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

AVERAGE BALANCES WITH AVERAGE YIELDS AND RATES

The following table presents average balance sheet amounts and average yields/rates for the years ended December 31, 2016, 2015 and 2014. The information should be reviewed in conjunction with the consolidated financial statements for the same years then ended. Two major components affecting our earnings are the interest earning assets and interest bearing liabilities. A summary of average interest earning assets and interest bearing liabilities is set forth below, together with the average yield on the interest earning assets and the average cost of the interest bearing liabilities (dollars in thousands).

AVERAGE BALANCES WITH AVERAGE YIELDS AND RATES
Years Ended

	December 31, 2016			December 31, 2015			December 31, 2014		
	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate
ASSETS									
INTEREST EARNING ASSETS:									
Loans[(1)(2)]	$ 2,452,803	$ 110,653	4.51%	$ 2,224,401	$ 100,471	4.52%	$ 1,420,802	$ 74,450	5.24%
Loans Held For Sale	5,036	162	3.22%	3,439	155	4.51%	11,012	47	0.43%
Securities:									
Inv. Sec. (Taxable)[(4)]	60,145	1,057	1.76%	75,977	1,587	2.09%	33,168	615	1.85%
Inv. Sec. (Tax Exempt)[(3)(4)]	699,472	36,393	5.20%	637,333	34,981	5.49%	659,219	36,263	5.50%
Mortgage-backed Sec.[(4)]	1,479,528	37,450	2.53%	1,432,087	33,661	2.35%	1,056,095	28,207	2.67%
Total Securities	2,239,145	74,900	3.35%	2,145,397	70,229	3.27%	1,748,482	65,085	3.72%
FHLB Stock, at Cost, and Other Investments	56,071	798	1.42%	46,584	298	0.64%	28,684	181	0.63%
Interest Earning Deposits	75,339	385	0.51%	39,533	101	0.26%	54,853	139	0.25%
Federal Funds Sold	747	5	0.67%	—	—	—	—	—	—
Total Interest Earning Assets	4,829,141	186,903	3.87%	4,459,354	171,254	3.84%	3,263,833	139,902	4.29%
NONINTEREST EARNING ASSETS:									
Cash and Due From Banks	51,160			52,400			43,342		
Bank Premises and Equipment	107,402			110,704			55,680		
Other Assets	265,876			265,769			133,554		
Less: Allowance for Loan Losses	(18,465)			(16,621)			(17,177)		
Total Assets	$ 5,235,114			$ 4,871,606			$ 3,479,232		

(1) *Interest on loans includes net fees on loans that are not material in amount.*

(2) *Interest income includes taxable-equivalent adjustments of $4,251, $4,209 and $3,899 for the years ended December 31, 2016, 2015, and 2014, respectively. See "Non-GAAP Financial Measures."*

(3) *Interest income includes taxable-equivalent adjustments of $13,739, $12,513 and $12,225 for the years ended December 31, 2016, 2015, and 2014, respectively. See "Non-GAAP Financial Measures."*

(4) *For the purpose of calculating the average yield, the average balance of securities is presented at historical cost.*

Note: *As of December 31, 2016, 2015 and 2014, loans totaling $8,280, $20,526 and $4,096, respectively, were on nonaccrual status. Our policy is to reverse previously accrued but unpaid interest on nonaccrual loans; thereafter, interest income is recorded to the extent received when appropriate.*

AVERAGE BALANCES WITH AVERAGE YIELDS AND RATES
Years Ended

	December 31, 2016			December 31, 2015			December 31, 2014		
	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate	Average Balance	Interest	Avg. Yield/ Rate
LIABILITIES AND SHAREHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES:									
Savings Deposits	$ 244,826	$ 280	0.11%	$ 232,385	$ 233	0.10%	$ 121,453	$ 136	0.11%
Time Deposits	941,716	7,984	0.85%	845,882	5,512	0.65%	610,178	4,287	0.70%
Interest Bearing Demand Deposits	1,681,422	5,991	0.36%	1,648,416	4,417	0.27%	1,231,711	3,530	0.29%
Total Interest Bearing Deposits	2,867,964	14,255	0.50%	2,726,683	10,162	0.37%	1,963,342	7,953	0.41%
Short-term Interest Bearing Liabilities	570,269	4,152	0.73%	384,694	1,250	0.32%	64,160	624	0.97%
Long-term Interest Bearing Liabilities-FHLB Dallas	497,160	7,607	1.53%	540,600	6,987	1.29%	497,296	6,955	1.40%
Subordinated Notes (5)	27,860	1,628	5.84%	—	—	—	—	—	—
Long-term Debt (6)	60,233	1,706	2.83%	60,229	1,455	2.42%	60,224	1,424	2.36%
Total Interest Bearing Liabilities	4,023,486	29,348	0.73%	3,712,206	19,854	0.53%	2,585,022	16,956	0.66%
NONINTEREST BEARING LIABILITIES:									
Demand Deposits	693,929			679,346			576,770		
Other Liabilities	49,275			41,627			29,672		
Total Liabilities	4,766,690			4,433,179			3,191,464		
SHAREHOLDERS' EQUITY	468,424			438,427			287,768		
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 5,235,114			$ 4,871,606			$ 3,479,232		
NET INTEREST INCOME		$ 157,555			$ 151,400			$ 122,946	
NET INTEREST MARGIN ON AVERAGE EARNING ASSETS			3.26%			3.40%			3.77%
NET INTEREST SPREAD			3.14%			3.31%			3.63%

(5) *The unamortized discount and debt issuance costs reflected in the carrying amount of the subordinated notes totaled approximately $555,000 for the year ended December 31, 2016.*

(6) *Represents issuance of junior subordinated debentures. In connection with the adoption of ASU 2015-03 that requires unamortized debt issuance costs be presented as a direct deduction from the related debt liability, our average long-term debt for the years ended December 31, 2016, 2015, and 2014 reflect unamortized debt issuance costs of $77,000, $82,000, and $87,000, respectively.*

ANALYSIS OF CHANGES IN INTEREST INCOME AND INTEREST EXPENSE

The following tables set forth the dollar amount of increase (decrease) in interest income and interest expense resulting from changes in the volume of interest earning assets and interest bearing liabilities and from changes in yields/rates (in thousands):

	Years Ended December 31, 2016 Compared to 2015		
	Average Volume	Average Yield/Rate	Increase (Decrease)
INTEREST INCOME:			
Loans [1]	$ 10,304	$ (122)	$ 10,182
Loans Held For Sale	59	(52)	7
Investment Securities (Taxable)	(301)	(229)	(530)
Investment Securities (Tax Exempt) [1]	3,295	(1,883)	1,412
Mortgage-backed Securities	1,141	2,648	3,789
FHLB Stock, at Cost and Other Investments	71	429	500
Interest Earning Deposits	135	149	284
Federal Funds Sold	5	—	5
Total Interest Income	14,709	940	15,649
INTEREST EXPENSE:			
Savings Deposits	13	34	47
Time Deposits	676	1,796	2,472
Interest Bearing Demand Deposits	90	1,484	1,574
Short-term Interest Bearing Liabilities	812	2,090	2,902
Long-term FHLB Advances	(593)	1,213	620
Subordinated Notes	1,628	—	1,628
Long-term Debt	—	251	251
Total Interest Expense	2,626	6,868	9,494
Net Interest Income	$ 12,083	$ (5,928)	$ 6,155

	Years Ended December 31, 2015 Compared to 2014		
	Average Volume	Average Yield/Rate	Increase (Decrease)
INTEREST INCOME:			
Loans [1]	$ 37,437	$ (11,416)	$ 26,021
Loans Held For Sale	(53)	161	108
Investment Securities (Taxable)	885	87	972
Investment Securities (Tax Exempt) [1]	(1,201)	(81)	(1,282)
Mortgage-backed Securities	9,141	(3,687)	5,454
FHLB Stock, at Cost and Other Investments	114	3	117
Interest Earning Deposits	(39)	1	(38)
Total Interest Income	46,284	(14,932)	31,352
INTEREST EXPENSE:			
Savings Deposits	113	(16)	97
Time Deposits	1,555	(330)	1,225
Interest Bearing Demand Deposits	1,129	(242)	887
Short-term Interest Bearing Liabilities	1,286	(660)	626
Long-term FHLB Advances	581	(549)	32
Long-term Debt	—	31	31
Total Interest Expense	4,664	(1,766)	2,898
Net Interest Income	$ 41,620	$ (13,166)	$ 28,454

(1) Interest yields on loans and securities that are nontaxable for federal income tax purposes are presented on a taxable equivalent basis. See "Non-GAAP Financial Measures."

Note: Volume/Yield/Rate variances (change in volume times change in yield/rate) have been allocated to amounts attributable to changes in volumes and to changes in yields/rates in proportion to the amounts directly attributable to those changes.

PROVISION FOR LOAN LOSSES

The provision for loan losses for the year ended December 31, 2016 was \$9.8 million compared to \$8.3 million for the year ended December 31, 2015. The provision for loan losses for the year ended December 31, 2014 was \$14.9 million. For the year ended December 31, 2016, net loan charge-offs increased \$9.7 million, to \$11.6 million compared to \$1.9 million for the same period in 2015 and decreased \$18.6 million during 2015 from \$20.5 million for the same period in 2014. Nonperforming assets to total assets decreased to 0.27% at December 31, 2016 from 0.63% at December 31, 2015 primarily due to the payoff of one long-time nonaccrual during the first quarter and the settlement of two large impaired relationships in the second quarter. During 2015, our nonperforming assets to total assets ratio increased to 0.63% at December 31, 2015 from 0.26% at December 31, 2014. This increase was primarily due to the downgrade of one large commercial borrowing relationship to impaired status during the first quarter of 2015 and the restructure of a large PCI commercial loan during the third quarter of 2015.

The increase in net charge-offs for 2016 was a result of an increase in total charge-offs of \$10.0 million partially offset by an increase in total recoveries of \$326,000. Net charge-offs for commercial loans increased \$10.5 million, resulting in net charge-offs of \$10.7 million for the year ended December 31, 2016, compared to net charge-offs of \$183,000 for the same period in 2015 and was primarily a result of the charge-off of two large commercial borrowing relationships totaling \$10.9 million. Net charge-offs for loans to individuals decreased 15.5%, to \$1.5 million for the year ended December 31, 2016 compared to the same period in 2015. For the year ended December 31, 2016, we experienced net recoveries in all of our real estate loan categories. Net recoveries of construction loans increased \$86,000 to \$269,000 and net recoveries for 1-4 family residential loans increased \$41,000, resulting in net recoveries of \$98,000 for the year ended December 31, 2016, compared to \$57,000 for the year ended December 31, 2015. Net recoveries of commercial real estate loans decreased \$62,000 to \$23,000 for the year ended December 31, 2016 compared to \$85,000 for the same period in 2015. Net recoveries for municipal loans were \$249,000 for the year ended December 31, 2016, due to the full recovery of the municipal loan charged off during 2015.

The decrease in net charge-offs for 2015 was a result of a decrease in total charge-offs of \$18.2 million, along with an increase in total recoveries of \$416,000. Net charge-offs for loans to individuals decreased 91.4%, to \$1.8 million for the year ended December 31, 2015 compared to the same period in 2014. This decrease was due to charge-offs on SFG loans and the write down of the SFG loans to fair value in connection with the sale of the SFG subprime automobile loans during the year ended December 31, 2014. Net charge-offs for commercial loans increased \$288,000, resulting in net charge-offs of \$183,000 for the year ended December 31, 2015, compared to net recoveries of \$105,000 for the same period in 2014. For the year ended December 31, 2015, we experienced net recoveries in all of our real estate loan categories. Net recoveries of construction loans increased \$41,000 to \$183,000, and net recoveries of commercial real estate loans increased \$77,000 to \$85,000 for the year ended December 31, 2015 compared to the same period in 2014. Net recoveries for 1-4 family residential loans decreased slightly, resulting in net recoveries of \$57,000 for the year ended December 31, 2015, compared to \$59,000 for the year ended December 31, 2014.

As of December 31, 2016, and 2015, our reviews of the loan portfolio indicated that loan loss allowances of \$17.9 million and \$19.7 million, respectively, were appropriate to cover probable losses in the portfolio.

NONINTEREST INCOME

Noninterest income consists of revenues generated from a broad range of financial services and activities including deposit related fee based services. The following schedule lists the accounts from which noninterest income was derived and gives totals for these accounts (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Deposit services	$ 20,702	$ 20,112	$ 15,280
Net gain on sale of securities available for sale	2,836	3,660	2,830
Impairment of investment in SFG Finance, LLC	—	—	(2,755)
Gain on sale of loans	2,795	2,082	323
Trust income	3,491	3,419	3,145
Bank owned life insurance income	2,626	2,623	1,334
Brokerage services	2,127	2,206	1,308
Other	4,834	3,793	3,024
Total noninterest income	$ 39,411	$ 37,895	$ 24,489

Total noninterest income for the year ended December 31, 2016 increased 4.0%, or $1.5 million, compared to 2015 and 54.7%, or $13.4 million, during the year ended December 31, 2015, compared to the same period in 2014. The increase in noninterest income for the year ended December 31, 2016 compared to the same period in 2015 was due to increases in deposit services, gain on sale of loans and other income, partially offset by a decrease in net gain on sale of AFS securities. The increase in noninterest income during 2015 compared to 2014 was due to an increase in all of the categories included in the table above, as well as mortgage servicing fee income, included in other income, primarily as a result of the acquisition of Omni in December 2014.

Deposit services income increased $590,000, or 2.9%, for the year ended December 31, 2016, as compared to the same period in 2015 and $4.8 million, or 31.6%, for the year ended December 31, 2015, as compared to the same period in 2014. The increase for 2016 was due to an increase in ATM and debit card income. The increase in 2015 was due primarily to an increase in ATM and debit card income as well as service charges on deposit accounts and non-sufficient funds and overdraft income primarily as a result of the acquisition of Omni.

During the year ended December 31, 2016, we sold U.S. Agency CMOs, U.S. Agency CMBS, Texas municipal securities, U.S. Agency MBS, and U.S. Treasury securities that resulted in a net gain on sale of AFS securities of $2.8 million. The fair value of the AFS securities portfolio at December 31, 2016 was $1.48 billion with a net unrealized loss on that date of $17.8 million. The net unrealized loss is comprised of $10.9 million in unrealized gains and $28.7 million in unrealized losses. The fair value of HTM securities portfolio at December 31, 2016 was $944.3 million with a net unrealized loss on that date of $11.9 million. The net unrealized loss is comprised of $18.6 million in unrealized gains and $30.4 million in unrealized losses. During the year ended December 31, 2016, we primarily purchased premium U.S. Agency CMOs, U.S. Agency CMBS, and Texas municipal securities. During the quarter ended December 31, 2016, the size of the securities portfolio increased slightly to partially offset the interest expense associated with the sub-debt issued. We sold U.S. Treasury securities, U.S. Agency CMOs, and U.S. Agency MBS to reallocate our securities portfolio by reinvesting primarily in moderate and seasoned AFS U.S. Agency CMOs to lessen extension risk and to a lesser extent CRA qualified U.S. Agency CMBS classified as HTM. There can be no assurance that the level of security gains reported during the year ended December 31, 2016 will continue in future periods.

During the year ended December 31, 2015, we proactively managed the investment portfolio and adjusted the securities acquired in the Omni acquisition to meet our investment objectives. We primarily sold CMOs along with some U.S. Agency mortgage pass-throughs, U.S. Agency CMBS, Texas municipal securities and U.S. Treasury securities. During the year ended December 31, 2014, we sold primarily lower yielding, longer duration municipal securities and more prepayment volatile MBS and replaced them with primarily shorter duration municipal securities. For the years ended December 31, 2015 and 2014, the sale of securities resulted in a net gain on the sale of AFS securities of $3.7 million and $2.8 million, respectively.

We recorded an impairment charge of $2.8 million on our investment in SFG in the year ended December 31, 2014. The impairment occurred as a result of our decision to sell the SFG purchased automobile loans and the associated write down to fair market value and transfer to loans held for sale of $74.8 million.

Gain on sale of loans increased $713,000, or 34.2%, for the year ended December 31, 2016, compared to the same period in 2015 and $1.8 million, or 544.6%, for the year ended December 31, 2015, compared to the same period in 2014. The increases for both periods were primarily a result of an increase in the volume of loans sold and the related servicing release premiums and secondary market fees received.

Bank owned life insurance ("BOLI") income increased slightly by $3,000, or 0.1%, for the year ended December 31, 2016, compared to the same period in 2015. BOLI income increased $1.3 million, or 96.6%, for the year ended December 31, 2015, compared to the same period in 2014 due to the addition of approximately $45.0 million in BOLI acquired in the acquisition of Omni in the fourth quarter of 2014.

Brokerage services income decreased $79,000, or 3.6%, for the year ended December 31, 2016, compared to the same period in 2015. Brokerage services income increased $898,000, or 68.7%, for the year ended December 31, 2015, compared to the same period in 2014 primarily as a result of the acquisition of Omni.

Other income increased $1.0 million, or 27.4%, for the year ended December 31, 2016 compared to the same period in 2015, primarily attributable to an increase in other investment income and mortgage servicing fee income. Other income increased $769,000, or 25.4%, for the year ended December 31, 2015 compared to the same period in 2014, primarily due to an increase in mortgage servicing fee income.

NONINTEREST EXPENSE

The following table lists the accounts which comprise noninterest expense (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Salaries and employee benefits	$ 63,978	$ 67,221	$ 60,821
Occupancy expense	13,722	12,883	7,259
Advertising, travel & entertainment	2,643	2,708	2,219
ATM and debit card expense	3,136	3,132	1,331
Professional fees	4,946	3,877	7,827
Software and data processing expense	2,911	3,858	4,629
Telephone and communications	1,931	1,978	1,222
FDIC insurance	2,141	2,510	1,765
FHLB prepayment fees	148	—	539
Other	13,966	14,787	10,092
Total noninterest expense	$ 109,522	$ 112,954	$ 97,704

Noninterest expense for the year ended December 31, 2016 decreased $3.4 million, or 3.0%, compared to the year ended December 31, 2015 and increased $15.3 million, or 15.6%, for the year ended December 31, 2015, compared to the year ended December 31, 2014.

Salaries and employee benefits expense decreased $3.2 million, or 4.8%, during the year ended December 31, 2016, compared to the same period in 2015 and increased $6.4 million, or 10.5%, during the year ended December 31, 2015, compared to the same period in 2014. The decrease in 2016 was primarily the result of a decrease in direct salary expense. The increase in 2015 was primarily the result of increases in direct salary expense, retirement expense and health insurance expense.

Direct salary expense and payroll taxes decreased $2.6 million, or 4.6%, for the year ended December 31, 2016, compared to the same period in 2015 and increased $11.0 million, or 24.4%, for the year ended December 31, 2015, compared to the same period in 2014. The decrease in 2016 was primarily due to $4.1 million of severance and stay pay, and non-recurring salary payments made during the year ended December 31, 2015. This decrease was partially offset by normal salary increases effective in the first quarter of 2016.

Retirement expense, included in salaries and employee benefits, increased $501,000, or 10.4%, for the year ended December 31, 2016, compared to the same period in 2015 and $2.8 million, or 136.2%, for the year ended December 31, 2015, compared to the same period in 2014. The increase for 2016 was primarily due to a one-time expense of $1.7 million related to the acceptance of early retirement packages by 16 employees during the first quarter of 2016, partially offset by a decrease in the restoration plan expense due to an increase in the discount rate to 4.56% from 4.14% for the same period in 2015. The increase for 2015 was primarily related to the increase in the defined benefit and restoration plans, and to a lesser extent, increases in our deferred compensation plan expense, 401(k) plan expense and split dollar plan expense. The defined benefit and restoration plan expense increased during 2015 primarily due to the unfunded status of the plan and the decrease in the discount rate to 4.14% for 2015 compared to 5.06% for 2014. The assumed long-term rate of return was 7.25% for years 2014 through 2016. We will continue to evaluate the assumed long-term rate of return and the discount rate to determine if either should be changed in the future. If either of these assumptions decrease, the cost and funding required for the retirement plan could increase.

Health and life insurance expense, included in salaries and employee benefits, decreased $1.2 million, or 18.6%, for the year ended December 31, 2016, compared to the same period in 2015 due to decreased health claims expense and plan administrative cost for the comparable period. Health and life insurance expense increased $1.5 million, or 30.7%, for the year ended December 31, 2015, compared to the same period in 2014 due to increased health claims expense and plan administrative cost during 2015 as well as the acquisition of Omni in the fourth quarter of 2014. We have a self-insured health plan which is supplemented with stop loss insurance policies. Health insurance costs are rising nationwide and these costs may increase during 2017.

Occupancy expense increased $839,000, or 6.5%,for the year ended December 31, 2016, compared to the same period in 2015, due to the early termination of a lease. During the third quarter, we prepaid a lease at approximately 59% of the remaining lease payments on a Fort Worth operations facility that was recently vacated. The cost of prepaying this lease, combined with writing off the leasehold improvements, was $1.8 million which was partially offset by lower taxes and utilities. Occupancy expense increased $5.6 million, or 77.5%, for the year ended December 31, 2015, compared to the same period in 2014, due to the addition of 14 branches resulting from the acquisition of Omni in the fourth quarter of 2014, while partially offset by a decrease in expenses related to our dissolution of SFG.

Advertising, travel and entertainment experienced a slight decrease of $65,000, or 2.4%, for the year ended December 31, 2016, compared to the same period in 2015 and increased $489,000, or 22.0%, for the year ended December 31, 2015, compared to the same period in 2014. The increase in 2015 compared to 2014, was due to increased expenses in 2015 related to the acquisition of Omni.

ATM and debit card expense increased slightly by $4,000, or 0.1%, for the year ended December 31, 2016, compared to the same period in 2015 and $1.8 million, or 135.3%, for the year ended December 31, 2015, compared to the same period in 2014. The increase in 2015 was due primarily to the addition of 21 ATMs associated with the acquisition of Omni.

Professional fees increased $1.1 million, or 27.6%, for the year ended December 31, 2016, compared to the same period in 2015 due to increased consulting fees associated with process improvement and re-branding efforts initiated in January 2016 and increased legal expense. Professional fees decreased $4.0 million, or 50.5%, for year ended December 31, 2015, compared to the same period in 2014. The decrease during 2015 was due to an increased level of non-recurring legal and accounting fees during 2014 associated with the Omni acquisition.

Software and data processing expense decreased $947,000, or 24.5%, for the year ended December 31, 2016, as compared to the same period in 2015 and $771,000, or 16.7%, for the year ended December 31, 2015, as compared to the same period in 2014. The decrease in 2016 was due primarily to additional software applications and integration costs incurred in connection with the integration of Omni during the first half of 2015 that were not incurred in 2016. The decrease in 2015 was due primarily to expense associated with the software contracts canceled related to the acquisition of Omni during the fourth quarter of 2014.

Telephone and communications decreased $47,000, or 2.4%, for the year ended December 31, 2016, as compared to the same period in 2015 and increased $756,000, or 61.9%, for the year ended December 31, 2015, as compared to the same period in 2014. The decrease in 2016 was primarily due to cost synergies that resulted from the integration of Omni as well as reductions in expense due to the closure of several branches and the dissolution of SFG during 2015. The increase in 2015 was primarily due to the addition of 14 branches associated with the acquisition of Omni while partially offset by a decrease related to our dissolution of SFG.

FDIC insurance decreased $369,000, or 14.7%, for the year ended December 31, 2016, as compared to the same period in 2015 and increased $745,000, or 42.2%, for the year ended December 31, 2015, as compared to the same period in 2014. The decrease in 2016 was due to the lower rate charged by the FDIC beginning in the third quarter of 2016. The increase in 2015 was due to an increase in the total assessment base, which resulted primarily due to the acquisition of Omni.

FHLB prepayment fees increased $148,000, or 100.00%, for the year ended December 31, 2016, as compared to the same period in 2015 as a result of the prepayment of $63.0 million in FHLB advances during the second quarter of 2016. There were no FHLB prepayment fees paid in 2015. We prepaid FHLB advances of $39.2 million during 2014.

Other expenses decreased $821,000, or 5.6%, for the year ended December 31, 2016, as compared to the same period in 2015 and increased $4.7 million, or 46.5%, for the year ended December 31, 2015, as compared to the same period in 2014. The decrease in 2016 was primarily due to decreases in advantage check card losses, core deposit intangible amortization, losses on other real estate owned ("OREO"), supplies expense, and online mobile banking expenses, which were partially offset by increases in the reserve for losses on loans sold with recourse, the reserve for losses on unfunded commitments, and repossessed asset expense. The increase in 2015 was primarily due to increases in amortization expense related to the core deposit intangible, losses associated with check cards, losses on other real estate owned ("OREO"), the retirement of assets in the dissolution of SFG and closures of branch locations, brokerage services expense, increases in online mobile banking expenses, supplies expense and equipment expense related to the acquisition of Omni.

INCOME TAXES

Pre-tax income for the year ended December 31, 2016 was $59.7 million compared to $51.3 million for the year ended December 31, 2015, and $18.7 million for the year ended December 31, 2014.

Income tax expense was $10.3 million for the year ended December 31, 2016 and represented an increase of $3.0 million, or 41.8%, compared to the year ended December 31, 2015, and increased $9.4 million, or 436.4%, to $7.3 million for the year ended December 31, 2015, compared to an income tax benefit of $2.2 million for the year ended December 31, 2014. The effective tax rate ("ETR") as a percentage of pre-tax income was 17.3% in 2016, and 14.2% in 2015, as compared to an effective tax benefit rate of 11.6% in 2014. The increase in the income tax expense and ETR for the years ended December 31, 2016 and 2015 was due to a decrease in tax-exempt income as a percentage of pre-tax income, as compared to the same periods in 2015 and 2014.

The ETR differs from the stated rate of 35% during the comparable period primarily due to the effect of tax-exempt income from municipal loans and securities, as well as bank owned life insurance. The net deferred tax asset totaled $28.9 million at December 31, 2016 as compared to $19.9 million in 2015. See "Note 16-Income Taxes" to our consolidated financial statements included in this report. No valuation allowance for deferred tax assets was recorded at December 31, 2016 or December 31, 2015, as management believes it is more likely than not that all of the deferred tax assets will be realized in future years.

LENDING ACTIVITIES

One of our main objectives is to seek attractive lending opportunities in Texas, primarily in the counties in which we operate. Substantially all of our loan originations are made to borrowers who live in and conduct business in the counties in Texas in which we operate or adjoin, with the exception of municipal loans. Municipal loans are made to municipalities, counties, school districts, and colleges primarily throughout the state of Texas.

Total loans as of December 31, 2016 increased $124.8 million, or 5.1%, and the average loan balance outstanding for the year increased $228.4 million, or 10.3%, compared to 2015. The increase in total loans is primarily a result of increased origination activity primarily in the Austin and Dallas-Fort Worth markets.

Commercial real estate loans increased $310.8 million, or 48.9%, from December 31, 2015 to December 31, 2016. Municipal loans as of December 31, 2016 increased $10.5 million, or 3.6%, from December 31, 2015. Commercial loans decreased $65.3 million, or 26.9%, from December 31, 2015 to December 31, 2016. Construction loans decreased $58.1 million, or 13.3%. Loans to individuals decreased $54.9 million, or 31.9%, from December 31, 2015 to December 31, 2016 and 1-4 family residential loans decreased $18.2 million, or 2.8%, from December 31, 2015 to December 31, 2016.

Commercial real estate loans increased primarily due to the growth in our Austin and Dallas-Fort Worth markets and the decrease in 1-4 family residential loans was due primarily to payoffs in excess of originations. Commercial loans decreased due to payoffs in excess of origination and the charge-off of two large commercial loans during the second quarter. The decrease in loans to individuals reflects the continued roll-off of the indirect automobile loan portfolio acquired from Omni.

Our greatest concentration of loans is in our real estate portfolio. Management does not consider there to be a concentration of risk in any one industry type, other than retail investment real estate properties. See "Item 1. Business – Market Area."

The aggregate amount of loans that we are permitted to make under applicable bank regulations to any one borrower, including non-affiliate related entities is 25% of Tier 1 capital. Our legal lending limit at December 31, 2016, was approximately $141.6 million. Our largest loan relationship at December 31, 2016 was approximately $51.5 million.

The average yield on loans for the year ended December 31, 2016, decreased to 4.51% from 4.52% for the year ended December 31, 2015. This decrease was due to the mix of the loan portfolio.

LOAN PORTFOLIO COMPOSITION AND ASSOCIATED RISK

The following table sets forth loan totals for the years presented (in thousands):

	December 31,				
	2016	2015	2014	2013	2012
Real Estate Loans:					
Construction	$ 380,175	$ 438,247	$ 267,830	$ 125,219	$ 113,744
1-4 Family Residential	637,239	655,410	690,895	390,499	368,845
Commercial	945,978	635,210	468,171	262,536	236,760
Commercial Loans	177,265	242,527	226,460	157,655	160,058
Municipal Loans	298,583	288,115	257,492	245,550	220,947
Loans to Individuals	117,297	172,244	270,285	169,814	162,623
Total Loans	$ 2,556,537	$ 2,431,753	$ 2,181,133	$ 1,351,273	$ 1,262,977

For purposes of this discussion, our loans are divided into Real Estate Loans, Commercial Loans, Municipal Loans and Loans to Individuals.

REAL ESTATE LOANS

Real estate loans represent our greatest concentration of loans. We attempt to mitigate the amount of risk associated with this group of loans through the type of loans originated and geographic distribution. At December 31, 2016, the majority of our real estate loans were collateralized by properties located in our market areas. Of the $1.96 billion in real estate loans, $637.2 million, or 32.5%, represent loans collateralized by residential dwellings that are primarily owner occupied. Historically, the amount of losses suffered on this type of loan has been significantly less than those on other properties. Our loan policy requires an appraisal or evaluation on the property, based on the size and complexity of the transaction, prior to funding any real estate loan and also outlines the requirements for appraisals on renewals.

We pursue an aggressive policy of reappraisal on any real estate loan that is in the process of foreclosure and potential exposures are recognized and reserved for or charged off as soon as they are identified. Our ability to liquidate certain types of properties that may be obtained through foreclosure could adversely affect the volume of our nonperforming real estate loans.

Real estate loans are divided into Construction Loans, 1-4 Family Residential Loans, and Commercial. Commercial real estate consists of $888.4 million of owner and non-owner occupied real estate loans, $53.1 million of loans secured by multi-family properties and $4.5 million of loans secured by farmland. Commercial Real Estate loans are discussed in more detail below.

Real Estate Construction Loans

Our construction loans are collateralized by property located primarily in or near the market areas we serve. Several of our construction loans will be owner occupied. Construction loans for non-owner occupied projects are financed, but these typically have cash flows from executed leased tenants, secondary sources of repayment and in some cases, additional collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property. Speculative and commercial construction loans are subject to underwriting standards similar to that of the commercial portfolio. Owner occupied 1-4 family residential construction loans are subject to the underwriting standards of the permanent loan.

Real Estate 1-4 Family Residential Loans

Residential loan originations are generated by our loan officers, in-house origination staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents and builders. We focus our lending efforts primarily on the origination of loans secured by first mortgages on owner occupied 1-4 family residences. Substantially all of our 1-4 family residential originations are secured by properties located in or near our market areas. Historically, we have originated a portion of our residential loans for sale into the secondary market. These loans are reflected on the balance sheet as loans held for sale. These secondary market investors, other than FNMA, typically pay us a service release premium in addition to a predetermined price based on the interest rate of the loan originated. We retain liabilities related to early prepayments, defaults, failure to adhere to origination and processing guidelines and other issues. We have internal controls in place to mitigate many of these liabilities and historically our realized liability has been extremely low. In addition, many of the retained liabilities expire one year from the date a loan is sold. We warehouse these loans until they are transferred to the secondary market investor, which usually occurs within 45 days.

Our 1-4 family residential loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan. Our 1-4 family residential loans are made at both fixed and adjustable interest rates.

Underwriting for 1-4 family residential loans includes debt-to-income analysis, credit history analysis, appraised value and down payment considerations. Changes in the market value of real estate can affect the potential losses in the portfolio.

We also make home equity loans, which are included as part of the 1-4 family residential loans, and at December 31, 2016, these loans totaled $99.6 million. Under Texas law, these loans, when combined with all other mortgage indebtedness for the property, are capped at 80% of appraised value.

Commercial Real Estate Loans

Commercial real estate loans primarily include loans collateralized by retail, commercial office buildings, multi-family, medical facilities and offices, senior living, assisted living and skilled nursing facilities, warehouse facilities, hotels and churches. We currently have a concentration of credit risk in our loans secured by retail investment real estate properties of approximately 11%. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

COMMERCIAL LOANS

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type. In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

MUNICIPAL LOANS

We have a specific lending department that makes loans to municipalities and school districts primarily throughout the state of Texas. Municipal loans outside the state of Texas have been limited to adjoining states. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service. Lending money directly to these municipalities allows us to earn a higher yield for similar durations than we could if we purchased municipal securities. Total loans to municipalities and school districts as of December 31, 2016 increased $10.5 million compared to 2015. At December 31, 2016, we had total loans to municipalities and school districts of $298.6 million.

LOANS TO INDIVIDUALS

Substantially all originations of our loans to individuals are made to consumers in our market areas. The majority of loans to individuals are collateralized by titled equipment, which are primarily automobiles. At December 31, 2016, these types of loans accounted for approximately $68.1 million, or 58.1%, of total loans to individuals. The indirect automobile portfolio acquired from Omni continued to pay down during 2016 to $35.5 million at December 31, 2016, compared to $79.1 million at December 31, 2015. We intend to let this portfolio fully liquidate.

Home equity loans, which are included in 1-4 family residential loans, have replaced some of the traditional loans to individuals. In addition, we make loans for a full range of other consumer purposes, which may be secured or unsecured depending on the credit quality and purpose of the loan.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards we employ for consumer loans include an application, a determination of the applicant's payment history on other debts, with the greatest weight being given to payment history with us, and an assessment of the borrower's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount. Most of our loans to individuals are collateralized, which management believes should assist in limiting our exposure.

LOAN MATURITIES AND SENSITIVITY TO CHANGES IN INTEREST RATES

The following table represents loan maturities and sensitivity to changes in interest rates for our real estate construction, commercial and municipal loans (in thousands). The amounts of these loans outstanding at December 31, 2016, which, based on remaining scheduled repayments of principal, are due in (1) one year or less, (2) more than one year but less than five years, and (3) more than five years, are shown in the following table. The amounts due after one year are classified according to the sensitivity to changes in interest rates.

	Due in One Year or Less(1)	After One but Within Five Years	After Five Years
Real Estate Loans – Construction	$ 153,175	$ 176,034	$ 50,966
Commercial Loans	76,586	79,563	21,116
Municipal Loans	29,630	94,611	174,342
Total	$ 259,391	$ 350,208	$ 246,424

Loans with Maturities After One Year for Which:	Interest Rates are Fixed or Predetermined	$ 320,648
	Interest Rates are Floating or Adjustable	$ 275,984

(1) The volume of commercial loans due within one year reflects our general policy of attempting to limit these loans to a short-term maturity. Nonaccrual loans totaling $5.6 million are reflected in the due after five years column.

LOANS TO AFFILIATED PARTIES

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2016, 2015 and 2014, these loans totaled $6.3 million, $8.1 million and $7.1 million, respectively. These loans represented 1.2%, 1.8%, and 1.7% of shareholders' equity as of December 31, 2016, 2015 and 2014, respectively.

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

Our allowance for loan losses was $17.9 million at December 31, 2016, or 0.7% of loans, a decrease of $1.8 million, or 9.2%, compared to $19.7 million at December 31, 2015. The decrease in the allowance for loan losses is related primarily to the reduction of impaired loans during 2016. Loans increased during 2016 as a result of increased origination activity primarily in the Austin and Dallas-Fort Worth markets.

The allowance for loan losses is based on the most current review of the loan portfolio and is a result of multiple processes. First, we utilize historical net charge-off data to establish general reserve amounts for each class of loans. The historical charge-off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements not reflected in the historical data. Second, our lenders have the primary responsibility for identifying problem loans based on customer financial stress and underlying collateral. These recommendations are reviewed by senior loan administration, the special assets department, and the loan review department. Third, the loan review department independently reviews the portfolio on an annual basis. The loan review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of considerations including the size of the loan, the type of credit extended, the seasoning of the loan and the performance of the loan. The loan review scope, as it relates to size, focuses more on larger dollar loan relationships, typically aggregate debt of $500,000 or greater. The loan review officer also reviews specific reserves compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If at the time of the review we determine it is probable we will not collect the principal and interest cash flows contractually due on the loan, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $150,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

We calculate historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced, consistent with the characteristics of remaining loans, to the total population of loans in the pool. The historical gross loss ratios are updated based on actual charge-off experience quarterly and adjusted for qualitative factors. All loans are subject to individual analysis if determined to be impaired with the exception of consumer loans and loans secured by 1-4 residential loans.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may occur as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit worthiness of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, and geographic and industry loan concentration.

As of December 31, 2016, our review of the loan portfolio indicated that a loan loss allowance of $17.9 million was appropriate to cover probable losses in the portfolio. Changes in economic and other conditions may require future adjustments to the allowance for loan losses.

The following table presents information regarding the average amount of net loans outstanding, changes in the allowance for loan losses, selected asset quality ratios and an allocation of the allowance for loan losses (dollars in thousands).

LOAN LOSS EXPERIENCE AND ALLOWANCE FOR LOAN LOSSES

	Years Ended December 31,				
	2016	2015	2014	2013	2012
Average Net Loans Outstanding	$ 2,452,803	$ 2,224,401	$ 1,420,802	$ 1,296,440	$ 1,180,095
Balance of Allowance for Loan Losses at Beginning of Period	$ 19,736	$ 13,292	$ 18,877	$ 20,585	$ 18,540
Loan Charge-Offs:					
Real Estate:					
Construction	—	(24)	(14)	—	(41)
1-4 Family Residential	(43)	(58)	(22)	(319)	(239)
Commercial	—	—	—	(67)	(159)
Commercial Loans	(11,396)	(336)	(66)	(512)	(402)
Municipal Loans	—	(249)	—	—	—
Loans to Individuals	(2,948)	(3,688)	(22,461)	(12,676)	(10,188)
Total Loan Charge-Offs	(14,387)	(4,355)	(22,563)	(13,574)	(11,029)
Recovery of Loans Previously Charged-off:					
Real Estate:					
Construction	269	207	156	77	121
1-4 Family Residential	141	115	81	91	172
Commercial	23	85	8	339	6
Commercial Loans	666	153	171	233	312
Municipal Loans	249	—	—	—	—
Loans to Individuals	1,434	1,896	1,624	2,247	1,727
Total Recovery of Loans Previously Charged-Off	2,782	2,456	2,040	2,987	2,338
Net Loan Charge-Offs	(11,605)	(1,899)	(20,523)	(10,587)	(8,691)
Provision for Loan Losses	9,780	8,343	14,938	8,879	10,736
Balance of Allowance for Loan Losses at End of Period	$ 17,911	$ 19,736	$ 13,292	$ 18,877	$ 20,585
Net Charge-Offs to Average Net Loans Outstanding	0.47%	0.09%	1.44%	0.82%	0.74%
Allowance for Loan Losses to Nonaccruing Loans	216.32	96.15	324.51	233.40	199.58
Allowance for Loan Losses to Nonperforming Assets	118.58	60.76	108.27	138.74	139.87
Allowance for Loan Losses to Total Loans	0.70	0.81	0.61	1.40	1.63

Allocation of Allowance for Loan Losses (dollars in thousands):

	Years Ended December 31,									
	2016		2015		2014		2013		2012	
	Amount	Percent of Loans To Total Loans	Amount	Percent of Loans To Total Loans	Amount	Percent of Loans To Total Loans	Amount	Percent of Loans To Total Loans	Amount	Percent of Loans To Total Loans
Real Estate										
Construction	$ 4,147	14.9%	$ 4,350	18.0%	$ 2,456	12.3%	$ 2,142	9.3%	$ 2,355	9.0%
1-4 Family Residential	2,665	24.9%	2,595	27.0%	2,822	31.6%	3,277	28.9%	3,545	29.2%
Commercial	7,204	37.0%	4,577	26.1%	3,025	21.5%	2,572	19.4%	2,290	18.7%
Commercial Loans	2,263	6.9%	6,596	10.0%	3,279	10.4%	1,970	11.7%	3,158	12.7%
Municipal Loans	750	11.7%	725	11.8%	716	11.8%	668	18.2%	633	17.5%
Loans to Individuals	882	4.6%	893	7.1%	994	12.4%	8,248	12.5%	7,373	12.9%
Other	—	—	—	—	—	—	—	—	1,231	0.0%
Ending Balance	$ 17,911	100.0%	$ 19,736	100.0%	$ 13,292	100.0%	$ 18,877	100.0%	$ 20,585	100.0%

See "Note 6 – Loans and Allowance for Probable Loan Losses" in our consolidated financial statements included in this report.

NONPERFORMING ASSETS

Nonperforming assets consist of delinquent loans 90 days or more past due, nonaccrual loans, OREO, repossessed assets and restructured loans. Nonaccrual loans are loans 90 days or more delinquent and collection in full of both the principal and interest is not expected. Additionally, some loans that are not delinquent may be placed on nonaccrual status due to doubts about full collection of principal or interest. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. OREO represents real estate taken in full or partial satisfaction of debts previously contracted. The dollar amount of OREO is based on a current evaluation of the OREO at the time it is recorded on our books, net of estimated selling costs. Updated valuations are obtained as needed and any additional impairments are recognized. Restructured loans represent loans that have been renegotiated to provide a below market or deferral of interest or principal because of deterioration in the financial position of the borrowers. The restructuring of a loan is considered a "troubled debt restructuring" if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Categorization of a loan as nonperforming is not in itself a reliable indicator of potential loan loss. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower must be considered in judgments as to potential loan loss.

Total nonperforming assets at December 31, 2016 were $15.1 million representing a decrease of $17.4 million, or 53.5%, from $32.5 million at December 31, 2015. From December 31, 2015 to December 31, 2016, nonaccrual loans decreased $12.2 million, or 59.7%, to $8.3 million. Of this total, $5.5 million are commercial loans, $1.1 million are residential real estate loans, $823,000 are loans to individuals, $808,000 are commercial real estate loans and $105,000 are construction loans. OREO decreased $405,000, or 54.4%, to $339,000 from December 31, 2015 to December 31, 2016. We are actively marketing all properties and none are being held for investment purposes. Restructured loans decreased $4.7 million, or 42.3%, to $6.4 million. Repossessed assets decreased $15,000, or 23.4%, to $49,000 at December 31, 2016 from $64,000 at December 31, 2015. Included in total nonperforming assets are $8.3 million of loans classified as troubled debt restructurings at December 31, 2016 and $26.7 million at December 31, 2015.

The following table presents information on nonperforming assets (dollars in thousands):

	NONPERFORMING ASSETS Years Ended December 31,				
	2016	2015	2014	2013	2012
Accruing Loans Past Due More Than 90 Days: (1)					
Loans to Individuals	$ 6	$ 3	$ 4	$ 3	$ 15
	6	3	4	3	15
Loans on Nonaccrual: (1)					
Real Estate Loans	1,980	5,171	3,408	3,506	5,774
Commercial Loans	5,477	13,896	416	1,062	1,812
Loans to Individuals	823	1,459	272	3,520	2,728
	8,280	20,526	4,096	8,088	10,314
Restructured Loans: (2)					
Real Estate Loans	5,301	3,045	4,542	2,399	2,135
Commercial Loans	464	7,401	595	307	231
Municipal Loans	571	637	699	759	—
Loans to Individuals	95	60	38	423	632
	6,431	11,143	5,874	3,888	2,998
Total Nonperforming Loans	14,717	31,672	9,974	11,979	13,327
Other Real Estate Owned	339	744	1,738	726	686
Repossessed Assets	49	64	565	901	704
Total Nonperforming Assets	$ 15,105	$ 32,480	$ 12,277	$ 13,606	$ 14,717
Nonperforming Assets to Total Assets	0.27%	0.63%	0.26%	0.39%	0.45%
Nonperforming Assets to Total Loans	0.59	1.34	0.56	1.01	1.17
Nonaccrual Loans to Total Loans	0.32	0.84	0.19	0.60	0.82

(1) Excludes PCI loans measured at fair value at acquisition.
(2) Includes $3.1 million and $7.5 million of PCI loans restructured during the years ended December 31, 2016 and 2015.

Nonperforming assets at December 31, 2016, as a percentage of total assets decreased to 0.27% from the previous year and as a percentage of loans decreased to 0.59%. Nonperforming assets decreased primarily due to the payoff of one long-time nonaccrual loan during the first quarter and the settlement of two large impaired relationships in the second quarter. Nonperforming assets hinder our ability to earn interest income. Decreases in earnings can result from both the loss of interest income and the costs associated with maintaining the OREO, for taxes, insurance and other operating expenses.

Potential problem loans consist of loans that are performing in accordance with contractual terms, but for which management has concerns about the ability of a borrower to continue to comply with repayment terms because of the borrower's potential operating or financial difficulties. Management monitors these loans closely and reviews their performance on a regular basis. At December 31, 2016, we had $42.6 million in potential problem loans that were graded as substandard accruing, of which none are included in any one of the non-accrual, restructured or 90 days past due loan categories.

Prior to 2014, the restructured loans to individuals referred to in the preceding table were primarily SFG loans which had payment extensions or whose maturities were extended due to late payments on the contract. Those loans continued to accrue interest on the principal balance.

The following is a summary of our recorded investment in loans (primarily nonaccrual loans) for which impairment has been recognized (in thousands). Impaired loans include restructured and nonaccrual loans for which the allowance was measured in accordance with section 310-10 of ASC Topic 310, "Receivables." At December 31, 2016 and 2015, there were no impaired loans without an allowance:

	December 31, 2016		
	Recorded Investment	Related Allowance for Loan Losses	Carrying Value
Real Estate Loans	$ 6,318	$ 46	$ 6,272
Commercial Loans	5,941	923	5,018
Municipal Loans	571	11	560
Loans to Individuals	241	106	135
Total (1)	$ 13,071	$ 1,086	$ 11,985

	December 31, 2015		
	Recorded Investment	Related Allowance for Loan Losses	Carrying Value
Real Estate Loans	$ 6,895	$ 174	$ 6,721
Commercial Loans	21,385	4,599	16,786
Municipal Loans	637	13	624
Loans to Individuals	257	105	152
Total (1)	$ 29,174	$ 4,891	$ 24,283

(1) Includes $3.1 million and $8.0 million of PCI loans that experienced deteriorations in credit quality subsequent to the acquisition date as of December 31, 2016 and 2015, respectively.

For the years ended December 31, 2016 and 2015, the average recorded investment in impaired loans was approximately $22.6 million and $23.6 million, respectively.

The amount of interest recognized on loans that were nonaccruing or restructured was $484,000, $1.2 million and $365,000 for the years ended December 31, 2016, 2015 and 2014, respectively. If these loans had been accruing interest at their original contracted rates, related income would have been $898,000 for the year ended December 31, 2016, $2.0 million for the year ended December 31, 2015 and $663,000 for the year ended December 31, 2014.

SECURITIES ACTIVITY

Our securities portfolio plays a primary role in management of our interest rate sensitivity and, therefore, is managed in the context of the overall balance sheet. The securities portfolio generates a substantial percentage of our interest income and serves as a necessary source of liquidity.

We account for debt and equity securities as follows:

- Available for Sale ("AFS"). Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as AFS. These assets are carried at fair value. Fair value is determined using quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services. Unrealized gains and losses on AFS securities are excluded from earnings and reported net of tax as a separate component of shareholders' equity until realized.

- Held to Maturity ("HTM"). Debt securities that management has the current intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts.

Premiums are amortized and discounts are accreted to maturity, or in the case of MBS, over the estimated life of the security, using the level yield interest method. Declines in the fair value of AFS and HTM securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (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) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recognized on the trade date and are determined using the specific identification method.

Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates the fair value of those assets and are assessed for other-than-temporary impairment.

Management attempts to deploy investable funds into instruments that are expected to provide a reasonable overall return on the portfolio given the current assessment of economic and financial conditions, while maintaining acceptable levels of capital, interest rate and liquidity risk. At December 31, 2016, the combined investment securities, MBS, FHLB stock and other investments as a percentage of total assets was 44.6% compared to loans, which were 45.9% of total assets. For a discussion of our strategy in relation to the securities portfolio, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Balance Sheet Strategy."

The following tables set forth the carrying amount of investment securities and MBS (in thousands):

Available for Sale:	December 31, 2016	December 31, 2015	December 31, 2014
Investment Securities:			
U.S. Treasury	$ 70,069	$ 103,587	$ 14,906
U.S. Government Agency Debentures	—	—	4,828
State and Political Subdivisions	385,197	244,246	267,684
Other Stocks and Bonds	6,651	12,790	13,239
Other Equity Securities	5,920	6,016	6,049
Mortgage-backed Securities: (1)			
Residential	627,508	588,502	964,298
Commercial	384,255	505,351	177,704
Total	$ 1,479,600	$ 1,460,492	$ 1,448,708

Held to Maturity:	December 31, 2016	December 31, 2015	December 31, 2014
Investment Securities:			
State and Political Subdivisions	$ 425,810	$ 385,496	$ 388,823
Mortgage-backed Securities: (1)			
Residential	136,312	31,379	52,217
Commercial	375,365	367,421	201,279
Total	$ 937,487	$ 784,296	$ 642,319

(1) All mortgage-backed securities issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.

We invest in MBS, including mortgage participation certificates, which are insured or guaranteed by U.S. Government agencies and GSEs, CMOs and real estate mortgage investment conduits ("REMICs"). MBS (which also are known as mortgage participation certificates or pass-through certificates) represent a participation interest in a pool of single-family or multi-family mortgages, the principal and interest payments on which are passed from the mortgage originators, through intermediaries (generally U.S. Government agencies and GSEs) that pool and re-package the participation interests in the form of securities, to investors such as ourselves. U.S. Government agencies, primarily Government National Mortgage Association ("GNMA") and GSEs, primarily Freddie Mac, and Fannie Mae guarantee the payment of principal and interest to investors. GSEs are not backed by the full faith and credit of the U.S. Government. Freddie Mac, Fannie Mae and FHLB are the primary GSEs from which we purchase securities. At December 31, 2016, all of our MBS were collateralized by U.S. Government agencies or GSEs.

MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

Our MBS include CMOs, which include securities issued by entities that have qualified under the Internal Revenue Code of 1986, as amended, as REMICs. CMOs and REMICs (collectively CMOs) were developed in response to investor concerns regarding the uncertainty of cash flows associated with the prepayment option of the underlying mortgages and are typically issued by governmental agencies, GSEs and special purpose entities, such as trusts, corporations or partnerships, established by financial institutions or other similar institutions. A CMO can be collateralized by loans or securities which are insured or guaranteed by Fannie Mae, Freddie Mac or GNMA. In contrast to pass-through MBS, in which cash flow is received pro rata by all security holders, the cash flow from the mortgages underlying a CMO is segmented and paid in accordance with a predetermined priority to investors holding various CMO classes. By allocating the principal and interest cash flows from the underlying collateral among the separate CMO classes, different classes of bonds are created, each with its own stated maturity, estimated average life, coupon rate and prepayment characteristics.

Like most fixed income securities, MBS are subject to interest rate risk. However, unlike most other fixed income securities, the mortgage loans underlying a mortgage-backed security generally may be prepaid at any time without penalty. The ability to prepay a mortgage loan generally results in significantly increased price and yield volatility (with respect to MBS) than is the case with noncallable fixed income securities. Most of our MBS were purchased at a premium. As these MBS prepay at a faster rate our yield on these securities will decrease. Conversely, as prepayments slow the yield on these MBS will increase. The total unamortized premium for our MBS decreased to $36.3 million at December 31, 2016 compared to $42.1 million at December 31, 2015.

During 2016, we sold U.S. Agency CMOs, U.S. Agency CMBS, Texas municipal securities, U.S. Agency MBS, and U.S. Treasury securities. The sale of these available for sale securities resulted in an overall gain of $2.8 million. There can be no assurance that the level of security gains reported during the year ended December 31, 2016, will continue in future periods.

The combined investment securities, MBS, FHLB stock and other investments increased to $2.48 billion at December 31, 2016, compared to $2.30 billion at December 31, 2015, an increase of $182.4 million, or 7.9%. This increase is primarily a result of an increase in our investments in state and political subdivisions of $181.3 million, or 28.8%, an increase in MBS of $30.8 million, or 2.1%, and an increase in FHLB stock of $10.0 million, or 19.7%, which was partially offset by decreases of $33.5 million, or 32.4%, and $6.1 million, or 48.0%, in our ownership of U.S. Treasury securities and other stock and bonds, respectively, during 2016 compared to 2015.

During 2015, as interest rates remained low, we primarily sold CMOs along with some U.S. Agency mortgage pass-throughs, U.S. Agency CMBS, Texas municipal securities and U.S. Treasury securities. The sale of these securities resulted in an overall gain on the sale of available for sale securities of $3.7 million.

During 2014, with interest rates low, we sold primarily lower yielding, longer duration municipal securities and more prepayment volatile MBS and replaced them with primarily shorter duration municipal securities. The sale of these securities resulted in an overall gain on the sale of available for sale securities of $2.8 million.

The combined fair value of the AFS and HTM securities portfolio at December 31, 2016 was $2.42 billion, which represented a net unrealized loss as of that date of $29.7 million. The net unrealized loss was comprised of $29.5 million in unrealized gains and $59.1 million of unrealized losses. The fair value of the AFS securities portfolio at December 31, 2016 was $1.48 billion, which represented a net unrealized loss as of that date of $17.8 million. The net unrealized loss was comprised of $10.9 million of unrealized gains and $28.7 million of unrealized losses. The majority of the $28.7 million of unrealized losses is reflected in our state and political subdivisions, and commercial and residential MBS. Net unrealized gains and losses on securities transferred to HTM from AFS are included as a component of shareholder's equity on the consolidated balance sheet. Net unrealized gains and losses on AFS securities, which is also a component of shareholders' equity on the consolidated balance sheet, can fluctuate significantly as a result of changes in interest rates. Because management cannot predict the future direction of interest rates, the effect on shareholders' equity in the future cannot be determined; however, this risk is monitored through the use of shock tests on the AFS securities portfolio using an array of interest rate assumptions.

We transferred securities from AFS to HTM with a fair value of $157.1 million and $57.7 million during the years ended December 31, 2016 and 2015, respectively. For the year ended December 31, 2016, the unrealized loss on the securities transferred from AFS to HTM was $10.2 million ($6.7 million net of tax) at the date of transfer based on the fair value of the securities on the transfer date. For the year ended December 31, 2015, the unrealized gain on the securities transferred from AFS to HTM was $1.3 million ($864,000, net of tax) at the date of transfer based on the fair value of the securities on the transfer date.

There were no securities transferred from AFS to HTM during 2014. There were no sales from the HTM portfolio during the years ended December 31, 2016, 2015 or 2014. There were $937.5 million and $784.3 million of securities classified as HTM at December 31, 2016 and 2015, respectively.

The maturities classified according to the sensitivity to changes in interest rates of the December 31, 2016 securities portfolio and the weighted yields are presented below (dollars in thousands). Tax-exempt obligations are shown on a taxable equivalent basis. Mortgage-backed securities are included in maturity categories based on their stated maturity date. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	MATURING							
	Within 1 Year		After 1 But Within 5 Years		After 5 But Within 10 Years		After 10 Years	
Available for Sale:	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Investment Securities:								
U.S. Treasury	$ —	—	$ —	—	$ 70,069	1.82%	$ —	—
State and Political Subdivisions	2,067	5.98%	25,471	6.17%	34,506	4.90%	323,153	5.04%
Other Stocks and Bonds	1,500	2.29%	2,110	2.00%	3,041	1.94%	—	—
Other Equity Securities	5,920	1.98%	—	—	—	—	—	—
Mortgage-backed Securities:								
Residential	73	4.35%	2,258	3.72%	60,721	2.06%	564,456	2.19%
Commercial	87	5.06%	7,227	3.23%	376,941	2.57%	—	—
Total	$ 9,647	2.93%	$ 37,066	5.21%	$ 545,278	2.56%	$ 887,609	3.23%

	MATURING							
	Within 1 Year		After 1 But Within 5 Years		After 5 But Within 10 Years		After 10 Years	
Held to Maturity:	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Investment Securities:								
State and Political Subdivisions	$ 6,406	(1.28)%	$ 42,418	2.69%	$ 96,327	4.92%	$ 280,659	6.04%
Mortgage-backed Securities:								
Residential	—	—	5,796	3.91%	1,674	4.85%	128,842	4.31%
Commercial	—	—	15,922	2.93%	331,851	2.81%	27,592	2.89%
Total	$ 6,406	(1.28)%	$ 64,136	2.86%	$ 429,852	3.29%	$ 437,093	5.33%

At December 31, 2016, there were no holdings of any one issuer, other than the U.S. Government, its agencies and its GSEs, in an amount greater than 10% of our shareholders' equity.

DEPOSITS AND BORROWED FUNDS

Deposits provide us with our primary source of funds. The increase of $77.7 million, or 2.2%, in total deposits during 2016 partially funded our increase in the loan portfolio. Deposits increased during 2016 primarily due to an increase in public fund deposits and increased market penetration. During 2016, our public fund deposits increased $76.8 million to $995.5 million at December 31, 2016 from $918.7 million at December 31, 2015. At December 31, 2016, brokered CDs reflected a decrease of approximately $49.8 million compared to December 31, 2015. At both December 31, 2016 and 2015, we had $1.0 million of brokered money market deposit accounts. Deposits, net of all brokered deposits, at December 31, 2016, increased $127.4 million, or 3.8%, compared to December 31, 2015. Time deposits, including brokered CDs, increased a total of $22.7 million, or 2.5%, during 2016 compared to 2015. Noninterest bearing demand deposits increased $31.5 million, or 4.7%, during 2016. Interest bearing demand deposits increased $7.1 million, or 0.4%, and saving deposits increased $16.3 million, or 7.0%, during 2016. The latter three categories, which are considered the lowest cost deposits, comprised 74.2% of total deposits at December 31, 2016 compared to 74.3% at December 31, 2015.

The following table sets forth deposits by category (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Noninterest Bearing Demand Deposits	$ 704,013	$ 672,470	$ 661,014
Interest Bearing Demand Deposits	1,667,405	1,660,295	1,646,155
Savings Deposits	249,509	233,172	226,276
Time Deposits	912,149	889,470	840,972
Total Deposits	$ 3,533,076	$ 3,455,407	$ 3,374,417

During the year ended December 31, 2016, total time deposits of $100,000 or more increased $90.3 million, or 14.9%, to $697.7 million from $607.4 million at December 31, 2015.

The table below sets forth the maturity distribution of time deposits of $100,000 or more (in thousands):

	December 31, 2016			December 31, 2015		
	Time Certificates Of Deposit	Other Time Deposits	Total	Time Certificates Of Deposit	Other Time Deposits	Total
Three months or less	$ 64,604	$ 23,750	$ 88,354	$ 70,677	$ 7,000	$ 77,677
Over three to six months	97,792	20,750	118,542	81,169	7,000	88,169
Over six to twelve months	141,540	6,500	148,040	149,753	—	149,753
Over twelve months	342,754	—	342,754	291,813	—	291,813
Total	$ 646,690	$ 51,000	$ 697,690	$ 593,412	$ 14,000	$ 607,412

At December 31, 2016, we had $35.5 million in brokered CDs that represented 1.0% of our deposits. Our brokered CDs at December 31, 2016 have maturities of less than three years and are reflected in the CDs under $100,000 category. At December 31, 2015, we had $85.3 million in brokered CDs and at December 31, 2014, we had $23.4 million in brokered CDs. Our current policy allows for a maximum of $180 million in brokered CDs. The potential higher interest cost and lack of customer loyalty are risks associated with the use of brokered CDs.

Short-term obligations, consisting primarily of FHLB advances, federal funds purchased and repurchase agreements, increased $225.8 million, or 34.9%, during 2016 compared to 2015 primarily to fund the increase in securities and loans. FHLB advances are collateralized by FHLB stock, nonspecified loans and securities.

Short-term obligations are summarized as follows (dollars in thousands):

	Years Ended December 31, 2016	2015	2014
Federal funds purchased and repurchase agreements:			
Balance at end of period	$ 7,097	$ 2,429	$ 4,237
Average amount outstanding during the period (1)	6,798	2,277	1,886
Maximum amount outstanding during the period (2)	11,516	2,429	4,237
Weighted average interest rate during the period (3)	0.1%	0.1%	0.2%
Interest rate at end of period	0.2%	0.1%	1.4%
FHLB advances:			
Balance at end of period	$ 866,518	$ 645,407	$ 297,368
Average amount outstanding during the period (1)	563,471	382,417	62,240
Maximum amount outstanding during the period (2)	866,518	656,431	297,368
Weighted average interest rate during the period (3)	0.7%	0.3%	0.9%
Interest rate at end of period	0.7%	0.5%	0.4%

(1) The average amount outstanding during the period was computed by dividing the total daily outstanding principal balances by the number of days in the period.
(2) The maximum amount outstanding at any month-end during the period.
(3) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.

Long-term obligations are summarized as follows (in thousands):

	Years Ended December 31,	
	2016	2015
Parent Company		
Subordinated notes: (1)		
5.50% Subordinated Notes Due 2026, net of unamortized debt issuance costs (2)	$ 98,100	$ —
Total Subordinated notes	98,100	—
Long-term debt: (3)		
Southside Statutory Trust III Due 2033, net of unamortized debt issuance costs (4)	20,544	20,539
Southside Statutory Trust IV Due 2037 (5)	23,196	23,196
Southside Statutory Trust V Due 2037 (6)	12,887	12,887
Magnolia Trust Company I Due 2035 (7)	3,609	3,609
Total Long-term debt	60,236	60,231
Total Parent company	158,336	60,231
Subsidiaries		
FHLB advances (8)	443,128	502,281
Total Subsidiaries	443,128	502,281
Total Long-term obligations	$ 601,464	$ 562,512

(1) This long-term debt consists of subordinated notes with a remaining maturity greater than one year that qualify under the risk-based capital guidelines as Tier 2 capital, subject to certain limitations.
(2) This debt carries a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a rate equal to three-month LIBOR plus 429.7 basis points.
(3) This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.
(4) This debt carries an adjustable rate of 3.93789% through March 30, 2017 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.
(5) This debt carried an adjustable rate of 2.18733% through January 29, 2017 and reset to 2.339% through April 29, 2017. This debt adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.
(6) This debt carries an adjustable rate of 3.21344% through March 14, 2017 and adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.
(7) This debt carried an adjustable rate of 2.71983% through February 22, 2017 and reset to 2.85344% through May 22, 2017. This debt adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.
(8) At December 31, 2016, the weighted average cost of these advances was 1.2%.

On September 19, 2016, the Company issued $100.0 million aggregate principal amount of fixed-to-floating rate subordinated notes that mature on September 30, 2026. This debt initially bears interest at a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a floating rate equal to three-month LIBOR plus 429.7 basis points. The proceeds from the sale of the subordinated notes were used for general corporate purposes, which included advances to the Bank to finance its activities. The unamortized discount and debt issuance costs reflected in the subordinated notes issued totaled approximately $1.9 million at December 31, 2016.

Long-term debt was $60.2 million at both December 31, 2016 and 2015. Long-term debt consists of $56.6 million of our junior subordinated debentures issued in connection with the issuance of trust preferred securities by Southside Statutory Trusts III, IV, V and $3.6 million of junior subordinated debentures issued to Magnolia Trust Company I. The unamortized debt issuance costs deducted from the carrying amount of the Southside Statutory Trust III junior subordinated debentures totaled $75,000 at December 31, 2016 and $80,000 at December 31, 2015.

Long-term FHLB advances decreased $59.2 million, or 11.8%, during 2016 to $443.1 million compared to $502.3 million in 2015. The decrease was the result of a decrease in long-term FHLB advances purchased during 2016 combined with advances classified as long-term at December 31, 2015 rolling into the short-term FHLB advance category.

During the fourth quarter of 2015 and continuing into the first half of 2016, the Company entered into various variable rate advance agreements with the FHLB. At December 31, 2016, these agreements had a total notional value of $250.0 million with rates ranging from one-month LIBOR plus 0.17% to one-month LIBOR plus 0.278%. In addition, the Company entered into various interest rate swap contracts that are treated as cash flow hedges under ASC Topic 815, “Derivatives and Hedging” that effectively converted the variable rate advances to fixed interest rates ranging from 0.932% to 1.647% and original terms ranging from four years to nine years. The cash flows from the swaps are expected to be effective in hedging the variability in future cash flows attributable to fluctuations in the one-month LIBOR interest rate. Refer to “Note 12 - Derivative Financial Instruments and Hedging Activities” in our consolidated financial statements included in this report for a detailed description of our hedging policy and methodology related to derivative instruments.

CAPITAL RESOURCES

Our total shareholders' equity at December 31, 2016 of $518.3 million increased 16.7%, or $74.2 million, from December 31, 2015 and represented 9.3% of total assets at December 31, 2016 compared to 8.6% at December 31, 2015.

The increase in shareholders' equity at December 31, 2016 was primarily comprised of the proceeds from the issuance of 2,185,000 shares of common stock totaling $76.0 million, net income of $49.3 million recorded for the year ended December 31, 2016, net issuance of common stock under employee stock plans of $1.6 million, stock compensation expense of $1.5 million, and $1.4 million of common stock issued under our dividend reinvestment plan. These increases were partially offset by cash dividends paid of $26.0 million, an increase in accumulated other comprehensive loss of $19.8 million, and the repurchase of $10.2 million of our common stock. The increase in accumulated other comprehensive loss is comprised primarily of an increase of $23.5 million, net of tax, in the unrealized loss on securities, net of reclassification adjustments, partially offset by an increase of $4.6 million, net of tax in the unrealized gain on effective cash flow hedge interest rate swap derivatives and the reclassification adjustments included in net income, and a decrease of $936,000, net of tax, related to the change in the funded status of our defined benefit plan. See "Note 4 – Accumulated Other Comprehensive Loss" to our consolidated financial statements included in this report.

As a result of new regulations, we are now required to comply with higher minimum capital requirements (the "Updated Capital Rules"). The Updated Capital Rules, which became applicable to the Company and the Bank on January 1, 2015, made substantial changes to these previous standards. Among other things, the new regulations (i) introduced a new capital requirement known as "Common Equity Tier 1" ("CET1"), (ii) stated that Tier 1 capital consist of CET1 and "Additional Tier 1 capital" instruments meeting certain requirements, (iii) defined CET1 to require that most deductions and adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) revised the scope of the deductions and adjustments from capital as compared to regulations that previously applied to the Company and other banking organizations.

The Updated Capital Rules also established the following minimum capital ratios, which started to phase in on January 1, 2015: 4.5 percent CET1 to risk-weighted assets; 6.0 percent Tier 1 capital to risk-weighted assets; 8.0 percent total capital to risk-weighted assets; and 4.0 percent Tier 1 leverage ratio to average consolidated assets. In addition, the Updated Capital Rules also introduced a minimum "capital conservation buffer" equal to 2.5% of an organization's total risk-weighted assets, which exists in addition to these new required minimum CET1, Tier 1, and total capital ratios. The "capital conservation buffer," which must consist entirely of CET1, is designed to absorb losses during periods of economic stress. The Updated Capital Rules provide for a number of deductions from and adjustments to CET1, which include the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carry-backs and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Under the previous capital framework, the effects of accumulated other comprehensive income items included in shareholders' equity under U.S. GAAP were excluded for the purposes of determining capital ratios. Under the Updated Capital Rules, the company has elected to permanently exclude capital in accumulated other comprehensive income in Common Equity Tier 1 capital, Tier 1 capital, and Total capital to risk-weighted assets and Tier 1 capital to adjusted quarterly average assets.

Under the Updated Capital Rules, certain hybrid securities, such as trust preferred securities, do not qualify as Tier 1 capital. For bank holding companies that had assets of less than $15 billion as of December 31, 2009, which includes Southside, trust preferred securities issued prior to May 19, 2010 can be treated as Tier 1 capital to the extent that they do not exceed 25% of Tier 1 capital after the application of capital deductions and adjustments.

Failure to meet minimum capital requirements could result in certain mandatory and possibly additional discretionary actions by our regulators that, if undertaken, could have a direct material effect on our financial statements. Management believes that, as of December 31, 2016, we met all capital adequacy requirements to which we were subject.

The Federal Deposit Insurance Act requires bank regulatory agencies to take "prompt corrective action" with respect to FDIC-insured depository institutions that do not meet minimum capital requirements. A depository institution's treatment for purposes of the prompt corrective action provisions will depend on how its capital levels compare to various capital measures and certain other factors, as established by regulation. Prompt corrective action and other discretionary actions could have a direct material effect on our financial statements.

It is management's intention to maintain our capital at a level acceptable to all regulatory authorities and future dividend payments will be determined accordingly. Regulatory authorities require that any dividend payments made by either us or the Bank not exceed earnings for that year. Accordingly, shareholders should not anticipate a continuation of the cash dividend simply because of the existence of a dividend reinvestment program. The payment of dividends will depend upon future earnings, our financial condition, and other related factors including the discretion of the board of directors.

To be categorized as well capitalized we must maintain minimum Common Equity Tier 1 risk-based, Tier 1 risk-based, Total capital risk-based and Tier 1 leverage ratios as set forth in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Actions Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016:			(dollars in thousands)			
Common Equity Tier 1 (to Risk Weighted Assets)						
Consolidated	$ 461,158	14.64%	$ 141,759	4.50%	N/A	N/A
Bank Only	$ 566,423	17.98%	$ 141,734	4.50%	$ 204,726	6.50%
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	$ 515,831	16.37%	$ 189,013	6.00%	N/A	N/A
Bank Only	$ 566,423	17.98%	$ 188,978	6.00%	$ 251,971	8.00%
Total Capital (to Risk Weighted Assets)						
Consolidated	$ 633,289	20.10%	$ 252,017	8.00%	N/A	N/A
Bank Only	$ 585,781	18.60%	$ 251,971	8.00%	$ 314,964	10.00%
Tier 1 Capital (to Average Assets) (1)						
Consolidated	$ 515,831	9.46%	$ 218,029	4.00%	N/A	N/A
Bank Only	$ 566,423	10.40%	$ 217,892	4.00%	$ 272,365	5.00%
As of December 31, 2015:						
Common Equity Tier 1 (to Risk Weighted Assets)						
Consolidated	$ 368,865	12.71%	$ 130,549	4.50%	N/A	N/A
Bank Only	$ 416,378	14.36%	$ 130,446	4.50%	$ 188,422	6.50%
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	$ 422,513	14.56%	$ 174,065	6.00%	N/A	N/A
Bank Only	$ 416,378	14.36%	$ 173,928	6.00%	$ 231,904	8.00%
Total Capital (to Risk Weighted Assets)						
Consolidated	$ 443,106	15.27%	$ 232,087	8.00%	N/A	N/A
Bank Only	$ 436,971	15.07%	$ 231,904	8.00%	$ 289,881	10.00%
Tier 1 Capital (to Average Assets) (1)						
Consolidated	$ 422,513	8.61%	$ 196,347	4.00%	N/A	N/A
Bank Only	$ 416,378	8.49%	$ 196,209	4.00%	$ 245,261	5.00%

(1) Refers to quarterly average assets as calculated in accordance with policies established by bank regulatory agencies.

Management believes that, as of December 31, 2016, Southside Bancshares and Southside Bank would meet all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis as if such requirements were currently in effect.

The table below summarizes our key equity ratios:

	Years Ended December 31,		
	2016	2015	2014
Return on Average Assets	0.94%	0.90%	0.60%
Return on Average Shareholders' Equity	10.54%	10.04%	7.24%
Dividend Payout Ratio – Basic	54.30%	60.61%	96.97%
Dividend Payout Ratio – Diluted	54.30%	60.61%	96.97%
Average Shareholders' Equity to Average Total Assets	8.95%	9.00%	8.27%

ACCOUNTING PRONOUNCEMENTS

See "Note 1 – Summary of Significant Accounting and Reporting Policies" to our consolidated financial statements included in this report.

EFFECTS OF INFLATION

Our consolidated financial statements, and their related notes, have been prepared in accordance with GAAP which requires the measurement of financial position and operating results in terms of historical dollars, without considering the change in the relative purchasing power of money over time and due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike many industrial companies, nearly all of our assets and liabilities are monetary. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the price of goods and services. Inflation can affect the amount of money customers have for deposits, as well as ability to repay loans.

MANAGEMENT OF LIQUIDITY

Liquidity management involves our ability to convert assets to cash with a minimum risk of loss to enable us to meet our obligations to our customers at any time. This means addressing (1) the immediate cash withdrawal requirements of depositors and other fund providers; (2) the funding requirements of all lines and letters of credit; and (3) the short-term credit needs of customers. Liquidity is provided by short-term investments that can be readily liquidated with a minimum risk of loss. Cash, interest earning deposits and short-term investments with maturities or repricing characteristics of one year or less continue to be a substantial percentage of total assets. At December 31, 2016, these investments were 7.2% of total assets, as compared with 11.0% for December 31, 2015, and 12.9% for December 31, 2014. The decrease to 7.2% at December 31, 2016 is primarily reflective of changes in the investment portfolio and the increase in total assets. Liquidity is further provided through the matching, by time period, of rate sensitive interest earning assets with rate sensitive interest bearing liabilities. Southside Bank has three unsecured lines of credit for the purchase of overnight federal funds at prevailing rates with Frost Bank, TIB -The Independent Bankers Bank and Comerica Bank for $30.0 million, $15.0 million and $7.5 million, respectively. There were no federal funds purchased at December 31, 2016. Southside Bank has a $5.0 million line of credit with Frost Bank to be used to issue letters of credit and at December 31, 2016, we had one outstanding letter of credit for $195,000. At December 31, 2016, the amount of additional funding Southside Bank could obtain from FHLB, collateralized by FHLB stock, nonspecified loans and securities, was approximately $482.6 million, net of FHLB stock purchases required. Southside Bank currently has no outstanding letters of credit from FHLB as collateral for a portion of its public fund deposits.

Interest rate sensitivity management seeks to avoid fluctuating net interest margins and to enhance consistent growth of new interest income through periods of changing interest rates. The ALCO closely monitors various liquidity ratios and interest rate spreads and margins. The ALCO performs interest rate simulation tests that apply various interest rate scenarios including immediate shocks and market value of portfolio equity ("MVPE") with interest rates immediately shocked plus and minus 200 basis points to assist in determining our overall interest rate risk and adequacy of the liquidity position. In addition, the ALCO utilizes a simulation model to determine the impact on net interest income of several different interest rate scenarios. By utilizing this technology, we can determine changes that need to be made to the asset and liability mix to minimize the change in net interest income under these various interest rate scenarios.

OFF-BALANCE-SHEET ARRANGEMENTS

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we are a party to certain financial instruments with off-balance-sheet risk to meet the financing needs of our customers. These off-balance-sheet instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the financial statements. The contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss that we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require the payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers and similarly do not necessarily represent future cash obligations.

Financial instruments with off-balance-sheet risk were as follows (in thousands):

	December 31, 2016	December 31, 2015
Unused commitments:		
Commitments to extend credit	$ 665,663	$ 546,660
Standby letters of credit	9,075	7,752
Total	$ 674,738	$ 554,412

We apply the same credit policies in making commitments and standby letters of credit as we do for on-balance-sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The following summarizes our contractual cash obligations and commercial commitments at December 31, 2016, and the effect such obligations are expected to have on liquidity and cash flow in future periods (in thousands). Payments reflected in the table below do not include interest.

	Payments Due By Period				
	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years	Total
Contractual obligations:					
FHLB advances (1)	$ 867,276	$ 350,626	$ 87,706	$ 4,038	$ 1,309,646
Subordinated notes, net of unamortized debt issuance costs, including current maturities (2)	—	—	—	98,100	98,100
Long-term debt, net of unamortized debt issuance costs, including current maturities (3)	—	—	—	60,236	60,236
Operating leases (4)	1,467	2,087	958	287	4,799
Deferred compensation agreements (5)	425	828	852	3,099	5,204
Time deposits (6)	488,226	346,775	71,917	5,231	912,149
Securities purchased not paid for	160	—	—	—	160
Total contractual obligations	$ 1,357,554	$ 700,316	$ 161,433	$ 170,991	$ 2,390,294

(1) We have fixed rate FHLB advances with maturity dates ranging from 2017 through 2028, with interest rates ranging from 0.401% to 4.799% with a total balance of $1.31 billion at December 31, 2016.

(2) The total balance of subordinated notes, net of unamortized debt issuance costs, was $98.1 million at December 31, 2016. The unamortized debt issuance costs deducted from the carrying amount of the subordinated notes totaled approximately $1.9 million at December 31, 2016. This fixed-to-floating rate debt carries a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a floating rate equal to three-month LIBOR plus 429.7 basis points.

(3) The total balance of long-term debt, net of unamortized debt issuance costs, was $60.2 million at December 31, 2016. The unamortized debt issuance costs deducted from the carrying amount of the Southside Statutory Trust III junior subordinated debentures totaled $75,000 at December 31, 2016. The scheduled maturities and interest rates were as follows:

- Floating rate debt of $20.6 million with a scheduled maturity of 2033, was indexed to three-month LIBOR plus 294 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 3.93789% through March 30, 2017.
- Floating rate debt of $23.2 million with a scheduled maturity of 2037, was indexed to three-month LIBOR plus 130 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt was 2.18733% through January 29, 2017 and reset to 2.339% through April 29, 2017.
- Floating rate debt of $12.9 million with a scheduled maturity of 2037, was indexed to three-month LIBOR plus 225 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt is 3.21344% through March 14, 2017.
- Floating rate debt of $3.6 million with a scheduled maturity of 2035, was indexed to three-month LIBOR plus 180 basis points and adjusts on a quarterly basis. The rate of interest associated with this debt was 2.71983% through February 22, 2017 and reset to 2.85344% through May 22, 2017.

(4) We have various operating leases for our office equipment that total $167,000 and expire on or before the end of 2019. In addition, we have operating leases totaling $4.6 million on our retail branch locations, loan production offices and full service branch locations which have future commitments of up to seven years and additional options, which we control, beyond the commitment period.

(5) We have deferred compensation agreements (the “agreements”) with 16 officers with remaining payments totaling $5.2 million. Payments from the agreements are to commence at the time of retirement or death. As of December 31, 2016, $3.1 million in payments had been made from such agreements. Of the 16 officers included in the agreements, payments have commenced to eight executives and/or their beneficiaries. In addition, one active officer retired on December 31, 2016 with payments commencing in 2017. The remaining seven officers are eligible to receive deferred compensation at various dates beginning in 2018. The totals reflected under five years assume the retirement of the eligible officers eligible officers in 2016. Additional information regarding executive compensation is incorporated into “Item 11. Executive Compensation” of this Annual Report on Form 10-K.

(6) We had $35.5 million of brokered CDs at December 31, 2016 with maturity dates ranging from 2017 through 2019 and coupons ranging from 0.6% to 1.3%%.

We do not expect to contribute to our defined benefit plan during 2017. We do expect to contribute to our defined benefit plan in future years, however, those amounts are indeterminable at this time.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the banking industry, a major risk exposure is changing interest rates. The primary objective of monitoring our interest rate sensitivity, or risk, is to provide management the tools necessary to manage the balance sheet to minimize adverse changes in net interest income as a result of changes in the direction and level of interest rates. Federal Reserve Board monetary control efforts, the effects of deregulation, the current economic downturn and legislative changes have been significant factors affecting the management of interest rate sensitivity positions in recent years.

In an attempt to manage our exposure to changes in interest rates, management closely monitors our exposure to interest rate risk through our ALCO. Our ALCO meets regularly and reviews our interest rate risk position and makes recommendations to our board for adjusting this position. In addition, our board reviews our asset/liability position on a monthly basis. We primarily use two methods for measuring and analyzing interest rate risk: net income simulation analysis and MVPE modeling. We utilize the net income simulation model as the primary quantitative tool in measuring the amount of interest rate risk associated with changing market rates. The model quantifies the effects of various interest rate scenarios on projected net interest income and net income over the next 12 months. The model was used to measure the impact on net interest income relative to a base case scenario of rates increasing 100 and 200 basis points or decreasing 100 and 200 basis points over the next 12 months. These simulations incorporate assumptions regarding balance sheet growth and mix, pricing and the repricing and maturity characteristics of the existing and projected balance sheet. The impact of interest rate-related risks such as prepayment, basis and option risk are also considered. Due to the low level of interest rates many of the current interest rates cannot decline 100 or 200 basis points. The model has floors for each of those interest rates and none are assumed to go negative. As of December 31, 2016, the model simulations projected that an immediate increase in interest rates of 100 basis points would result in a positive variance on net interest income of 0.88% and an immediate increase in interest rates of 200 basis points would result in a negative variance on net interest income of 0.21%, relative to the base case over the next 12 months, while an immediate decrease in interest rates of 100 and 200 basis points would result in positive variances on net interest income of 2.25% and 1.67%, respectively, relative to the base case over the next 12 months. As of December 31, 2015, the model simulations projected that immediate increases in interest rates of 100 and 200 basis points would result in negative variances on net interest income of 0.42% and 1.78%, respectively, relative to the base case over the next 12 months, while an immediate decrease in interest rates of 100 and 200 basis points would result in a negative variance on net interest income of 1.18% and 0.38%, respectively, relative to the base case over the next 12 months. As part of the overall assumptions, certain assets and liabilities have been given reasonable floors. This type of simulation analysis requires numerous assumptions including but not limited to changes in balance sheet mix, prepayment rates on mortgage-related assets and fixed rate loans, cash flows and repricings of all financial instruments, changes in volumes and pricing, future shapes of the yield curve, relationship of market interest rates to each other (basis risk), credit spread and deposit sensitivity. Assumptions are based on management's best estimates but may not accurately reflect actual results under certain changes in interest rates.

The ALCO monitors various liquidity ratios to ensure a satisfactory liquidity position for us. Management continually evaluates the condition of the economy, the pattern of market interest rates and other economic data to determine the types of investments that should be made and at what maturities. Using this analysis, management from time to time assumes calculated interest sensitivity gap positions to maximize net interest income based upon anticipated movements in the general level of interest rates. Regulatory authorities also monitor our gap position along with other liquidity ratios. In addition, as described above, we utilize a simulation model to determine the impact of net interest income under several different interest rate scenarios. By utilizing this technology, we can determine changes that need to be made to the asset and liability mixes to mitigate the change in net interest income under these various interest rate scenarios.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item is set forth in Part IV.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), undertook an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act of 1934, as amended (the "Exchange Act")) as of December 31, 2015 and, based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of that date in recording, processing, summarizing and reporting in a timely manner the information that the Company is required to disclose in its reports under the Exchange Act and in accumulating and communicating to the Company's management, including the Company's CEO and CFO, such information as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

No changes were made to our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the last fiscal quarter of the period covered by this report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, is a process designed by, or under the supervision of, our CEO and CFO and effected by our board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework ("2013 framework").

Based on this assessment, management concluded that we maintained effective internal control over financial reporting as of December 31, 2016.

The effectiveness of our internal control over financial reporting as of December 31, 2016 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which appears in this Item under the heading "Attestation Report of Independent Registered Public Accounting Firm."

Southside Bancshares, Inc.
February 24, 2017

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Southside Bancshares, Inc.

We have audited Southside Bancshares, Inc. 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 (2013 framework) (the COSO criteria). Southside Bancshares, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Southside Bancshares, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2016 consolidated financial statements of Southside Bancshares, Inc. and subsidiaries and our report dated February 24, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
February 24, 2017

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2017 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2017 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2017 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2017 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated herein by reference to our Proxy Statement (Schedule 14A) for our 2017 Annual Meeting of shareholders to be filed with the SEC within 120 days of our fiscal year-end.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

1. Financial Statements

The following consolidated financial statements of Southside Bancshares, Inc. and its subsidiaries are filed as part of this report.

- Consolidated Balance Sheets as of December 31, 2016 and 2015.
- Consolidated Statements of Income for the years ended December 31, 2016, 2015 and 2014.
- Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014.
- Consolidated Statements of Changes in Equity for the years ended December 31, 2016, 2015 and 2014.
- Consolidated Statements of Cash Flow for the years ended December 31, 2016, 2015 and 2014.
- Notes to Consolidated Financial Statements.

2. Financial Statement Schedules

All schedules are omitted because they are not applicable or not required, or because the required information is included in the consolidated financial statements or notes thereto.

3. Exhibits

The exhibits listed in the Exhibit Index (following the signature pages of this report) are filed with, or incorporated by reference in, this report.

SIGNATURES

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

SOUTHSIDE BANCSHARES, INC.

DATE: February 24, 2017

BY: /s/ Lee R. Gibson

Lee R. Gibson, CPA
President and Chief Executive Officer
(Principal Executive Officer)

DATE: February 24, 2017

BY: /s/ Julie N. Shamburger

Julie N. Shamburger, CPA
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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

Signature	Title	Date
/s/ Joe Norton (W.D. (Joe) Norton)	Chairman of the Board and Director	February 24, 2017
/s/ John (Bob) Garrett (John R. (Bob) Garrett)	Vice Chairman of the Board and Director	February 24, 2017
/s/ Lee R. Gibson (Lee R. Gibson)	President, Chief Executive Officer and Director	February 24, 2017
/s/ Lawrence Anderson (Lawrence Anderson)	Director	February 24, 2017
/s/ S. Elaine Anderson (S. Elaine Anderson)	Director	February 24, 2017
/s/ Michael Bosworth (Michael Bosworth)	Director	February 24, 2017
/s/ Herbert C. Buie (Herbert C. Buie)	Director	February 24, 2017
/s/ Alton Cade (Alton Cade Jr.)	Director	February 24, 2017
/s/ Patricia A. Callan (Patricia A. Callan)	Director	February 24, 2017
/s/ Sam Dawson (Sam Dawson)	Director	February 24, 2017
/s/ Melvin B. Lovelady (Melvin B. Lovelady)	Director	February 24, 2017
/s/ William Sheehy (William Sheehy)	Director	February 24, 2017
/s/ Preston L. Smith (Preston L. Smith)	Director	February 24, 2017
/s/ Don W. Thedford (Don W. Thedford)	Director	February 24, 2017

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Southside Bancshares, Inc.

We have audited the accompanying consolidated balance sheets of Southside Bancshares, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in equity and cash flow 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southside Bancshares, Inc. and subsidiaries at December 31, 2016 and 2015, and the consolidated 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 also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Southside Bancshares, Inc.'s 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 (2013 framework) and our report dated February 24, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Dallas, Texas
February 24, 2017

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	December 31, 2016	December 31, 2015
ASSETS		
Cash and due from banks	$ 59,363	$ 54,288
Interest earning deposits	102,251	26,687
Federal funds sold	8,040	—
Total cash and cash equivalents	169,654	80,975
Securities available for sale, at estimated fair value	1,479,600	1,460,492
Securities held to maturity, at carrying value (estimated fair value of $944,282 and $799,763, respectively)	937,487	784,296
FHLB stock, at cost	61,084	51,047
Other investments	5,508	5,462
Loans held for sale	7,641	3,811
Loans:		
Loans	2,556,537	2,431,753
Less: Allowance for loan losses	(17,911)	(19,736)
Net loans	2,538,626	2,412,017
Premises and equipment, net	106,003	107,929
Goodwill	91,520	91,520
Other intangible assets, net	4,608	6,548
Interest receivable	25,183	22,700
Deferred tax asset, net	28,891	19,903
Unsettled trades to sell securities	—	9,343
Bank owned life insurance	97,775	95,080
Other assets	10,187	10,873
TOTAL ASSETS	$ 5,563,767	$ 5,161,996
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Noninterest bearing	$ 704,013	$ 672,470
Interest bearing	2,829,063	2,782,937
Total deposits	3,533,076	3,455,407
Short-term obligations:		
Federal funds purchased and repurchase agreements	7,097	2,429
FHLB advances	866,518	645,407
Total short-term obligations	873,615	647,836
Long-term obligations:		
FHLB advances	443,128	502,281
Subordinated notes, net of unamortized debt issuance costs	98,100	—
Long-term debt, net of unamortized debt issuance costs	60,236	60,231
Total long-term obligations	601,464	562,512
Unsettled trades to purchase securities	160	19,350
Other liabilities	37,178	32,829
TOTAL LIABILITIES	5,045,493	4,717,934
Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 17)		
Shareholders' equity:		
Common stock: ($1.25 par value, 40,000,000 shares authorized, 31,455,951 shares issued at December 31, 2016 and 27,865,798 shares issued at December 31, 2015)	39,320	34,832
Paid-in capital	535,240	424,078
Retained earnings	30,098	41,527
Treasury stock, at cost (2,913,064 at December 31, 2016 and 2,469,638 at December 31, 2015)	(47,891)	(37,692)
Accumulated other comprehensive loss	(38,493)	(18,683)
TOTAL SHAREHOLDERS' EQUITY	518,274	444,062
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 5,563,767	$ 5,161,996

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	Years Ended December 31,		
	2016	2015	2014
Interest income			
Loans	$ 106,564	$ 96,417	$ 70,598
Investment securities – taxable	1,057	1,587	615
Investment securities – tax-exempt	22,654	22,468	24,038
Mortgage-backed securities	37,450	33,661	28,207
FHLB stock and other investments	798	298	181
Other interest earning assets	390	101	139
Total interest income	168,913	154,532	123,778
Interest expense			
Deposits	14,255	10,162	7,953
Short-term obligations	4,152	1,250	624
Long-term obligations	10,941	8,442	8,379
Total interest expense	29,348	19,854	16,956
Net interest income	139,565	134,678	106,822
Provision for loan losses	9,780	8,343	14,938
Net interest income after provision for loan losses	129,785	126,335	91,884
Noninterest income			
Deposit services	20,702	20,112	15,280
Net gain on sale of securities available for sale	2,836	3,660	2,830
Impairment of investment in SFG Finance, LLC	—	—	(2,755)
Gain on sale of loans	2,795	2,082	323
Trust income	3,491	3,419	3,145
Bank owned life insurance income	2,626	2,623	1,334
Brokerage services	2,127	2,206	1,308
Other	4,834	3,793	3,024
Total noninterest income	39,411	37,895	24,489
Noninterest expense			
Salaries and employee benefits	63,978	67,221	60,821
Occupancy expense	13,722	12,883	7,259
Advertising, travel & entertainment	2,643	2,708	2,219
ATM and debit card expense	3,136	3,132	1,331
Professional fees	4,946	3,877	7,827
Software and data processing expense	2,911	3,858	4,629
Telephone and communications	1,931	1,978	1,222
FDIC insurance	2,141	2,510	1,765
FHLB prepayment fees	148	—	539
Other	13,966	14,787	10,092
Total noninterest expense	109,522	112,954	97,704
Income before income tax expense	59,674	51,276	18,669
Income tax expense (benefit)	10,325	7,279	(2,164)
Net income	$ 49,349	$ 43,997	$ 20,833
Earnings per common share – basic	$ 1.86	$ 1.65	$ 0.99
Earnings per common share – diluted	$ 1.86	$ 1.65	$ 0.99
Dividends paid per common share	$ 1.01	$ 1.00	$ 0.96

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Years ended December 31,		
	2016	2015	2014
Net income	$ 49,349	$ 43,997	$ 20,833
Other comprehensive (loss) income:			
Securities available for sale and transferred securities:			
Net unrealized holding (losses) gains on available for sale securities during the period	(23,459)	(8,564)	24,338
Change in net unrealized loss on securities transferred to held to maturity	(10,240)	1,329	—
Reclassification adjustment for amortization of unrealized losses on securities transferred to held to maturity	429	930	1,405
Reclassification adjustment for net gain on sale of available for sale securities, included in net income	(2,836)	(3,660)	(2,830)
Derivatives:			
Change in net unrealized gain on effective cash flow hedge interest rate swap derivatives	5,255	—	—
Reclassification adjustment for net loss on interest rate swap derivatives, included in net income	1,815	—	—
Pension plans:			
Amortization of net actuarial loss, included in net periodic benefit cost	1,828	2,448	1,042
Amortization of prior service credit, included in net periodic benefit cost	(8)	(16)	(14)
Effect of settlement recognition	(8)	(62)	—
Prior service cost adjustment due to plan amendments	(121)	—	43
Change in net actuarial (loss) gain	(3,132)	2,806	(15,574)
Other comprehensive (loss) income, before tax	(30,477)	(4,789)	8,410
Income tax benefit (expense) related to items of other comprehensive income (loss)	10,667	1,676	(2,943)
Other comprehensive (loss) income, net of tax	(19,810)	(3,113)	5,467
Comprehensive income	$ 29,539	$ 40,884	$ 26,300

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(in thousands, except share amounts)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accu-mulated-Other Compre-hensive Income (Loss)	Total Equity
Balance at December 31, 2013	$ 25,483	$ 214,091	$ 78,673	$ (37,692)	$ (21,037)	$ 259,518
Net Income	—	—	20,833	—	—	20,833
Other comprehensive income	—	—	—	—	5,467	5,467
Issuance of common stock for dividend reinvestment plan (40,142 shares)	50	1,163	—	—	—	1,213
Net issuance of common stock in connection with the acquisition of OmniAmerican Bancorp, Inc. (5,168,138 shares)	6,460	144,832	—	—	—	151,292
Stock compensation expense	—	1,086	—	—	—	1,086
Tax expense related to stock awards	—	(76)	—	—	—	(76)
Net issuance of common stock under employee stock plans (84,537 shares)	106	1,094	(126)	—	—	1,074
Cash dividends paid on common stock ($0.96 per share).	—	—	(17,919)	—	—	(17,919)
Impairment of investment in SFG Finance, LLC	—	2,755	—	—	—	2,755
Stock dividend declared (899,089 shares)	1,124	24,941	(26,065)	—	—	—
Balance at December 31, 2014	33,223	389,886	55,396	(37,692)	(15,570)	425,243
Net Income	—	—	43,997	—	—	43,997
Other comprehensive loss	—	—	—	—	(3,113)	(3,113)
Issuance of common stock for dividend reinvestment plan (49,908 shares)	62	1,308	—	—	—	1,370
Stock compensation expense	—	1,395	—	—	—	1,395
Tax benefit related to stock awards	—	75	—	—	—	75
Net issuance of common stock under employee stock plans (28,486 shares)	35	251	(120)	—	—	166
Cash dividends paid on common stock ($1.00 per share).	—	—	(25,071)	—	—	(25,071)
Stock dividend declared (1,209,277 shares)	1,512	31,163	(32,675)	—	—	—
Balance at December 31, 2015	34,832	424,078	41,527	(37,692)	(18,683)	444,062
Net Income	—	—	49,349	—	—	49,349
Other comprehensive loss	—	—	—	—	(19,810)	(19,810)
Issuance of common stock for dividend reinvestment plan (44,575 shares)	56	1,355	—	—	—	1,411
Net issuance of common stock (2,185,000 shares)	2,731	73,261	—	—	—	75,992
Purchase of common stock (443,426 shares)	—	—	—	(10,199)	—	(10,199)
Stock compensation expense	—	1,541	—	—	—	1,541
Tax benefit related to stock awards	—	332	—	—	—	332
Net issuance of common stock under employee stock plans (108,225 shares)	136	1,473	(50)	—	—	1,559
Cash dividends paid on common stock ($1.01 per share).	—	—	(25,963)	—	—	(25,963)
Stock dividend declared (1,252,353 shares)	1,565	33,200	(34,765)	—	—	—
Balance at December 31, 2016	$ 39,320	$ 535,240	$ 30,098	$ (47,891)	$ (38,493)	$ 518,274

The accompanying notes are an integral part of these consolidated financial statements.

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(in thousands)

	Years Ended December 31,		
	2016	2015	2014
OPERATING ACTIVITIES:			
Net income	$ 49,349	$ 43,997	$ 20,833
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and net amortization	9,084	8,624	3,458
Securities premium amortization (discount accretion), net	19,126	21,978	18,522
Loan (discount accretion) premium amortization, net	(2,520)	(2,746)	(1,343)
Provision for loan losses	9,780	8,343	14,938
Stock compensation expense	1,541	1,395	1,086
Deferred tax expense (benefit)	1,768	(3,392)	(925)
Tax (benefit) expense related to stock awards	(332)	(75)	72
Net gain on sale of securities available for sale	(2,836)	(3,660)	(2,830)
Impairment of investment in SFG Finance, LLC	—	—	2,755
Net loss on premises and equipment	376	584	14
Gross proceeds from sales of loans held for sale	82,062	70,014	11,007
Gross originations of loans held for sale	(85,892)	(70,926)	(13,007)
Net loss on other real estate owned	219	430	137
Net gain on sale of customer receivables	(194)	—	—
Net change in:			
Interest receivable	(2,483)	(264)	2,512
Other assets	1,823	325	(5,573)
Interest payable	2,334	129	(99)
Other liabilities	3,520	(1,775)	4,477
Net cash provided by operating activities	86,725	72,981	56,034
INVESTING ACTIVITIES:			
Securities available for sale:			
Purchases	(1,001,742)	(984,725)	(803,163)
Sales	573,051	660,092	650,391
Maturities, calls and principal repayments	207,500	278,995	272,073
Securities held to maturity:			
Purchases	(44,656)	(98,556)	—
Maturities, calls and principal repayments	31,251	23,322	21,889
Proceeds from redemption of FHLB stock	3,644	8,603	12,872
Purchases of FHLB stock and other investments	(13,667)	(19,850)	(4,915)
Net loans originated	(139,607)	(251,465)	(158,572)
Proceeds from sales of customer receivables	3,325	—	—
Proceeds from sale of SFG loans	—	—	67,575
Net cash paid in acquisition	—	—	(127,020)
Purchases of premises and equipment	(6,549)	(3,765)	(5,162)
Proceeds from sales of premises and equipment	128	26	8
Proceeds from sales of other real estate owned	2,024	640	535
Proceeds from sales of repossessed assets	894	2,274	6,199
Net cash used in investing activities	(384,404)	(384,409)	(67,290)

(continued)

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW (continued)
(in thousands)

	Years Ended December 31, 2016	2015	2014
FINANCING ACTIVITIES:			
Net change in deposits	$ 78,426	$ 82,251	$ 45,253
Net increase (decrease) in federal funds purchased and repurchase agreements	4,668	(1,808)	1,378
Proceeds from FHLB advances	8,158,985	23,022,132	7,102,277
Repayment of FHLB advances	(7,996,913)	(22,771,367)	(7,091,125)
Net proceeds from issuance of subordinated long-term debt	98,060	—	—
Tax benefit (expense) related to stock awards	332	75	(72)
Net issuance of common stock under employee stock plan	1,559	166	1,074
Purchase of common stock	(10,199)	—	—
Proceeds from the issuance of common stock for dividend reinvestment plan	1,411	1,370	1,213
Proceeds from the issuance of common stock	75,992	—	—
Cash dividends paid	(25,963)	(25,071)	(17,919)
Payments for other financing activities	—	—	(599)
Net cash provided by financing activities	386,358	307,748	41,480
Net increase (decrease) in cash and cash equivalents	88,679	(3,680)	30,224
Cash and cash equivalents at beginning of period	80,975	84,655	54,431
Cash and cash equivalents at end of period	$ 169,654	$ 80,975	$ 84,655
SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:			
Interest paid	$ 27,014	$ 19,725	$ 17,055
Income taxes paid	$ 5,700	$ 8,500	$ 4,300
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:			
Loans transferred to other repossessed assets and real estate through foreclosure	$ 5,777	$ 1,706	$ 5,211
Transfer of available for sale securities to held to maturity securities	$ 157,083	$ 57,724	$ —
Adjustment to pension liability	$ 1,441	$ (5,176)	$ 14,503
5% stock dividend	$ 34,765	$ 32,675	$ 26,065
Unsettled trades to purchase securities	$ (160)	$ (19,350)	$ (5,982)
Unsettled trades to sell securities	$ —	$ 9,343	$ 57,202
Common stock issued in acquisition	$ —	$ —	$ 151,891

The accompanying notes are an integral part of these consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Organization. Southside Bancshares, Inc., incorporated in Texas in 1982, is a bank holding company for Southside Bank, a Texas state bank headquartered in Tyler, Texas that was formed in 1960. We operate through 60 banking centers, 17 of which are located in grocery stores. We consider our primary market areas to be East Texas, the greater Fort Worth, Texas area and the greater Austin, Texas area. We are a community-focused financial institution that offers a full range of financial services to individuals, businesses, municipal entities, and nonprofit organizations in the communities that we serve. These services include consumer and commercial loans, deposit accounts, trust services, safe deposit services and brokerage services.

Basis of Presentation and Consolidation. The consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles ("GAAP") and include the accounts of Southside Bancshares, Inc. (the "Company"), and its wholly-owned subsidiaries, Southside Bank ("Southside Bank" or "the Bank"), OmniAmerican Bancorp ("Omni"), SFG Finance, LLC (formerly Southside Financial Group, LLC) which was a wholly-owned subsidiary of the Bank and was dissolved in April 2015, and the nonbank subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation.

On December 17, 2014, we acquired OmniAmerican Bancorp, Inc., a bank holding company traded on the NASDAQ Global Market and the holding company for OmniAmerican Bank, a federal savings association, headquartered in Fort Worth, Texas. See "Note 2 - Acquisition" in the accompanying notes to consolidated financial statements included elsewhere in this report.

We determine if we have a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity ("VIE") under GAAP. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. We consolidate voting interest entities in which we have all, or at least a majority of, the voting interest. As defined in applicable accounting standards, VIEs are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when an enterprise has both the power to direct the activities of the VIE that most significantly impact the VIEs economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE.

Certain prior period amounts have been reclassified to conform to current year presentation. In connection with the adoption of ASU 2015-03 "Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs," that requires unamortized debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, our consolidated balance sheet as of December 31, 2015 reflects a decrease of $80,000 in other assets and long-term debt.

Stock Dividend. On May 5, 2016, our board of directors declared a 5% stock dividend to common stock shareholders of record as of May 31, 2016, which was paid on June 28, 2016. On April 13, 2015, our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 27, 2015, which was paid on May 14, 2015. All share data for all periods presented has been adjusted to give retroactive recognition to these stock dividends.

Use of Estimates. In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. These estimates are subjective in nature and involve matters of judgment. Actual results could differ from these estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, assumptions used in the defined benefit plan and the fair values of financial instruments. The status of contingencies are particularly subject to change and significant assumptions used in periodic evaluation of securities for other-than-temporary impairment. Certain prior-period amounts have been reclassified to conform to the current period presentation.

Segment Information. Operating segments are components of a business about which separate financial information is available and that are evaluated regularly by the chief operating decision-maker in deciding how to allocate resources and assess performance. Our chief operating decision-maker uses consolidated results to make operating and strategic decisions. Therefore, we have determined that our business is conducted in one reportable segment.

Business Combinations. Business combinations are accounted for using the acquisition method of accounting. Under this accounting method, the acquired company's net assets are recorded at fair value on the date of acquisition, and the results of operations of the acquired company are combined with our results from that date forward. Costs related to the acquisition are expensed as incurred. The difference between the purchase price and the fair value of the net assets acquired (including intangible assets with finite lives) is recorded as goodwill. The accounting policy for goodwill and intangible assets is summarized in this note under the heading "Goodwill and Other Intangibles."

Acquired loans (non-impaired and impaired) are initially measured at fair value as of the acquisition date. The fair value estimates for acquired loans are based on the estimate of expected cash flows, both principal and interest and prepayments, discounted at prevailing market interest rates. Credit discounts representing the principal losses expected over the life of the loan are also a component of the initial fair value; therefore, an allowance for loan losses is not recorded at the acquisition date.

We evaluate acquired loans for impairment in accordance with the provisions of ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality" ("ASC 310-30"). Acquired loans are considered impaired if there is evidence of credit deterioration since origination and if it is probable at time of acquisition that all contractually required payments will not be collected. Expected cash flows at the acquisition date in excess of the fair value of the loans is referred to as the accretable yield and recorded as interest income over the life of the loans. Acquired impaired loans are not classified as nonaccrual or nonperforming as they are considered to be performing under the provisions of ASC 310-30. Subsequent to the acquisition date, increases in expected cash flows will generally result in a recovery of any previously recorded allowance for loan loss, to the extent applicable, and/or a reclassification from the nonaccretable difference to accretable yield, which will be recognized prospectively. The present value of any decreases in expected cash flows after the acquisition date will generally result in an impairment charge recorded as a provision for loan losses, resulting in an increase to the allowance for loan loss.

For acquired non-impaired loans, the difference between the acquisition date fair value and the contractual amounts due at the acquisition date represents the fair value adjustment. Fair value adjustments may be discounts (or premiums) to a loan's cost basis and are accreted (or amortized) to interest income over the loan's remaining contractual life using the level yield method.

Cash Equivalents. Cash equivalents, for purposes of reporting cash flow, include cash, amounts due from banks and federal funds sold that have an initial maturity of less than 90 days. We maintain deposits with other institutions in amounts that exceed federal deposit insurance coverage. Management regularly evaluates the credit risk associated with the counterparties to these transactions and believes that we are not exposed to any significant credit risks on cash and cash equivalents.

Cash on hand or on deposit with the Federal Reserve Bank of $20.3 million and $19.4 million was required to meet regulatory reserves and clearing requirements at December 31, 2016 and 2015, respectively.

Basic and Diluted Earnings per Common Share. Basic earnings per common share is based on net income divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of stock options granted using the treasury stock method. A reconciliation of the weighted-average shares used in calculating basic earnings per common share and the weighted average common shares used in calculating diluted earnings per common share for the reported periods is provided in "Note 3 – Earnings Per Share."

Comprehensive Income. Comprehensive income includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of comprehensive income include the after tax effect of changes in the fair value of securities available for sale, changes in the net unrealized loss on securities transferred to held to maturity, changes in the accumulated gain or loss on effective cash flow hedging instruments, changes in the funded status of defined benefit retirement plans and the noncredit portion of other-than-temporary impairment. Comprehensive income is reported in the accompanying consolidated statements of comprehensive income and in "Note 4 - Accumulated Other Comprehensive Loss."

Loans. All loans are stated at principal outstanding net of unearned discount and other deferred expenses or fees. Interest income on loans is recognized using the level yield method or simple interest method. Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. A loan is considered impaired, based on current information and events, if it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Substantially all of our impaired loans are collateral-dependent, and as such, are measured for impairment based on the fair value of the collateral.

Loans Held For Sale. Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

Loan Fees. We treat loan fees, net of direct costs, as an adjustment to the yield of the related loan over its term.

Allowance for Loan Losses. An allowance for loan losses is provided through charges to income in the form of a provision for loan losses. Loans which management believes are uncollectible are charged against this account with subsequent recoveries, if any, credited to the account. The amount of the allowance for loan losses is determined by management's evaluation of the quality and inherent risks in the loan portfolio, economic conditions and other factors which warrant current recognition.

Nonaccrual Loans. A loan is placed on nonaccrual when principal or interest is contractually past due 90 days or more unless, in the determination of management, the principal and interest on the loan are well collateralized and in the process of collection. In addition, a loan is placed on nonaccrual when, in the opinion of management, the future collectability of interest and principal is not expected. When classified as nonaccrual, accrued interest receivable on the loan is reversed and the future accrual of interest is suspended. Payments of contractual interest are recognized as income only to the extent that full recovery of the principal balance of the loan is reasonably certain.

Other Real Estate Owned and Foreclosed Assets. Other Real Estate Owned ("OREO") includes real estate acquired in full or partial settlement of loan obligations. OREO is initially carried at the fair value of the collateral net of estimated selling costs. Prior to foreclosure, the recorded amount of the loan is written down, if necessary, to the appraised fair value of the real estate to be acquired, less selling costs, by charging the allowance for loan losses. Any subsequent reduction in fair value net of estimated selling costs is charged to noninterest expense. Costs of maintaining and operating foreclosed properties are expensed as incurred and included in other expense in our income statement. Expenditures to complete or improve foreclosed properties are capitalized only if expected to be recovered; otherwise, they are expensed.

Other foreclosed assets are held for sale and are initially recorded at fair value less estimated selling costs at the date of foreclosure, by charging the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Foreclosed assets are included in other assets in the accompanying consolidated balance sheets. Expenses from operations and changes in the valuation allowance are included in noninterest expense.

Securities. Available for Sale ("AFS"). Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity and changes in the availability of and the yield of alternative investments are classified as AFS. These assets are carried at fair value with changes recorded in other comprehensive income. Fair value is determined using quoted market prices as of the close of business on the balance sheet date. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services.

Held to Maturity ("HTM"). Debt securities that management has the positive intent and ability to hold until maturity are classified as HTM and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts.

Premiums are amortized and discounts are accreted to maturity, or in the case of mortgage-backed securities ("MBS"), over the estimated life of the security, using the level yield interest method.

Unrealized gains and losses on AFS securities are excluded from earnings and reported net of tax in accumulated other comprehensive income until realized. Declines in the fair value of AFS or HTM securities below their cost that are deemed to be other-than-temporary are reflected in earnings as a realized loss if there is no ability or intent to hold to recovery. If the Company does not intend to sell and will not be required to sell prior to recovery of its amortized cost basis, only the credit component of the impairment is reflected in earnings as a realized loss with the noncredit portion recognized in other comprehensive income. In estimating other-than-temporary impairment losses, we consider (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) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded in the month of the trade date and are determined using the specific identification method.

Securities with Limited Marketability. Securities with limited marketability, such as stock in the FHLB, are carried at cost and assessed for other-than-temporary impairment.

Premises and Equipment. Land is carried at cost. Bank premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed on a straight line basis over the estimated useful lives of the related assets. Useful lives are estimated to be 15 to 40 years for premises and 3 to 10 years for equipment. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements. Maintenance and repairs are charged to expense as incurred while major improvements and replacements are capitalized.

Bank-Owned Life Insurance. The Company has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement. Changes in the net cash surrender value of the policies, as well as insurance proceeds received are reflected in noninterest income on the consolidated statements of income and are not subject to income taxes.

Goodwill and Other Intangibles. Other intangible assets consist primarily of core deposits. Intangible assets with definite useful lives are amortized on an accelerated basis over their estimated life. Goodwill and intangible assets that have indefinite useful lives are subject to at least an annual impairment test and more frequently if a triggering event occurs. If any such impairment is determined, a write-down is recorded.

During the year ended December 31, 2015, we changed our annual goodwill impairment testing date from December 31st to October 1st of each year, commencing on October 1, 2015. The change in the testing date did not impact the financial statements. During the year ended December 31, 2016 and 2015, the fair value of the reporting unit was greater than the carrying value of the reporting unit. As a result, we did not record any goodwill impairment for the year ended December 31, 2016 and 2015, and we had no cumulative goodwill impairment.

For the years ended December 31, 2016, 2015 and 2014, amortization expense related to our core deposit intangible was $1.8 million, $2.2 million, and $187,000, respectively.

Repurchase Agreements. We sell certain securities under agreements to repurchase. The agreements are treated as collateralized financing transactions and the obligations to repurchase securities sold are reflected as a liability in the accompanying consolidated balance sheets. The dollar amount of the securities underlying the agreements remains in the asset account. We determine the type of securities to pledge. Generally we pledge U.S. agency MBS.

Derivative Financial Instruments and Hedging Activities. Derivative financial instruments are carried on the consolidated balance sheets as other assets or other liabilities, as applicable, at estimated fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative financial instrument is determined by whether it has been designated and qualifies as part of a hedging relationship and, further, by the type of hedging relationship. We present derivative financial instruments at fair value in the consolidated balance sheets on a net basis when a right of offset exists, based on transactions with a single counterparty and any cash collateral paid to and/or received from that counterparty for derivative contracts that are subject to legally enforceable master netting arrangements.

For derivative instruments that are designated and qualify as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item (i.e., the ineffective portion), if any, is recognized in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

For derivatives designated as hedging instruments at inception, statistical regression analysis is used at inception and for each reporting period thereafter to assess whether the derivative used has been and is expected to be highly effective in offsetting changes in the fair value or cash flows of the hedged item. All components of each derivative instrument's gain or loss are included in the assessment of hedge effectiveness. Net hedge ineffectiveness is recorded in "other noninterest income" on the consolidated statements of income.

Further information on our derivative instruments and hedging activities is included in "Note 12 - Derivative Financial Instruments and Hedging Activities."

Revenue Recognition. The following summarizes our revenue recognition policies as they relate to certain noninterest income line items in the consolidated statements of income.

Service charges on deposit accounts include fees for banking services provided, overdrafts and non-sufficient funds. Revenue is generally recognized in accordance with published deposit account agreements for retail accounts or contractual agreements for commercial accounts.

Trust income includes fees and commissions from investment management, administrative and advisory services primarily for individuals, and to a lesser extent, partnerships and corporations. Revenue is recognized on an accrual basis at the time the services are performed and are based on either the market value of the assets managed or the services provided.

Advertising Costs. Advertising costs are expensed as incurred. Advertising expense was $869,000 for the year ended December 31, 2016, and $1.0 million for both years ended December 31, 2015 and 2014.

Income Taxes. We file a consolidated federal income tax return. Income tax expense represents the taxes expected to be paid or returned for current year taxes adjusted for the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of changes in tax rates is recognized in income in the period the change occurs.

FHLB Advance Option Fees. Option fees paid to the FHLB giving us the option to enter into long-term advance commitments at specified interest rates in the future are capitalized and reviewed for impairment. Once the option is exercised, the FHLB advance option fee is amortized over the term of the advance as interest expense.

Fair Value of Financial Instruments. Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment. In cases where quoted market prices are not available, fair values are based on estimates using present value or other estimation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Defined Benefit Pension Plan. Defined benefit pension plan costs are charged to retirement expense and included in "salaries and employee benefits" on the consolidated statements of income. Defined benefit pension obligations and the annual pension costs are determined by independent actuaries and through the use of a number of assumptions that are reviewed by management. These assumptions include a compensation rate increase, a discount rate used to determine the current benefit obligation and a long-term expected rate of return on plan assets. Net periodic defined benefit pension expense includes service cost, interest cost based on the assumed discount rate, an expected return on plan assets, amortization of prior service cost and amortization of net actuarial gains or losses. Prior service costs include the impact of plan amendments on the liabilities and are amortized over the future service periods of active employees expected to receive benefits under the plan. Actuarial gains and losses result from experience different from that assumed and from changes in assumptions. Amortization of actuarial gains and losses is included as a component of net periodic defined benefit pension cost.

The plan obligations and related assets of our defined benefit pension plan are presented in "Note 11 – Employee Benefits."

Share-Based Awards. Share-based compensation transactions are recognized as compensation cost in the income statement based on their fair values on the date of the grant and recorded over the vesting period.

Loss Contingencies. Loss contingencies, including claims and legal actions arising in the ordinary course of business are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Trust Assets. Assets of our trust department, other than cash on deposit at Southside Bank, are not included in the accompanying financial statements because they are not our assets.

Accounting Pronouncements:

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." This 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. This update affects entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. In August 2015, FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which effectively delayed the adoption date by one year. We are required to adopt ASU 2014-09 in the first quarter of fiscal 2018. Early adoption is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through cumulative adjustment. Our revenue consists of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and noninterest income. We are currently evaluating the impact this guidance will have in relation to our noninterest income derived from contracts with our customers as it relates to deposit services, trust income, brokerage services, and merchant services (included in other noninterest income) which we have determined to be in the scope of ASU 2014-09. We anticipate our assessment for these areas to be completed during the second quarter of 2017 at which time we will select the transition method to be applied upon adoption. We are concurrently evaluating the impact and resources needed to fulfill the additional disclosures required by this guidance.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) 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 for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The guidance requires companies to apply the requirements in the year of adoption, through cumulative adjustment while the guidance related to equity securities without readily determinable fair values, should be applied prospectively. The adoption of this guidance is not expected to have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 requires a lessee to recognize assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current GAAP which requires only capital leases to be recognized on the balance sheet, the new ASU 2016-02 will require both types of leases to be recognized on the balance sheet. ASU 2016-02 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The guidance requires companies to apply the requirements in the year of adoption using a modified retrospective approach. We are currently evaluating the potential impact of the pending adoption of ASU 2016-02 on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification in the statement of cash flows. ASU 2016-09 requires that all excess tax benefits and tax deficiencies be recognized as income tax expense or benefit in the income statement and should be classified along with other income tax cash flows as an operating activity instead of a financing activity as currently required under GAAP. ASU 2016-09 also simplifies accounting for forfeitures by allowing an entity to make an entity-wide accounting policy election either to estimate the number of forfeitures expected to occur or to recognize the effects of forfeitures when they occur in compensation cost. Additionally, cash paid by an employer when directly withholding shares for tax-withholding purposes should be classified as a financing activity, and to qualify for equity classification, an employer can now withhold up to the maximum statutory tax rate instead of the minimum statutory tax rate as currently required by GAAP. ASU 2016-09 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. ASU 2016-09 is not expected to have a significant impact on our consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.” ASU 2016-10 clarifies certain aspects of ASU 2014-09 “Revenue from Contracts with Customers (Topic 606)” related to (i) identifying performance obligations and (ii) the licensing implementation guidance. ASU 2016-10 is effective concurrently with ASU 2014-09 which we are required to adopt in the first quarter of fiscal year 2018. Early adoption is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through cumulative adjustment. We are currently evaluating the potential impact of the pending adoption of ASU 2016-10 on our consolidated financial statements, and we have not yet identified which transition method will be applied upon adoption.

In May 2016, the FASB issued ASU 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.” ASU 2016-12 clarifies ASU 2014-09 “Revenue from Contracts with Customers (Topic 606)” guidance on (i) assessing collectability, (ii) presenting sales tax, (iii) measuring non-cash consideration and (iv) certain transition matters. ASU 2016-12 is effective concurrently with ASU 2014-09 which we are required to adopt in the first quarter of fiscal year 2018. Early adoption is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through cumulative adjustment. We are currently evaluating the potential impact of the pending adoption of ASU 2016-12 on our consolidated financial statements, and we have not yet identified which transition method will be applied upon adoption.

In June 2016, the FASB issued ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. ASU 2016-13 also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchased financial assets with credit deterioration since their origination. ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The guidance requires companies to apply the requirements in the year of adoption through cumulative adjustment with some aspects of the update requiring a prospective transition approach. We are currently evaluating the potential impact of the pending adoption of ASU 2016-13 on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force).” ASU 2016-15 is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. ASU 2016-15 addresses eight classification issues related to the statement of cash flows: (i) debt prepayment or debt extinguishment, (ii) settlement of zero-coupon bonds, (iii) contingent consideration payments made after a business combination, (iv) proceeds from the settlement of insurance claims, (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (vi) distributions received from equity method invitees, (vii) beneficial interest in securitizations transactions, and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The guidance requires companies to apply the requirements retrospectively to all prior periods presented. If it is impracticable for a company to apply ASU 2016-15 retrospectively, requirements may be applied prospectively as of the earliest date practicable. We are currently evaluating the potential impact of the pending adoption of ASU 2016-15 on our consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." Under current GAAP, the tax effects of intra-entity asset transfers (intercompany sales) are deferred until the transferred asset is sold to a third party or otherwise recovered through use. This is an exception to the principle in ASC Topic 740, Income Taxes, that generally requires comprehensive recognition of current and deferred income taxes. ASU 2016-16 eliminates the exception for all intra-entity sales of assets other than inventory. As a result, a company would recognize the tax expense from the sale of the asset in the seller's tax jurisdiction when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. Any deferred tax asset that arises in the buyer's jurisdiction would also be recognized at the time of the transfer. ASU 2016-16 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted as of the beginning of an annual reporting period for which the financial statements (interim or annual) have not been issued or made available for issuance. The guidance requires companies to apply the requirements on a modified retrospective basis through a cumulative adjustment directly to retained earnings as of the beginning of the period of adoption. ASU 2016-16 is not expected to have a significant impact on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash." ASU 2016-18 is intended to reduce diversity in practice in how restricted cash and restricted cash equivalents are presented in the statement of cash flows. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The guidance requires companies to apply the requirements retrospectively to all prior periods presented. ASU 2016-18 is not expected to have a significant impact on our consolidated financial statements.

In December 2016, FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers," which is intended to provide clarification of aspects of the guidance issued in ASU 2014-09. ASU 2016-20 addresses (i) loan guarantee fees, (ii) impairment testing of contract costs, (iii) provisions for losses on construction-type and production-type contracts, and (iv) various disclosures. ASU 2016-20 is effective concurrently with ASU 2014-09 which we are required to adopt in the first quarter of fiscal year 2018. Early adoption is permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through cumulative adjustment. We are currently evaluating the potential impact of the pending adoption of ASU 2016-20 on our consolidated financial statements, and we have not yet identified which transition method will be applied upon adoption.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." ASU 2017-01 is intended to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted for (i) transactions which the acquisition date occurs before the issuance date or effective date of the ASU, only when the transaction has not been reported in financial statements that have been issued or made available for issuance, or (ii) for transactions in which a subsidiary is deconsolidated or a group of assets is derecognized that occur before the issuance date or effective date of the ASU, only when the transaction has not been reported in financial statements that have been issued or made available for issuance. The guidance requires companies to apply the requirements prospectively. ASU 2017-01 is not expected to have a significant impact on our consolidated financial statements.

2. ACQUISITION

On December 17, 2014, we acquired 100% of the outstanding stock of OmniAmerican Bancorp, Inc. and its wholly-owned subsidiary OmniAmerican Bank (collectively, "Omni") headquartered in Fort Worth, Texas. The total purchase price included the issuance of 5.2 million shares of our common stock and $157.4 million in cash for all outstanding shares of OmniAmerican Bancorp stock and outstanding stock options. The total merger consideration for the Omni merger was $298.3 million. The operations of Omni were merged into the Company as of the date of the acquisition.

The Omni merger was accounted for using the purchase method of accounting and accordingly, purchased assets, including identifiable intangible assets, and assumed liabilities were recorded at their respective acquisition date fair values. The fair value of assets acquired, adjusted for subsequent measurement period adjustments, excluding goodwill, totaled $1.36 billion, including total loans of $763.3 million and total investment securities of $428.4 million. Total fair value of the liabilities assumed totaled $1.13 billion, including deposits of $801.3 million. In 2014, the Company recognized initial goodwill of $69.3 million. As of December 31, 2015, total goodwill related to the Omni acquisition was $69.5 million, after recording $148,000 of net measurement period adjustments during 2015. Goodwill represents consideration transferred in excess of the fair value of the net assets acquired. Goodwill is not expected to be deductible for tax purposes.

The following table reflects the changes in the carrying amount of our goodwill (in thousands):

	For the Year Ended December 31,	
	2016	2015
Beginning balance	$ 91,520	$ 91,372
Plus: measurement period adjustments	—	148
Ending balance	$ 91,520	$ 91,520

We recognized a core deposit intangible of $8.6 million which will be amortized using an accelerated method over a 10 year period consistent with expected future cash flows.

For the year ended December 31, 2014, the Company incurred a total of pre-tax merger related expenses associated with the Omni merger of approximately $15.9 million which consisted of $4.4 million of legal and consulting fees and $2.6 million of software expenses due to canceling of contracts. These expenses were recognized in the consolidated statements of income in professional fees and software and data processing expense, respectively. In addition, approximately $8.9 million was immediately recognized as share-based compensation at closing as a result of the vesting provisions of the underlying awards. The share-based compensation expense is a component of salaries and employee benefits in the consolidated statements of income.

We incurred cost of $599,000 directly related to the issuance of the shares related to the merger which were offset against additional paid-in-capital in the consolidated statements of changes in equity. We also recorded non-compete agreements for $300,000 that will be amortized using the straight-line method over three years in conjunction with the merger.

Loans acquired with Omni were measured at fair value at the acquisition date with no carryover of any allowance for loan losses. Loans were segregated into those loans considered to be performing and those considered purchased credit impaired ("PCI"). PCI loans are loans acquired with evidence of deteriorated credit quality for which it was probable, at acquisition, that all contractually required cash flows would not be collected.

The table below details the PCI loan portfolio at acquisition date (in thousands):

	Purchased Credit Impaired Loans at Acquisition Date
Contractually required principal and interest payments	$ 46,647
Nonaccretable difference	23,262
Cash flows expected to be collected	23,385
Accretable difference	1,898
Fair value of loans acquired with a deterioration of credit quality	$ 21,487

Acquired loans that were considered performing at acquisition date and therefore not subject to ASC 310-30 are shown below (in thousands):

	Fair Value at Acquisition Date	Contractual Amounts Receivable	Cash Flows Not Expected to be Collected at Acquisition Date (1)
Real Estate Loans:			
Construction	$ 49,625	$ 56,877	$ 3,947
1-4 Family Residential	282,577	608,986	248,669
Commercial	152,087	190,920	15,692
Commercial Loans	59,007	72,583	8,602
Loans to Individuals	199,292	261,280	34,689
Total Loans	$ 742,588	$ 1,190,646	$ 311,599

(1) Cash flows not expected to be collected relate to estimated credit losses and expected prepayments.

3. EARNINGS PER SHARE

Earnings per share on a basic and diluted basis has been adjusted to give retroactive recognition to stock dividends and is calculated as follows (in thousands, except per share amounts):

	Years Ended December 31,		
	2016	2015	2014
Basic and Diluted Earnings:			
Net Income	$ 49,349	$ 43,997	$ 20,833
Basic weighted-average shares outstanding	26,453	26,621	21,033
Add: Stock options	125	90	104
Diluted weighted-average shares outstanding	26,578	26,711	21,137
Basic Earnings Per Share:			
Net Income	$ 1.86	$ 1.65	$ 0.99
Diluted Earnings Per Share:			
Net Income	$ 1.86	$ 1.65	$ 0.99

For the year ended December 31, 2016, there were approximately 17,000 antidilutive options. For the years ended December 31, 2015 and 2014 there were approximately 35,000 and 10,000 antidilutive options, respectfully.

4. ACCUMULATED OTHER COMPREHENSIVE LOSS

The changes in accumulated other comprehensive loss by component are as follows (in thousands):

	Year Ended December 31, 2016				
			Pension Plans		
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$ (239)	$ —	$ (44)	$ (18,400)	$ (18,683)
Other comprehensive (loss) income:					
Other comprehensive (loss) income before reclassifications	(33,699)	5,255	(129)	(3,132)	(31,705)
Reclassified from accumulated other comprehensive income	(2,407)	1,815	(8)	1,828	1,228
Income tax benefit (expense)	12,637	(2,475)	48	457	10,667
Net current-period other comprehensive (loss) income, net of tax	(23,469)	4,595	(89)	(847)	(19,810)
Ending balance, net of tax	$ (23,708)	$ 4,595	$ (133)	$ (19,247)	$ (38,493)

	Year Ended December 31, 2015				
			Pension Plans		
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$ 6,238	$ —	$ 7	$ (21,815)	$ (15,570)
Other comprehensive (loss) income:					
Other comprehensive (loss) income before reclassifications	(7,235)	—	(62)	2,806	(4,491)
Reclassified from accumulated other comprehensive income	(2,730)	—	(16)	2,448	(298)
Income tax benefit (expense)	3,488	—	27	(1,839)	1,676
Net current-period other comprehensive (loss) income, net of tax	(6,477)	—	(51)	3,415	(3,113)
Ending balance, net of tax	$ (239)	$ —	$ (44)	$ (18,400)	$ (18,683)

	Year Ended December 31, 2014				
			Pension Plans		
	Unrealized Gains (Losses) on Securities	Unrealized Gains (Losses) on Derivatives	Net Prior Service (Cost) Credit	Net Gain (Loss)	Total
Beginning balance, net of tax	$ (8,656)	$ —	$ (12)	$ (12,369)	$ (21,037)
Other comprehensive income (loss):					
Other comprehensive income (loss) before reclassifications	24,338	—	43	(15,574)	8,807
Reclassified from accumulated other comprehensive income	(1,425)	—	(14)	1,042	(397)
Income tax (expense) benefit	(8,019)	—	(10)	5,086	(2,943)
Net current-period other comprehensive income (loss), net of tax	14,894	—	19	(9,446)	5,467
Ending balance, net of tax	$ 6,238	$ —	$ 7	$ (21,815)	$ (15,570)

The reclassifications out of accumulated other comprehensive (loss) income into net income are presented below (in thousands):

	Year ended December 31,		
	2016	2015	2014
Unrealized losses on securities transferred to held to maturity:			
Amortization of unrealized losses [1]	$ (429)	$ (930)	$ (1,405)
Tax benefit	150	326	492
Net of tax	$ (279)	$ (604)	$ (913)
Unrealized gains and losses on available for sale securities:			
Realized net gain on sale of securities [2]	$ 2,836	$ 3,660	$ 2,830
Tax expense	(993)	(1,281)	(991)
Net of tax	$ 1,843	$ 2,379	$ 1,839
Derivatives:			
Realized net loss on interest rate swap derivatives [3]	$ (1,815)	$ —	$ —
Tax benefit	635	—	—
Net of tax	$ (1,180)	$ —	$ —
Amortization of pension plan:			
Net actuarial loss [4]	$ (1,828)	$ (2,448)	$ (1,042)
Prior service credit [4]	8	16	14
Total before tax	(1,820)	(2,432)	(1,028)
Tax benefit	637	851	359
Net of tax	$ (1,183)	$ (1,581)	$ (669)
Total reclassifications for the period, net of tax	$ (799)	$ 194	$ 257

(1) Included in interest income on the consolidated statements of income.
(2) Listed as net gain on sale of securities available for sale on the consolidated statements of income.
(3) Included in interest expense for long-term obligations on the consolidated statements of income.
(4) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (income) presented in “Note 11 - Employee Benefits.”

5. SECURITIES

The amortized cost, gross unrealized gains and losses, carrying value, and estimated fair value of investment and mortgage-backed securities are reflected in the tables below (in thousands):

	December 31, 2016						
		Recognized in OCI			Not recognized in OCI		
AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment Securities:							
U.S. Treasury	$ 74,016	$ —	$ 3,947	$ 70,069	$ —	$ —	$ 70,069
State and Political Subdivisions	394,050	3,217	12,070	385,197	—	—	385,197
Other Stocks and Bonds	6,587	64	—	6,651	—	—	6,651
Other Equity Securities	6,039	—	119	5,920	—	—	5,920
Mortgage-backed Securities: (1)							
Residential	630,603	6,434	9,529	627,508	—	—	627,508
Commercial	386,109	1,201	3,055	384,255	—	—	384,255
Total	$ 1,497,404	$ 10,916	$ 28,720	$ 1,479,600	$ —	$ —	$ 1,479,600
HELD TO MATURITY							
Investment Securities:							
State and Political Subdivisions	$ 435,080	$ 3,987	$ 13,257	$ 425,810	$ 7,595	$ 3,493	$ 429,912
Mortgage-backed Securities: (1)							
Residential	142,060	—	5,748	136,312	1,534	950	136,896
Commercial	379,016	1,067	4,718	375,365	4,372	2,263	377,474
Total	$ 956,156	$ 5,054	$ 23,723	$ 937,487	$ 13,501	$ 6,706	$ 944,282

	December 31, 2015						
		Recognized in OCI			Not recognized in OCI		
AVAILABLE FOR SALE	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Investment Securities:							
U.S. Treasury	$ 103,906	$ 61	$ 380	$ 103,587	$ —	$ —	$ 103,587
State and Political Subdivisions	236,534	8,323	611	244,246	—	—	244,246
Other Stocks and Bonds	12,772	63	45	12,790	—	—	12,790
Other Equity Securities	6,052	—	36	6,016	—	—	6,016
Mortgage-backed Securities: (1)							
Residential	580,621	9,120	1,239	588,502	—	—	588,502
Commercial	512,116	466	7,231	505,351	—	—	505,351
Total	$ 1,452,001	$ 18,033	$ 9,542	$ 1,460,492	$ —	$ —	$ 1,460,492
HELD TO MATURITY							
Investment Securities:							
State and Political Subdivisions	$ 389,997	$ 4,772	$ 9,273	$ 385,496	$ 13,061	$ 1,363	$ 397,194
Mortgage-backed Securities: (1)							
Residential	31,430	—	51	31,379	2,018	1	33,396
Commercial	371,727	1,233	5,539	367,421	4,232	2,480	369,173
Total	$ 793,154	$ 6,005	$ 14,863	$ 784,296	$ 19,311	$ 3,844	$ 799,763

(1) All mortgage-backed securities issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.

We transferred securities from AFS to HTM with an estimated fair value of $157.1 million and $57.7 million during the years ended December 31, 2016 and 2015, respectively. For the year ended December 31, 2016, the unrealized loss on the securities transferred from AFS to HTM was $10.2 million ($6.7 million net of tax) at the date of transfer based on the estimated fair value of the securities on the transfer date. For the year ended December 31, 2015, the unrealized gain on the securities transferred from AFS to HTM was $1.3 million ($864,000, net of tax) at the date of transfer based on the estimated fair value of the securities on the transfer date. We transferred these securities due to overall balance sheet strategies and our management has the current intent and ability to hold these securities until maturity. The overall net unrealized loss on the transferred securities included in accumulated other comprehensive income will be amortized over the remaining life of the underlying security as an adjustment of the yield on those securities.

The following tables represent the estimated fair value and unrealized loss on securities (in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
As of December 31, 2016:						
AVAILABLE FOR SALE						
Investment Securities:						
U.S. Treasury	$ 70,069	$ 3,947	$ —	$ —	$ 70,069	$ 3,947
State and Political Subdivisions	264,485	12,069	887	1	265,372	12,070
Other Equity Securities	5,920	119	—	—	5,920	119
Mortgage-backed Securities:						
Residential	369,903	9,491	6,199	38	376,102	9,529
Commercial	245,422	3,055	—	—	245,422	3,055
Total	$ 955,799	$ 28,681	$ 7,086	$ 39	$ 962,885	$ 28,720
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$ 179,939	$ 2,190	$ 29,427	$ 1,303	$ 209,366	$ 3,493
Mortgage-backed Securities:						
Residential	107,024	950	—	—	107,024	950
Commercial	186,854	2,263	—	—	186,854	2,263
Total	$ 473,817	$ 5,403	$ 29,427	$ 1,303	$ 503,244	$ 6,706
As of December 31, 2015:						
AVAILABLE FOR SALE						
Investment Securities:						
U.S. Treasury	$ 64,172	$ 380	$ —	$ —	$ 64,172	$ 380
State and Political Subdivisions	15,550	116	19,270	495	34,820	611
Other Stocks and Bonds	2,954	45	—	—	2,954	45
Other Equity Securities	6,016	36	—	—	6,016	36
Mortgage-backed Securities:						
Residential	229,514	1,215	3,817	24	233,331	1,239
Commercial	422,316	7,039	5,110	192	427,426	7,231
Total	$ 740,522	$ 8,831	$ 28,197	$ 711	$ 768,719	$ 9,542
HELD TO MATURITY						
Investment Securities:						
State and Political Subdivisions	$ 24,340	$ 214	$ 62,240	$ 1,149	$ 86,580	$ 1,363
Mortgage-backed Securities:						
Residential	1,717	1	—	—	1,717	1
Commercial	193,710	2,439	2,481	41	196,191	2,480
Total	$ 219,767	$ 2,654	$ 64,721	$ 1,190	$ 284,488	$ 3,844

We review those securities in an unrealized loss position for significant differences between fair value and the cost basis to evaluate if a classification of other-than-temporary impairment is warranted. In estimating other-than-temporary impairment losses, management considers, among other things, the length of time and the extent to which the fair value has been less than cost and the financial condition and near-term prospects of the issuer. The Company considers an other-than-temporary impairment to have occurred when there is an adverse change in expected cash flows. When it is determined that a decline in fair value of AFS or HTM securities is other-than-temporary, the carrying value of the security is reduced to its estimated fair value, with a corresponding charge to earnings for the credit portion and the noncredit portion to other comprehensive income. Based upon the length of time and the extent to which fair value is less than cost, we believe that none of the securities with an unrealized loss have other-than-temporary impairment at December 31, 2016.

The majority of the securities in an unrealized loss position are highly rated municipal securities and U.S. Agency mortgage- backed securities ("MBS") where the unrealized loss is a direct result of the change in interest rates and spreads. For those securities in an unrealized loss position, we do not currently intend to sell the securities and it is not more likely than not that we will be required to sell the securities before the anticipated recovery of their amortized cost basis. To the best of management's knowledge and based on our consideration of the qualitative factors associated with each security, there were no securities in our investment securities and MBS portfolio with an other-than-temporary impairment at December 31, 2016.

Interest income recognized on securities for the years presented (in thousands):

	Years Ended December 31,		
	2016	2015	2014
U.S. Treasury	$ 739	$ 1,132	$ 264
U.S. Government Agency Debentures	—	118	104
State and Political Subdivisions	22,654	22,474	24,077
Other Stocks and Bonds	195	213	208
Other Equity Securities	123	118	—
Mortgage-backed Securities	37,450	33,661	28,207
Total interest income on securities	$ 61,161	$ 57,716	$ 52,860

Of the $2.8 million in net securities gains from the AFS portfolio for the year ended December 31, 2016, there were $6.3 million in realized gains and $3.4 million in realized losses. Of the $3.7 million in net securities gains from the AFS portfolio for the year ended December 31, 2015, there were $4.9 million in realized gains and $1.2 million in realized losses. Of the $2.8 million in net securities gains from the AFS portfolio for the year ended December 31, 2014, there were $8.2 million in realized gains and $5.4 million in realized losses. There were no sales from the HTM portfolio during the years ended December 31, 2016, 2015 or 2014. We calculate realized gains and losses on sales of securities under the specific identification method.

The amortized cost, carrying value, and estimated fair value of securities at December 31, 2016, are presented below by contractual maturity (in thousands). Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. MBS are presented in total by category due to the fact that MBS typically are issued with stated principal amounts, and the securities are backed by pools of mortgages that have loans with varying maturities. The characteristics of the underlying pool of mortgages, such as fixed-rate or adjustable-rate, as well as prepayment risk, are passed on to the certificate holder. The term of a mortgage-backed pass-through security thus approximates the term of the underlying mortgages and can vary significantly due to prepayments.

	December 31, 2016	
	Amortized Cost	Estimated Fair Value
Available for sale securities:		
Investment Securities		
Due in one year or less	$ 3,553	$ 3,567
Due after one year through five years	26,465	27,581
Due after five years through ten years	111,393	107,616
Due after ten years	333,242	323,153
	474,653	461,917
Mortgage-backed Securities and Other Equity Securities	1,022,751	1,017,683
Total	$ 1,497,404	$ 1,479,600

	December 31, 2016	
	Carrying Value	Estimated Fair Value
Held to maturity securities:		
Investment Securities		
Due in one year or less	$ 6,406	$ 6,392
Due after one year through five years	42,418	42,659
Due after five years through ten years	96,327	96,359
Due after ten years	280,659	284,502
	425,810	429,912
Mortgage-backed Securities	511,677	514,370
Total	$ 937,487	$ 944,282

Investment securities and MBS with book values of $1.50 billion and $1.33 billion were pledged as of December 31, 2016 and 2015, respectively, to collateralize Federal Home Loan Bank of Dallas ("FHLB") advances, repurchase agreements and public funds or for other purposes as required by law.

Securities with limited marketability, such as FHLB stock and other investments, are carried at cost, which approximates fair value and are assessed for other-than-temporary impairment. These securities have no maturity date.

6. LOANS AND ALLOWANCE FOR PROBABLE LOAN LOSSES

Loans in the accompanying consolidated balance sheets are classified as follows (in thousands):

	December 31, 2016	December 31, 2015
Real Estate Loans:		
Construction	$ 380,175	$ 438,247
1-4 Family Residential	637,239	655,410
Commercial	945,978	635,210
Commercial Loans	177,265	242,527
Municipal Loans	298,583	288,115
Loans to Individuals	117,297	172,244
Total Loans (1)	2,556,537	2,431,753
Less: Allowance for Loan Losses (2)	17,911	19,736
Net Loans	$ 2,538,626	$ 2,412,017

(1) Includes approximately $372.4 million and $581.1 million of loans acquired with the Omni acquisition as of December 31, 2016 and 2015, respectively.

(2) The allowance for loan loss recorded on PCI loans totaled $3,000 and $629,000 for the years ended December 31, 2016 and 2015, respectively.

Loans to Affiliated Parties

In the normal course of business, we make loans to certain of our own executive officers and directors and their related interests. As of December 31, 2016, 2015 and 2014, these loans totaled $6.3 million, $8.1 million and $7.1 million, respectively. These loans represented 1.2%, 1.8%, and 1.7% of shareholders' equity as of December 31, 2016, 2015 and 2014, respectively.

Real Estate Construction Loans

Our construction loans are collateralized by property located primarily in the market areas we serve. Several of our construction loans will be owner occupied upon completion. Construction loans for non-owner occupied projects are financed, but these typically have cash flows from leases with tenants, secondary sources of repayment, and in some cases, additional collateral. Our construction loans have both adjustable and fixed interest rates during the construction period. Construction loans to individuals are typically priced and made with the intention of granting the permanent loan on the property. Speculative and commercial construction loans are subject to underwriting standards similar to that of the commercial portfolio. Owner occupied 1-4 family residential construction loans are subject to the underwriting standards of the permanent loan.

Real Estate 1-4 Family Residential Loans

Residential loan originations are generated by our loan officers, in-house origination staff, marketing efforts, present customers, walk-in customers and referrals from real estate agents and builders. We focus our lending efforts primarily on the origination of loans secured by first mortgages on owner occupied 1-4 family residences. Substantially all of our 1-4 family residential loan originations are secured by properties located in or near our market areas.

Our 1-4 family residential loans generally have maturities ranging from five to 30 years. These loans are typically fully amortizing with monthly payments sufficient to repay the total amount of the loan. Our 1-4 family residential loans are made at both fixed and adjustable interest rates.

Underwriting for 1-4 family residential loans includes debt-to-income analysis, credit history analysis, appraised value and down payment considerations. Changes in the market value of real estate can affect the potential losses in the portfolio.

Commercial Real Estate Loans

Commercial real estate loans as of December 31, 2016 consists of $888.4 million of owner and non-owner occupied commercial real estate loans, $53.1 million of loans secured by multi-family properties and $4.5 million of loans secured by farmland. Commercial real estate loans primarily include loans collateralized by retail, commercial office buildings, multi-family, medical facilities and offices, senior living, assisted living and skilled nursing facilities, warehouse facilities, hotels and churches. We currently have a concentration of credit risk in our loans secured by retail investment real estate properties of approximately 11%. In determining whether to originate commercial real estate loans, we generally consider such factors as the financial condition of the borrower and the debt service coverage of the property. Commercial real estate loans are made at both fixed and adjustable interest rates for terms generally up to 20 years.

Commercial Loans

Our commercial loans are diversified loan types including short-term working capital loans for inventory and accounts receivable and short- and medium-term loans for equipment or other business capital expansion. Management does not consider there to be a concentration of risk in any one industry type. In our commercial loan underwriting, we assess the creditworthiness, ability to repay, and the value and liquidity of the collateral being offered. Terms of commercial loans are generally commensurate with the useful life of the collateral offered.

Municipal Loans

We have a specific lending department that makes loans to municipalities and school districts primarily throughout the state of Texas. Municipal loans outside the state of Texas have been limited to adjoining states. The majority of the loans to municipalities and school districts have tax or revenue pledges and in some cases are additionally supported by collateral. Municipal loans made without a direct pledge of taxes or revenues are usually made based on some type of collateral that represents an essential service.

Loans to Individuals

Substantially all originations of our loans to individuals are made to consumers in our market areas. The majority of loans to individuals are collateralized by titled equipment, which are primarily automobiles. Loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. The underwriting standards we employ for consumer loans include an application, a determination of the applicant's payment history on other debts, with the greatest weight being given to payment history with us, and an assessment of the borrower's ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, in relation to the proposed loan amount. Most of our loans to individuals are collateralized, which management believes should assist in limiting our exposure.

Allowance for Loan Losses

The allowance for loan losses is based on the most current review of the loan portfolio and is a result of multiple processes. First, we utilize historical net charge-off data to establish general reserve amounts for each class of loans. The historical charge-off figure is further adjusted through qualitative factors that include general trends in past dues, nonaccruals and classified loans to more effectively and promptly react to both positive and negative movements not reflected in the historical data. Second, our lenders have the primary responsibility for identifying problem loans based on customer financial stress and underlying collateral. These recommendations are reviewed by senior loan administration, the special assets department, and the loan review department. Third, the loan review department independently reviews the portfolio on an annual basis. The loan review department follows a board-approved annual loan review scope. The loan review scope encompasses a number of considerations including the size of the loan, the type of credit extended, the seasoning of the loan and the performance of the loan. The loan review scope, as it relates to size, focuses more on larger dollar loan relationships, typically aggregate debt of $500,000 or greater. The loan review officer also reviews specific reserves compared to general reserves to determine trends in comparative reserves as well as losses not reserved for prior to charge-off to determine the effectiveness of the specific reserve process.

At each review, a subjective analysis methodology is used to grade the respective loan. Categories of grading vary in severity from loans that do not appear to have a significant probability of loss at the time of review to loans that indicate a probability that the entire balance of the loan will be uncollectible. If at the time of the review we determine it is probable we will not collect the principal and interest cash flows contractually due on the loan, estimates of future expected cash flows or appraisals of the collateral securing the debt are used to determine the necessary allowances. The internal loan review department maintains a list of all loans or loan relationships that are graded as having more than the normal degree of risk associated with them. In addition, a list of specifically reserved loans or loan relationships of $150,000 or more is updated on a quarterly basis in order to properly determine necessary allowances and keep management informed on the status of attempts to correct the deficiencies noted with respect to the loan.

We calculate historical loss ratios for pools of similar loans with similar characteristics based on the proportion of actual charge-offs experienced, consistent with the characteristics of remaining loans, to the total population of loans in the pool. The historical gross loss ratios are updated based on actual charge-off experience quarterly and adjusted for qualitative factors. All loans are subject to individual analysis if determined to be impaired with the exception of consumer loans and loans secured by 1-4 residential loans.

Industry and our own experience indicates that a portion of our loans will become delinquent and a portion of the loans will require partial or full charge-off. Regardless of the underwriting criteria utilized, losses may occur as a result of various factors beyond our control, including, among other things, changes in market conditions affecting the value of properties used as collateral for loans and problems affecting the credit worthiness of the borrower and the ability of the borrower to make payments on the loan. Our determination of the appropriateness of the allowance for loan losses is based on various considerations, including an analysis of the risk characteristics of various classifications of loans, previous loan loss experience, specific loans which would have loan loss potential, delinquency trends, estimated fair value of the underlying collateral, current economic conditions, and geographic and industry loan concentration.

Credit Quality Indicators

We categorize loans into risk categories on an ongoing basis based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. We use the following definitions for risk ratings:

- Pass (Rating 1 – 4) – This rating is assigned to all satisfactory loans. This category, by definition, consists of acceptable credit. Credit and collateral exceptions should not be present, although their presence would not necessarily prohibit a loan from being rated Pass, if deficiencies are in process of correction. These loans are not included in the Watch List.
- Pass Watch (Rating 5) – These loans require some degree of special treatment, but not due to credit quality. This category does not include loans specially mentioned or adversely classified; however, particular attention must be accorded such credits due to characteristics such as:
  - A lack of, or abnormally extended payment program;
  - A heavy degree of concentration of collateral without sufficient margin;
  - A vulnerability to competition through lesser or extensive financial leverage; and
  - A dependence on a single or few customers or sources of supply and materials without suitable substitutes or alternatives.
- Special Mention (Rating 6) – A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in our credit position at some future date. Special Mention assets are not adversely classified and do not expose us to sufficient risk to warrant adverse classification.
- Substandard (Rating 7) – Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
- Doubtful (Rating 8) – Loans classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation, in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

All accruing loans are reserved for as a group of similar type credits and included in the general portion of the allowance for loan losses. Loans to individuals and 1-4 family residential loans, including loans not accruing, are collectively evaluated and included in the general portion of the allowance for loan losses. All loans considered troubled debt restructurings ("TDR") are evaluated individually for further impairment.

The general portion of the loan loss allowance is reflective of historical charge-off levels for similar loans adjusted for changes in current conditions and other relevant factors. These factors are likely to cause estimated losses to differ from historical loss experience and include:

- Changes in lending policies or procedures, including underwriting, collection, charge-off, and recovery procedures;
- Changes in local, regional and national economic and business conditions, including entry into new markets;
- Changes in the volume or type of credit extended;
- Changes in the experience, ability, and depth of lending management;
- Changes in the volume and severity of past due, nonaccrual, restructured, or classified loans;
- Changes in charge-off trends;
- Changes in loan review or Board oversight;
- Changes in the level of concentrations of credit; and
- Changes in external factors, such as competition and legal and regulatory requirements.

These factors are also considered for the purchased Omni loan portfolio specifically in regards to changes in credit quality, past due, nonaccrual and charge-off trends.

The following tables detail activity in the allowance for loan losses by portfolio segment (in thousands):

	Year Ended December 31, 2016						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans [1]	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period	$ 4,350	$ 2,595	$ 4,577	$ 6,596	$ 725	$ 893	$ 19,736
Provision (reversal) for loan losses [2]	(472)	(28)	2,604	6,397	(224)	1,503	9,780
Loans charged off	—	(43)	—	(11,396)	—	(2,948)	(14,387)
Recoveries of loans charged off	269	141	23	666	249	1,434	2,782
Balance at end of period	$ 4,147	$ 2,665	$ 7,204	$ 2,263	$ 750	$ 882	$ 17,911

	Year Ended December 31, 2015						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Balance at beginning of period [4]	$ 2,456	$ 2,822	$ 3,025	$ 3,279	$ 716	$ 994	$ 13,292
Provision (reversal) for loan losses [2]	1,711	(284)	1,467	3,500	258	1,691	8,343
Loans charged off	(24)	(58)	—	(336)	(249)	(3,688)	(4,355)
Recoveries of loans charged off	207	115	85	153	—	1,896	2,456
Balance at end of period	$ 4,350	$ 2,595	$ 4,577	$ 6,596	$ 725	$ 893	$ 19,736

	Year Ended December 31, 2014						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals [3]	Total
Balance at beginning of period	$ 2,142	$ 3,277	$ 2,572	$ 1,970	$ 668	$ 8,248	$ 18,877
Provision (reversal) for loan losses	172	(514)	445	1,204	48	13,583	14,938
Loans charged off	(14)	(22)	—	(66)	—	(22,461)	(22,563)
Recoveries of loans charged off	156	81	8	171	—	1,624	2,040
Balance at end of period [4]	$ 2,456	$ 2,822	$ 3,025	$ 3,279	$ 716	$ 994	$ 13,292

(1) Of the $11.4 million in commercial charge-offs recorded for the year ended December 31, 2016, $10.9 million relates to the charge-off of two large commercial borrowing relationships.

(2) Of the $9.8 million recorded in provision for loan losses for the year ended December 31, 2016, none related to provision expense on PCI loans. Of the $8.3 million recorded in provision for loan losses for the year ended December 31, 2015, $629,000 related to provision expense on PCI loans.

(3) Of the $22.5 million in charge-offs recorded in the Loans to Individuals category for the year ended December 31, 2014, approximately $7.1 million relate to the write-down of SFG loans to fair value in connection with the sale of the subprime automobile loans that was completed in the fourth quarter 2014.

(4) Loans acquired with the Omni acquisition were measured at fair value on December 17, 2014 with no carryover of allowance for loan loss.

The following tables present the balance in the allowance for loan losses by portfolio segment based on impairment method(in thousands):

	As of December 31, 2016						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment (1)	$ 13	$ 16	$ 17	$ 923	$ 11	$ 106	$ 1,086
Ending balance – collectively evaluated for impairment	4,134	2,649	7,187	1,340	739	776	16,825
Balance at end of period	$ 4,147	$ 2,665	$ 7,204	$ 2,263	$ 750	$ 882	$ 17,911

	As of December 31, 2015						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Ending balance – individually evaluated for impairment (1)	$ 12	$ 25	$ 137	$ 4,599	$ 13	$ 105	$ 4,891
Ending balance – collectively evaluated for impairment	4,338	2,570	4,440	1,997	712	788	14,845
Balance at end of period	$ 4,350	$ 2,595	$ 4,577	$ 6,596	$ 725	$ 893	$ 19,736

(1) There was approximately $3,000 and $629,000 of allowance for loan losses associated with PCI loans as of December 31, 2016 and 2015, respectively.

The following tables present the recorded investment in loans by portfolio segment based on impairment method (in thousands):

	December 31, 2016						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$ 480	$ 1,693	$ 1,184	$ 5,840	$ 571	$ 241	$ 10,009
Loans collectively evaluated for impairment	379,526	629,893	942,818	170,159	298,012	116,923	2,537,331
Purchased credit impaired loans	169	5,653	1,976	1,266	—	133	9,197
Total ending loan balance	$ 380,175	$ 637,239	$ 945,978	$ 177,265	$ 298,583	$ 117,297	$ 2,556,537

	December 31, 2015						
	Real Estate						
	Construction	1-4 Family Residential	Commercial	Commercial Loans	Municipal Loans	Loans to Individuals	Total
Loans individually evaluated for impairment	$ 508	$ 1,751	$ 3,757	$ 14,250	$ 637	$ 258	$ 21,161
Loans collectively evaluated for impairment	437,518	646,590	628,405	220,199	287,478	171,782	2,391,972
Purchased credit impaired loans	221	7,069	3,048	8,078	—	204	18,620
Total ending loan balance	$ 438,247	$ 655,410	$ 635,210	$ 242,527	$ 288,115	$ 172,244	$ 2,431,753

The following tables set forth loans by credit quality indicator (in thousands):

	December 31, 2016					
	Pass	Pass Watch [(1)]	Special Mention [(1)]	Substandard [(1)]	Doubtful [(1)]	Total
Real Estate Loans:						
Construction	$ 374,443	$ 34	$ 571	$ 5,108	$ 19	$ 380,175
1-4 Family Residential	632,937	68	—	3,380	854	637,239
Commercial	885,049	17,739	10,587	32,603	—	945,978
Commercial Loans	158,943	1,187	8,086	9,012	37	177,265
Municipal Loans	297,014	—	998	571	—	298,583
Loans to Individuals	115,952	—	9	629	707	117,297
Total	$ 2,464,338	$ 19,028	$ 20,251	$ 51,303	$ 1,617	$ 2,556,537

	December 31, 2015					
	Pass	Pass Watch	Special Mention [(1)]	Substandard [(1)]	Doubtful[(1)]	Total
Real Estate Loans:						
Construction	$ 434,893	$ —	$ 1,754	$ 1,576	$ 24	$ 438,247
1-4 Family Residential	643,498	1,403	1,636	4,915	3,958	655,410
Commercial	620,117	—	—	14,988	105	635,210
Commercial Loans	204,775	716	1,738	27,681	7,617	242,527
Municipal Loans	286,415	—	1,063	637	—	288,115
Loans to Individuals	170,558	2	—	478	1,206	172,244
Total	$ 2,360,256	$ 2,121	$ 6,191	$ 50,275	$ 12,910	$ 2,431,753

(1) Includes PCI loans comprised of $5,000 pass watch, $511,000 special mention, $1.5 million substandard and $28,000 doubtful as of December 31, 2016. Includes PCI loans comprised of $95,000 special mention, $3.6 million substandard and $9.9 million doubtful as of December 31, 2015.

Nonperforming Assets and Past Due Loans

Nonaccrual loans are loans 90 days or more delinquent and collection in full of both the principal and interest is not expected. Additionally, some loans that are not delinquent may be placed on nonaccrual status due to doubts about full collection of principal or interest. When a loan is categorized as nonaccrual, the accrual of interest is discontinued and any accrued balance is reversed for financial statement purposes. Payments received on nonaccrual loans are applied to the outstanding principal balance. Payments of contractual interest are recognized as income only to the extent that full recovery of the principal balance of the loan is reasonably certain. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Other factors, such as the value of collateral securing the loan and the financial condition of the borrower, are considered in judgments as to potential loan loss.

Nonaccrual loans and accruing loans past due more than 90 days include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

PCI loans are recorded at fair value at acquisition date. Although the PCI loans may be contractually delinquent, we do not classify these loans as past due or nonperforming as the loans were written down to fair value at the acquisition date, and the accretable yield is recognized in interest income over the remaining life of the loan. However, subsequent to acquisition, we re-assess PCI loans for additional impairment and record additional impairment in the event we conclude it is probable that we will be unable to collect all cash flows originally expected to be collected at acquisition plus any additional cash flows expected to be collected due to changes in estimates after acquisition. All such PCI loans for which we recognize subsequent impairment are reported as impaired loans in the financial statements.

The following table sets forth nonperforming assets (in thousands):

	At December 31, 2016	At December 31, 2015
Nonaccrual loans [1]	$ 8,280	$ 20,526
Accruing loans past due more than 90 days [1]	6	3
Restructured loans [2]	6,431	11,143
Other real estate owned	339	744
Repossessed assets	49	64
Total Nonperforming Assets	$ 15,105	$ 32,480

(1) Excludes PCI loans measured at fair value at acquisition.

(2) Includes $3.1 million and $7.5 million in PCI loans restructured during the years ended December 31, 2016 and 2015.

Foreclosed assets include other real estate owned and repossessed assets. For 1-4 family residential real estate properties, a loan is recognized as a foreclosed property once legal title to the real estate property has been received upon completion of foreclosure or the borrower has conveyed all interest in the residential property through a deed in lieu of foreclosure. At December 31, 2016 there was a total of $28,000 in loans secured by 1-4 family residential properties for which formal foreclosure proceedings were in process. There was a total of $67,000 in loans secured by 1-4 family residential properties for which formal foreclosure proceedings were in process as of December 31, 2015.

The following table sets forth the recorded investment in nonaccrual by class of loans (in thousands):

	Nonaccrual Loans [1]	
	December 31, 2016	December 31, 2015
Real Estate Loans:		
Construction	$ 105	$ 508
1-4 Family Residential	1,067	1,847
Commercial	808	2,816
Commercial Loans	5,477	13,896
Loans to Individuals	823	1,459
Total	$ 8,280	$ 20,526

(1) Excludes PCI loans measured at fair value at acquisition.

Loans are considered impaired if, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Impairment is evaluated in total for smaller-balance loans of a similar nature and on an individual loan basis for other loans. The measurement of loss on impaired loans is generally based on the fair value of the collateral if repayment is expected solely from the collateral or the present value of the expected future cash flows discounted at the historical effective interest rate stipulated in the loan agreement. In measuring the fair value of the collateral, in addition to relying on third party appraisals, we use assumptions, such as discount rates, and methodologies, such as comparison to the recent selling price of similar assets, consistent with those that would be utilized by unrelated third parties performing a valuation. Loans that are evaluated and determined not to meet the definition of an impaired loan are reserved for at the general reserve rate for its appropriate class.

At the time a loss is probable in the collection of contractual amounts, specific reserves are allocated. Loans are charged off to the liquidation value of the collateral net of liquidation costs, if any, when deemed uncollectible or as soon as collection by liquidation is evident.

The following tables set forth impaired loans by class of loans (in thousands). Impaired loans include restructured and nonaccrual loans for which the allowance was measured in accordance with section 310-10 of ASC Topic 310, "Receivables." There were no impaired loans recorded without an allowance for the years ended December 31, 2016 or 2015:

	December 31, 2016		
	Unpaid Contractual Principal Balance	Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:			
Construction	$ 486	$ 480	$ 13
1-4 Family Residential	4,487	4,264	16
Commercial	1,631	1,574	17
Commercial Loans	6,108	5,941	923
Municipal Loans	571	571	11
Loans to Individuals	277	241	106
Total [(1)]	$ 13,560	$ 13,071	$ 1,086

	December 31, 2015		
	Unpaid Contractual Principal Balance	Recorded Investment	Related Allowance for Loan Losses
Real Estate Loans:			
Construction	$ 1,320	$ 508	$ 12
1-4 Family Residential	1,842	1,751	25
Commercial	4,756	4,636	137
Commercial Loans	29,844	21,385	4,599
Municipal Loans	637	637	13
Loans to Individuals	288	257	105
Total [(1)]	$ 38,687	$ 29,174	$ 4,891

(1) Includes \$3.1 million and \$8.0 million of PCI loans that experienced deterioration in credit quality subsequent to the acquisition date as of December 31, 2016 and December 31, 2015, respectively.

The following tables present the aging of the recorded investment in past due loans by class of loans (in thousands):

	December 31, 2016					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current [(1)]	Total
Real Estate Loans:						
Construction	$ 917	$ 64	$ 86	$ 1,067	$ 379,108	$ 380,175
1-4 Family Residential	6,225	755	600	7,580	629,659	637,239
Commercial	70	154	154	378	945,600	945,978
Commercial Loans	783	300	3,459	4,542	172,723	177,265
Municipal Loans	113	—	—	113	298,470	298,583
Loans to Individuals	1,550	320	185	2,055	115,242	117,297
Total	$ 9,658	$ 1,593	$ 4,484	$ 15,735	$ 2,540,802	$ 2,556,537

	December 31, 2015					
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current [(1)]	Total
Real Estate Loans:						
Construction	$ 121	$ 258	$ 208	$ 587	$ 437,660	$ 438,247
1-4 Family Residential	3,703	781	1,080	5,564	649,846	655,410
Commercial	359	1,289	361	2,009	633,201	635,210
Commercial Loans	527	138	335	1,000	241,527	242,527
Municipal Loans	—	—	—	—	288,115	288,115
Loans to Individuals	2,457	608	285	3,350	168,894	172,244
Total	$ 7,167	$ 3,074	$ 2,269	$ 12,510	$ 2,419,243	$ 2,431,753

(1) Includes PCI loans measured at fair value at acquisition.

The following table sets forth average recorded investment and interest income recognized on impaired loans by class of loans (in thousands):

	December 31, 2016		December 31, 2015		December 31, 2014	
	Average Recorded Investment [(1)]	Interest Income Recognized [(1)]	Average Recorded Investment [(1)]	Interest Income Recognized [(1)]	Average Recorded Investment [(1)]	Interest Income Recognized [(1)]
Real Estate Loans:						
Construction	$ 510	$ 22	$ 1,518	$ —	$ 1,346	$ 4
1-4 Family Residential	3,247	169	3,410	61	3,511	67
Commercial	4,490	63	3,323	64	2,173	52
Commercial Loans	13,481	48	13,807	256	1,286	26
Municipal Loans	612	33	824	37	750	41
Loans to Individuals	257	9	725	4	1,920	3
Total	$ 22,597	$ 344	$ 23,607	$ 422	$ 10,986	$ 193

(1) Excludes PCI loans measured at fair value at acquisition that have not experienced further deterioration in credit quality subsequent to the acquisition date.

Troubled Debt Restructurings

The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, restructuring amortization schedules and other actions intended to minimize potential losses.

The following tables set forth the recorded balance of loans considered to be TDRs that were restructured (dollars in thousands):

	Year Ended December 31, 2016				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Contracts
Real Estate Loans:					
Construction	$ 375	$ —	$ 23	$ 398	2
1-4 Family Residential	—	71	2,602	2,673	4
Commercial	500	—	—	500	1
Commercial Loans	2,230	—	59	2,289	8
Loans to Individuals	29	—	77	106	8
Total	$ 3,134	$ 71	$ 2,761	$ 5,966	23

	Year Ended December 31, 2015				
	Extend Amortization Period	Interest Rate Reductions	Combination (1)	Total Modifications	Number of Contracts
Real Estate Loans:					
1-4 Family Residential	$ —	$ 80	$ 255	$ 335	3
Commercial	438	—	1,290	1,728	4
Commercial Loans	13,249	—	7,507	20,756	12
Loans to Individuals	60	—	130	190	14
Total	$ 13,747	$ 80	$ 9,182	$ 23,009	33

(1) These modifications may include an extension of the amortization period, interest rate reduction, and/or converting the loan to interest-only for a limited period of time.

The majority of loans restructured as TDRs during the year ended December 31, 2016 were modified with maturity extensions. Interest continues to be charged on principal balances outstanding during the extended term. Therefore, the financial effects of the recorded investment of loans restructured as TDRs during the years ended December 31, 2016 and 2015 were not significant. Generally, the loans identified as TDRs were previously reported as impaired loans prior to restructuring and therefore the modification did not impact our determination of the allowance for loan losses.

On an ongoing basis, the performance of the TDRs is monitored for subsequent payment default. Payment default for TDRs is recognized when the borrower is 90 days or more past due. There were $768,000 and $627,000 of TDRs in default as of December 31, 2016 and 2015, respectively. Payment defaults for TDRs did not significantly impact the determination of the allowance for loan loss in either period presented.

At December 31, 2016 and 2015, there were no commitments to lend additional funds to borrowers whose terms have been modified in TDRs.

Purchased Credit Impaired Loans

The following table presents the outstanding principal balance and carrying value for PCI loans (in thousands):

	December 31, 2016	December 31, 2015
Outstanding principal balance	$ 10,612	$ 27,644
Carrying amount	$ 9,197	$ 18,620

The following table presents the changes of the accretable yield for PCI loans (in thousands):

	December 31, 2016	December 31, 2015
Balance at beginning of period	$ 2,493	$ 1,820
Reclassifications (to) from nonaccretable discount	1,796	2,739
Accretion	(1,809)	(2,066)
Balance at end of period	$ 2,480	$ 2,493

7. PREMISES AND EQUIPMENT

	December 31, 2016	December 31, 2015
	(in thousands)	
Premises	$ 127,970	$ 124,626
Furniture and equipment	36,603	35,069
	164,573	159,695
Less: accumulated depreciation	58,570	51,766
Total	$ 106,003	$ 107,929

During both years ended December 31, 2016 and 2015, assets with accumulated depreciation of $1.2 million were written off.

Depreciation expense was $8.0 million, $8.1 million, and $3.3 million for the years ended December 31, 2016, 2015 and 2014, respectively.

8. DEPOSITS

	December 31, 2016	December 31, 2015
	(in thousands)	
Noninterest bearing demand deposits:		
Private accounts	$ 678,279	$ 651,992
Public accounts	25,734	20,478
Total noninterest bearing demand deposits	704,013	672,470
Interest bearing deposits:		
Private accounts:		
Savings deposits	249,490	233,157
Money market demand deposits	329,426	341,432
Platinum money market deposits	353,381	323,526
Interest bearing checking	212,296	177,409
NOW demand deposits	234,217	253,041
Certificates and other time deposits of $250,000 or more	58,312	57,209
Certificates and other time deposits under $250,000	422,134	498,901
Total private accounts	1,859,256	1,884,675
Public accounts:		
Savings deposits	19	15
Money market demand deposits	15,126	22,518
Platinum money market deposits	382,017	383,716
Interest bearing checking	12,856	6,679
NOW demand deposits	128,086	151,974
Certificates and other time deposits of $250,000 or more	409,671	311,824
Certificates and other time deposits under $250,000	22,032	21,536
Total public accounts	969,807	898,262
Total interest bearing deposits	2,829,063	2,782,937
Total deposits	$ 3,533,076	$ 3,455,407

For the years ended December 31, 2016, 2015 and 2014, interest expense on time deposits of $250,000 or more was $3.2 million, $1.4 million and $1.1 million, respectively.

At December 31, 2016, the scheduled maturities of certificates and other time deposits, including public accounts, were as follows (in thousands):

2017	$ 488,226
2018	266,867
2019	79,908
2020	42,683
2021	29,234
2022 and thereafter	5,231
	$ 912,149

At December 31, 2016, we had $35.5 million in brokered certificates of deposit ("CDs") that represented 1.0% of our deposits. Approximately $29.8 million of our brokered CDs were non-callable with a weighted average cost of 66 basis points and remaining maturities of one to fifteen months. The remaining $5.7 million were long terms CDs that mature within three years and have short-term calls that we control. These brokered CDs are reflected in the CDs under $250,000 category. At December 31, 2015, we had $85.3 million in brokered CDs. We utilized long-term brokered CDs because the brokered CDs better matched overall ALCO objectives at the time of issuance by protecting us with fixed rates should interest rates increase, while providing us options to call the funding should interest rates decrease. Our current policy allows for a maximum of $180 million in brokered CDs.

At December 31, 2016 and 2015, we had approximately $10.3 million and $11.6 million, respectively, in deposits from related parties, including directors and named executive officers.

The aggregate amount of demand deposit overdrafts that have been reclassified as loans were $993,000 and $637,000 at December 31, 2016 and 2015, respectively.

9. SHORT-TERM BORROWINGS

Information related to short-term borrowings is provided in the table below (dollars in thousands):

	December 31, 2016	December 31, 2015
Federal funds purchased and repurchase agreements:		
Balance at end of period	$ 7,097	$ 2,429
Average amount outstanding during the period (1)	6,798	2,277
Maximum amount outstanding during the period (2)	11,516	2,429
Weighted average interest rate during the period (3)	0.1%	0.1%
Interest rate at end of period	0.2%	0.1%
FHLB advances:		
Balance at end of period	$ 866,518	$ 645,407
Average amount outstanding during the period (1)	563,471	382,417
Maximum amount outstanding during the period (2)	866,518	656,431
Weighted average interest rate during the period (3)	0.7%	0.3%
Interest rate at end of period	0.7%	0.5%

(1) The average amount outstanding during the period was computed by dividing the total daily outstanding principal balances by the number of days in the period.
(2) The maximum amount outstanding at any month-end during the period.
(3) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.

Southside Bank has three unsecured lines of credit for the purchase of overnight federal funds at prevailing rates with Frost Bank, TIB – The Independent Bankers Bank and Comerica Bank for $30.0 million, $15.0 million and $7.5 million, respectively. Southside Bank has a $5.0 million line of credit with Frost Bank to be used to issue letters of credit and at December 31, 2016, we had one outstanding letter of credit for $195,000. At December 31, 2016, the amount of additional funding Southside Bank could obtain from FHLB, collateralized by FHLB stock, nonspecified loans and securities, was approximately $482.6 million, net of FHLB stock purchases required. There were no federal funds purchased at December 31, 2016 or 2015. Southside Bank obtained no letters of credit from FHLB as collateral for its public fund deposits.

Southside Bank enters into sales of securities under agreements to repurchase ("repurchase agreements"). These repurchase agreements totaled $7.1 million and $2.4 million at December 31, 2016 and 2015, respectively, and had maturities of less than one year. These repurchase agreements are secured by investment securities and are stated at the amount of cash received in connection with the transaction.

10. LONG-TERM OBLIGATIONS

	December 31, 2016	December 31, 2015
	(dollars in thousands)	
FHLB advances:		
Balance at end of period	$ 443,128	$ 502,281
Weighted average interest rate during the period [1]	1.5%	1.3%
Interest rate at end of period	1.2%	1.3%
Subordinated notes, net of unamortized debt issuance costs: [2]		
Balance at end of period	$ 98,100	$ —
Weighted average interest rate during the period [1]	5.8%	—%
Interest rate at end of period	5.5%	—%
Long-term debt, net of unamortized debt issuance costs: [3]		
Balance at end of period	$ 60,236	$ 60,231
Weighted average interest rate during the period [1]	2.8%	2.4%
Interest rate at end of period	3.0%	2.6%

(1) The weighted average interest rate during the period was computed by dividing the actual interest expense by the average balance outstanding during the period.
(2) This long-term debt consists of subordinated notes with a remaining maturity greater than one year that qualify under the risk-based capital guidelines as Tier 2 capital, subject to certain limitations.
(3) This long-term debt consists of trust preferred securities that qualify under the risk-based capital guidelines as Tier 1 capital, subject to certain limitations.

Maturities of fixed rate long-term obligations based on scheduled repayments at December 31, 2016 are as follows (in thousands):

	Years Ended December 31,						
	2017	2018	2019	2020	2021	Thereafter	Total
FHLB advances	$ 758	$ 308,287	$ 42,339	$ 76,016	$ 11,690	$ 4,038	$ 443,128
Subordinated notes, net of unamortized debt issuance costs	—	—	—	—	—	98,100	98,100
Long-term debt, net of unamortized debt issuance costs	—	—	—	—	—	60,236	60,236
Total long-term obligations	$ 758	$ 308,287	$ 42,339	$ 76,016	$ 11,690	$ 162,374	$ 601,464

FHLB advances represent borrowings with fixed interest rates ranging from 0.85% to 4.799% and with maturities of one to twelve years. FHLB advances are collateralized by FHLB stock, nonspecified loans and securities.

During the fourth quarter of 2015 and continuing into the first half of 2016, the Company entered into various variable rate advance agreements with the FHLB. At December 31, 2016, these agreements had a total notional value of $250.0 million with rates ranging from one-month LIBOR plus 0.17% to one-month LIBOR plus 0.278%. In addition, the Company entered into various interest rate swap contracts that are treated as cash flow hedges under ASC Topic 815, “Derivatives and Hedging” that effectively converted the variable rate advances to fixed interest rates ranging from 0.932% to 1.647% and original terms ranging from four years to nine years. The cash flows from the swaps are expected to be effective in hedging the variability in future cash flows attributable to fluctuations in the one-month LIBOR interest rate. Refer to “Note 12 - Derivative Financial Instruments and Hedging Activities” in our consolidated financial statements included in this report for a detailed description of our hedging policy and methodology related to derivative instruments.

	December 31, 2016	December 31, 2015
	(in thousands)	
Parent Company		
Subordinated notes:		
5.50% Subordinated Notes Due 2026, net of unamortized debt issuance costs [1]	$ 98,100	$ —
Total Subordinated notes	98,100	—
Long-term debt:		
Southside Statutory Trust III Due 2033, net of unamortized debt issuance costs [2]	20,544	20,539
Southside Statutory Trust IV Due 2037 [3]	23,196	23,196
Southside Statutory Trust V Due 2037 [4]	12,887	12,887
Magnolia Trust Company I Due 2035 [5]	3,609	3,609
Total Long-term debt	60,236	60,231
Total Parent company	158,336	60,231
Subsidiaries		
FHLB advances	443,128	502,281
Total Subsidiaries	443,128	502,281
Total Long-term obligations	$ 601,464	$ 562,512

(1) This debt carries a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a rate equal to three-month LIBOR plus 429.7 basis points.
(2) This debt carries an adjustable rate of 3.93789% through March 30, 2017 and adjusts quarterly at a rate equal to three-month LIBOR plus 294 basis points.
(3) This debt carried an adjustable rate of 2.18733% through January 29, 2017 and reset to 2.339% through April 29, 2017. This debt adjusts quarterly at a rate equal to three-month LIBOR plus 130 basis points.
(4) This debt carries an adjustable rate of 3.21344% through March 14, 2017 and adjusts quarterly at a rate equal to three-month LIBOR plus 225 basis points.
(5) This debt carried an adjustable rate of 2.71983% through February 22, 2017 and reset to 2.85344% through May 22, 2017. This debt adjusts quarterly at a rate equal to three-month LIBOR plus 180 basis points.

On September 19, 2016, the Company issued $100.0 million aggregate principal amount of fixed-to-floating rate subordinated notes that mature on September 30, 2026. This debt initially bears interest at a fixed rate of 5.50% through September 29, 2021 and thereafter, adjusts quarterly at a floating rate equal to three-month LIBOR plus 429.7 basis points. The proceeds from the sale of the subordinated notes were used for general corporate purposes, which included advances to the Bank to finance its activities. The unamortized discount and debt issuance costs deducted from the subordinated notes issued totaled approximately $1.9 million at December 31, 2016.

The unamortized debt issuance costs reflected in the carrying amount of the Southside Statutory Trust III junior subordinated debentures totaled $75,000 at December 31, 2016 and $80,000 at December 31, 2015.

11. EMPLOYEE BENEFITS

Deferred Compensation Agreements

Southside Bank has deferred compensation agreements with 16 of its executive officers, which generally provide for payment of an aggregate amount of $5.2 million over a maximum period of 15 years after retirement or death. Of the 16 executives included in the agreements, payments have commenced to eight former executives and/or their beneficiaries. In addition, one executive retired on December 31, 2016 with payments commencing in 2017. Three executive officers became eligible to receive payments in 2016 as a result of the acceptance of an early retirement package offered in late December of 2015. Deferred compensation expense was $357,000, $553,000 and $224,000 for the years ended December 31, 2016, 2015 and 2014, respectively. At December 31, 2016 and 2015, the deferred compensation plan liability totaled $3.6 million and $3.9 million, respectively.

Health Insurance

We provide accident and health insurance for substantially all employees through a self-funded insurance program. The cost of health care benefits was $4.9 million, $6.0 million and $4.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Our healthcare plan was amended to provide health insurance coverage for any retiree having 50 years of service with the Company. In addition, the eligible retiree must have Medicare coverage, including part A, part B and part D. There were two retirees participating in the health insurance plan as of December 31, 2016 and 2015. There were no retirees participating as of December 31, 2014.

Employee Stock Ownership Plan

We have an Employee Stock Ownership Plan (the "ESOP") which covers substantially all employees. Contributions to the ESOP are at the sole discretion of the board of directors. We contributed $350,000 to the ESOP for both years ended December 31, 2016 and 2015, and $250,000 for the year ended December 31, 2014. At December 31, 2016 and 2015, the ESOP owned 316,908 and 326,178 shares of common stock, respectively. The number of shares has been adjusted as a result of stock dividends. These shares are treated as externally held shares for dividend and earnings per share calculations.

Long-term Disability

We have an officer's long-term disability income policy which provides coverage in the event they become disabled as defined under its terms. Individuals are automatically covered under the policy if they (a) have been elected as an officer, (b) have been an employee of Southside Bank for three years and (c) receive earnings of $50,000 or more on an annual basis. The policy provides, among other things, that should a covered individual become totally disabled he would receive two-thirds of his current salary, not to exceed $15,000 per month. The benefits paid out of the policy are limited by the benefits paid to the individual under the terms of our other Company-sponsored benefit plans.

Split Dollar Agreements

We entered into split dollar agreements with eight of our executive officers. The agreements provide we will be the beneficiary of bank owned life insurance ("BOLI") insuring the executives' lives. The agreements provide the executives the right to designate the beneficiaries of the death benefits guaranteed in each agreement. The agreements originally provided for death benefits of an initial aggregate amount of $4.5 million. The individual amounts are increased annually on the anniversary date of the agreement by inflation adjustment factors ranging from 3% to 5%. As of December 31, 2016, the expected death benefits total $5.8 million. The agreements also state that after the executive's retirement, we shall also pay an annual gross-up bonus to the executive in an amount sufficient to enable the executive to pay federal income tax on both the economic benefit and on the gross-up bonus. The expense required to record the post retirement liability associated with the split dollar post retirement bonuses was $172,000, $28,000 and $7,000 for the years ended December 31, 2016, 2015 and 2014, respectively. For the years ended December 31, 2016 and 2015, the split dollar liability totaled $1.8 million and $1.9 million, respectively.

401(k) Plan

We have a 401(k) defined contribution plan (the "401(k) Plan") covering substantially all employees, who have completed one year of service and are age 21 or older. A participant may elect to defer a percentage of their compensation subject to certain limits based on federal tax laws. For the years ended December 31, 2016, 2015 and 2014, expense attributable to the 401(k) Plan amounted to $562,000, $447,000 and $171,000, respectively.

Pension Plans

We have a defined benefit pension plan ("the Plan") pursuant to which participants are entitled to benefits based on final average monthly compensation and years of credited service determined in accordance with plan provisions.

Entrance into the Plan by new employees was frozen effective December 31, 2005. Employees hired after December 31, 2005 are not eligible to participate in the plan. All participants in the Plan are fully vested. Benefits are payable monthly commencing on the later of age 65 or the participant's date of retirement. Eligible participants may retire at reduced benefit levels after reaching age 55. We contribute amounts to the pension fund sufficient to satisfy funding requirements of the Employee Retirement Income Security Act.

Plan assets included 234,796 shares of our stock at December 31, 2016 and 2015. Our stock included in the Plan assets was purchased at fair value. The number of shares has been adjusted as a result of stock dividends. During 2016, our funded status improved and at December 31, 2016, we had an unfunded status of $2.8 million compared to an unfunded status of $3.7 million at December 31, 2015. The improvement was a result of greater than expected return on the fair value of plan assets and contributions to the plan since December 31, 2015, and the updated mortality assumption at December 31, 2016 compared to December 31, 2015, partially offset by a decrease in the discount rate at December 31, 2016 compared to December 31, 2015. In late December 2015, we offered an early retirement package to 24 of our employees, of which 16 accepted the early retirement offer by the acceptance deadline of January 29, 2016. During 2016, the Plan provided special and contractual termination benefits of $1.5 million to 15 employees that accepted an early retirement package during the year ended December 31, 2016. The Plan provided special and contractual termination benefits of $176,000 to an employee that accepted an early retirement package during the year ended December 31, 2015.

In connection with the acquisition of Omni, we acquired the OmniAmerican Bank Defined Benefit Plan ("the Acquired Plan") which was remeasured at fair value. The Acquired Plan originally called for benefits to be paid to eligible employees at retirement based primarily upon years of service and the compensation levels at retirement. As of December 31, 2006, the benefits under the Acquired Plan were frozen. No further benefits will be earned by employees after that date. In addition, no new participants may be added to the Acquired Plan after December 31, 2006. During 2016, our funded status deteriorated, and at December 31, 2016, we had an unfunded status of $1.2 million compared to an unfunded status of $945,000 at December 31, 2015. The deterioration was a result of less than expected return on the fair value of plan assets since December 31, 2015 and a decline in the discount rate at December 31, 2016 compared to December 31, 2015, partially offset by a settlement event which improved the funded status during the year ended December 31, 2016 and an updated mortality assumption at December 31, 2016 compared to December 31, 2015.

We have a nonfunded supplemental retirement plan (the "Restoration Plan") for our employees whose benefits under the principal retirement plan are reduced because of compensation deferral elections or limitations under federal tax laws.

Both the Plan and the Restoration Plan were amended effective January 1, 2013 to change the formula for determining death benefits for participants who die while in service of the employer and who are early retirement eligible on their date of death.

We use a measurement date of December 31 for our plans.

	Year ended December 31,								
	2016			2015			2014		
	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan
	(in thousands)								
Change in Projected Benefit Obligation:									
Benefit obligation at end of prior year	$ 80,040	$ 4,685	$ 12,024	$ 84,050	$ 5,977	$ 13,259	$ 70,046	$ —	$ 10,848
Service cost	1,375	—	207	1,838	—	334	1,697	—	275
Interest cost	3,731	212	535	3,410	238	668	3,497	—	563
Actuarial loss (gain)	4,978	275	237	(6,777)	(753)	(1,968)	13,146	—	1,813
Benefits paid	(3,632)	(31)	(280)	(2,590)	(28)	(269)	(4,118)	—	(240)
Expenses paid	(91)	(39)	—	(67)	(30)	—	(175)	—	—
Plan acquired through acquisition (1)	—	—	—	—	—	—	—	5,977	—
Plan amendments	121	—	—	—	—	—	(43)	—	—
Settlements	—	(864)	—	—	(719)	—	—	—	—
Special and contractual termination benefits	1,549	—	—	176	—	—	—	—	—
Benefit obligation at end of year	88,071	4,238	12,723	80,040	4,685	12,024	84,050	5,977	13,259
Change in Plan Assets:									
Fair value of plan assets at end of prior year	76,355	3,740	—	79,730	4,512	—	78,990	—	—
Actual return	7,661	187	—	(718)	5	—	5,033	—	—
Employer contributions	5,000	—	280	—	—	269	—	—	240
Benefits paid	(3,632)	(31)	(280)	(2,590)	(28)	(269)	(4,118)	—	(240)
Expenses paid	(91)	(39)	—	(67)	(30)	—	(175)	—	—
Settlements	—	(864)	—	—	(719)	—	—	—	—
Plan acquired through acquisition (1)	—	—	—	—	—	—	—	4,512	—
Fair value of plan assets at end of year	85,293	2,993	—	76,355	3,740	—	79,730	4,512	—
(Un)Funded status at end of year	(2,778)	(1,245)	(12,723)	(3,685)	(945)	(12,024)	(4,320)	(1,465)	(13,259)
Accrued benefit (liability) asset recognized	$ (2,778)	$ (1,245)	$ (12,723)	$ (3,685)	$ (945)	$ (12,024)	$ (4,320)	$ (1,465)	$ (13,259)
Accumulated benefit obligation at end of year	$ 77,639	$ 4,238	$ 11,133	$ 69,737	$ 4,685	$ 10,290	$ 71,201	$ 5,977	$ 10,811

(1) Defined benefit plan acquired with the acquisition of Omni on December 17, 2014.

Amounts related to our defined benefit pension plans and restoration plan recognized as a component of other comprehensive (loss) income were as follows (in thousands):

	Year ended December 31,							
	2016			2015			2014	
	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Restoration Plan
Recognition of net loss	$ 1,642	$ —	$ 186	$ 1,505	$ —	$ 943	$ 543	$ 499
Recognition of prior service (credit) cost	(14)	—	6	(23)	—	7	(19)	5
Recognition of gain due to settlement	—	(8)	—	—	(62)	—	—	—
Net (loss) gain occurring during the year	(2,541)	(354)	(237)	375	463	1,968	(13,761)	(1,813)
Net prior service (cost) credit occurring during the year	(121)	—	—	—	—	—	43	—
	(1,034)	(362)	(45)	1,857	401	2,918	(13,194)	(1,309)
Deferred tax benefit (expense)	362	127	16	(650)	(141)	(1,021)	4,618	458
Other comprehensive (loss) income, net of tax	$ (672)	$ (235)	$ (29)	$ 1,207	$ 260	$ 1,897	$ (8,576)	$ (851)

Net amounts recognized in net periodic benefit cost and other comprehensive loss were as follows (in thousands):

	December 31, 2016			December 31, 2015		
	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan
Net loss	$ 1,642	$ —	$ 186	$ 1,505	$ —	$ 943
Prior service (credit) cost	(14)	—	6	(23)	—	7
Gain recognized due to settlement	—	(8)	—	—	(62)	—
	1,628	(8)	192	1,482	(62)	950
Deferred tax (expense) benefit	(569)	3	(67)	(519)	22	(333)
Accumulated other comprehensive income (loss), net of tax	$ 1,059	$ (5)	$ 125	$ 963	$ (40)	$ 617

Amounts recognized as a component of accumulated other comprehensive loss were as follows (in thousands):

	December 31, 2016			December 31, 2015		
	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan
Net (loss) gain	$ (26,855)	$ 40	$ (2,868)	$ (25,956)	$ 401	$ (2,816)
Prior service (cost) credit	(96)	—	(38)	40	—	(44)
	(26,951)	40	(2,906)	(25,916)	401	(2,860)
Deferred tax benefit (expense)	9,433	(14)	1,017	9,071	(141)	1,001
Accumulated other comprehensive (loss) income, net of tax	$ (17,518)	$ 26	$ (1,889)	$ (16,845)	$ 260	$ (1,859)

Net periodic pension cost and postretirement benefit cost included the following components (in thousands):

	Year ended December 31,		
	2016	2015	2014
Defined Benefit Pension Plan:			
Service cost	$ 1,375	$ 1,838	$ 1,697
Interest cost	3,731	3,410	3,497
Expected return on assets	(5,224)	(5,684)	(5,648)
Net loss amortization	1,642	1,505	543
Prior service credit amortization	(14)	(23)	(19)
Special and contractual termination benefits	1,549	176	—
Net periodic benefit cost	$ 3,059	$ 1,222	$ 70
Defined Benefit Pension Plan Acquired:			
Service cost	$ —	$ —	$ —
Interest cost	212	238	—
Expected return on assets	(265)	(294)	—
Net loss amortization	—	—	—
Prior service credit amortization	—	—	—
Gain recognized due to settlement	(8)	(62)	—
Net periodic benefit cost	$ (61)	$ (118)	$ —
Restoration Plan:			
Service cost	$ 207	$ 334	$ 275
Interest cost	535	668	563
Net loss amortization	186	943	499
Prior service cost amortization	6	7	5
Net periodic benefit cost	$ 934	$ 1,952	$ 1,342

The amounts in accumulated other comprehensive income (loss) that are expected to be recognized as components of net periodic benefit cost during 2017 are as follows (in thousands):

	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan
Net loss	$ 1,375	$ —	$ 190
Prior service (credit) cost	(14)	—	6
	1,361	—	196
Deferred tax benefit	(476)	—	(69)
Accumulated other comprehensive loss, net of tax	$ 885	$ —	$ 127

The Plan and Acquired Plan assets, which consist primarily of marketable equity and debt instruments, are valued using market quotations in active markets for identical assets, market quotations for similar assets in active or non-active markets or the net asset value (NAV) provided by the plan administrator. The Plans' obligations and the annual pension expense are determined by independent actuaries and through the use of a number of assumptions. Key assumptions in measuring the Plans' obligations include the discount rate, the rate of salary increases and the estimated future return on plan assets.

In determining the discount rate, we utilized a cash flow matching analysis to determine a range of appropriate discount rates for the defined benefit pension plan and restoration plan. In developing the cash flow matching analysis, we had our actuaries construct a portfolio of high quality noncallable bonds to match as closely as possible the timing of future benefit payments of the plans at December 31, 2016. We utilized a bond selection-settlement approach that selects a portfolio of bonds from a universe of high quality corporate bonds rated Aa by at least half of the rating agencies available. Based on the results of this cash flow matching analysis, we were able to determine an appropriate discount rate.

Salary increase assumptions are based upon historical experience and anticipated future management actions. The expected long-term rate of return assumption reflects the average return expected based on the investment strategies and asset allocation of the assets invested to provide for the Plans' liabilities. We considered broad equity and bond indices, long-term return projections, and actual long-term historical Plan performance when evaluating the expected long-term rate of return assumption.

The assumptions used to determine the benefit obligation were as follows:

	December 31, 2016			December 31, 2015		
	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan
Discount rate	4.23%	4.23%	4.23%	4.56%	4.56%	4.56%
Compensation increase rate	3.50%	—	3.50%	3.50%	—	3.50%

The assumptions used to determine net periodic pension cost and postretirement benefit cost were as follows:

	Year ended December 31,		
	2016	2015	2014
Defined Benefit Pension Plan:			
Discount rate	4.56%	4.14%	5.06%
Expected long-term rate of return on plan assets	7.25%	7.25%	7.25%
Compensation increase rate	3.50%	3.50%	4.50%
Defined Benefit Pension Plan Acquired			
Discount rate	4.56%	4.14%	—
Expected long-term rate of return on plan assets	7.25%	7.25%	—
Compensation increase rate	—	—	—
Restoration Plan:			
Discount rate	4.56%	4.14%	5.06%
Compensation increase rate	3.50%	3.50%	4.50%

Material changes in pension benefit costs may occur in the future due to changes in these assumptions. Future annual amounts could be impacted by changes in the number of SSB Plan participants, changes in the level of benefits provided, changes in the discount rates, changes in the expected long-term rate of return, changes in the level of contributions to the Plan and other factors.

The major categories of assets in our Plan and the Acquired Plan are presented in the following table (in thousands). Assets are segregated by the level of the valuation inputs within the fair value hierarchy established by ASC Topic 820 "Fair Value Measurements and Disclosures," utilized to measure fair value (see "Note 13 – Fair Value Measurement"). Our Restoration Plan is unfunded.

	December 31, 2016		December 31, 2015	
	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired
Level 1:				
Cash	$ 484	$ —	$ 588	$ —
Equity Securities:				
U.S. large cap (1)	27,383	—	26,098	—
U.S. mid cap (2)	8,533	—	7,527	—
U.S. small cap (3)	9,851	—	6,186	—
Fixed Income Securities:				
International developed (4)	2,663	—	2,975	—
International emerging (2)	1,246	—	1,108	—
Level 2:				
Cash Equivalents	13,152	—	13,491	—
Equity Securities:				
U.S. large cap (1)	—	1,082	—	1,231
U.S. mid cap (2)	—	125	—	157
U.S. small cap (3)	—	66	—	156
International (5)	—	427	—	514
Fixed Income Securities:				
Corporate bonds (6)	1,130	304	1,443	376
U.S. government agencies (6)	13,248	—	9,116	—
Municipal bonds (6)	7,211	—	7,365	—
U.S. agency mortgage-backed securities (7)	392	—	458	—
Asset-backed securities (8)	—	590	—	729
Real estate (9)	—	180	—	189
Balanced Asset Allocation (10)	—	60	—	189
Other (11)	—	159	—	199
Total fair value of plan assets	$ 85,293	$ 2,993	$ 76,355	$ 3,740

(1) For the defined benefit pension plan, this category is comprised of individual securities that are actively managed and a broadly diversified "passive" mutual fund. The Acquired Plan assets in this category consist of pooled separate accounts invested in mutual funds and domestic stocks.
(2) For the defined benefit pension plan, this category is comprised of broadly diversified "passive" mutual funds. The Acquired Plan assets in this category consist of pooled separate accounts invested in mutual funds and domestic stocks.
(3) For the defined benefit pension plan, this category is comprised of broadly diversified "passive" mutual funds and shares of Southside Bancshares stock that is owned in the Plan. The Acquired Plan assets in this category consist of pooled separate accounts invested in mutual funds and domestic stocks.
(4) This category is comprised of individual securities that are actively managed and a broadly diversified "passive" mutual fund.
(5) This category is comprised of pooled separate accounts invested in mutual funds and international stocks.
(6) For the defined benefit pension plan, this category is comprised of individual investment grade securities that are generally held to maturity in the Plan. The Acquired Plan assets in this category consist of pooled separate accounts invested in investment grade and below investment grade bonds.
(7) This category is comprised of individual securities that are generally not held to maturity.
(8) This category is mainly comprised of a pooled separate account invested in asset backed securities, residential mortgage backed securities, commercial mortgage backed securities and corporate bonds.
(9) This category is comprised of a pooled separate account invested in commercial real estate and includes mortgage loans which are backed by the associated properties.

(10) This category is comprised of a pooled separate account invested in a single mutual fund invested in a combination of fixed income and equity investment options.
(11) This category is comprised a pooled separate account invested in a broad range of instruments including, but not limited to, equities, bonds, currencies, convertible securities and derivatives such as futures, options, swaps and forwards.

We did not have any plan assets with Level 3 input fair value measurements at December 31, 2016 or 2015. Due to asset allocation model changes, there were transfers between Level 1 and Level 2 during the year ended December 31, 2016.

Our overall investment strategy is to realize long-term growth of the Plan within acceptable risk parameters, while funding benefit payments from dividend and interest income, to the extent possible. The target allocations for plan assets are 55.0% equities, 44.5% fixed income and 0.5% cash equivalents. Equity securities are diversified among U.S. and international (both developed and emerging), large, mid and small caps, and value and growth securities. The investment objective of equity funds is long-term capital appreciation with current income. Fixed income securities include government agencies, CDs, corporate bonds, municipal bonds, and MBS. The investment objective of fixed income funds is to maximize investment return while preserving investment principal. Mutual funds, primarily because of the superior diversification they provide, are used to provide specific international developed and emerging market exposure.

As of December 31, 2016, expected future benefit payments related to our defined benefit pension plan, defined benefit pension plan acquired and restoration plan were as follows (in thousands):

	Defined Benefit Pension Plan	Defined Benefit Pension Plan Acquired	Restoration Plan
2017	$ 3,771	$ 45	$ 537
2018	3,781	59	583
2019	3,959	65	631
2020	4,089	224	690
2021	4,212	123	804
2022 through 2026	23,964	496	4,523
	$ 43,776	$ 1,012	$ 7,768

We do not expect to make additional contributions to the Plan, the Acquired Plan, or the restoration plan in 2017.

Share-based Incentive Plans

2009 Incentive Plan

On April 16, 2009, our shareholders approved the Southside Bancshares, Inc. 2009 Incentive Plan (the "2009 Incentive Plan"), which is a stock-based incentive compensation plan. A total of 1,477,459 shares of our common stock were reserved and available for issuance pursuant to awards granted under the 2009 Incentive Plan. Under the 2009 Incentive Plan, we were authorized to grant nonqualified stock options ("NQSOs"), restricted stock units ("RSUs") or any combination thereof to certain officers. During the years ended December 31, 2016 and 2015, we granted RSUs and NQSOs pursuant to the 2009 Incentive Plan. There were no awards granted during 2014. All share data for all periods presented has been adjusted to give retroactive recognition to stock dividends.

As of December 31, 2016, 2015 and 2014, there were 584,876, 546,794 and 256,354 unvested awards outstanding, respectively. For the years ended December 31, 2016, 2015 and 2014, there was $1.5 million, $1.4 million and $1.1 million of share-based compensation expense related to the 2009 Incentive Plans, respectively, and $539,000, $488,000 and $379,000 of income tax benefit related to the stock compensation expense, respectively.

As of December 31, 2016, 2015 and 2014, there was $5.6 million, $4.0 million and $1.8 million of unrecognized compensation cost related to the 2009 Incentive Plan, respectively. The remaining cost at December 31, 2016 is expected to be recognized over a weighted-average period of 3.08 years.

The NQSOs have contractual terms of 10 years and vest in equal annual installments over either a three- or four-year period.

The fair value of each RSU is the ending stock price on the date of grant. The RSUs vest in equal annual installments over either a three- or four-year period.

Each award is evidenced by an award agreement that specifies the option price, if applicable, the duration of the award, the number of shares to which the award pertains, and such other provisions as the Board determines.

Shares issued in connection with stock compensation awards are issued from available authorized shares and not from treasury shares. During 2016, 108,225 shares were issued in connection with stock compensation awards. During 2015 and 2014, 30,088 shares and 93,384 shares, respectively, were issued in connection with stock compensation awards.

The estimated weighted-average grant-date fair value per option and the underlying Black-Scholes option-pricing model assumptions are summarized in the following table for years in which we granted NQSO's pursuant to the 2009 plan:

	Years Ended December 31,		
	2016	2015	2014
Weighted-average grant date fair value per option	$7.18	$6.29	$—
Weighted-average assumptions:			
Risk-free interest rates	1.79%	2.01%	—
Expected dividend yield	2.69%	3.24%	—
Expected volatility factors of the market price of Southside Bancshares common stock	27.02%	30.91%	—
Expected option life (in years)	6.2	6.3	—

A combined summary of activity in our share-based plans as of December 31, 2016 is presented below:

		Restricted Stock Units Outstanding		Stock Options Outstanding		
	Shares Available for Grant	Number of Shares	Weighted-Average Grant-Date Fair Value	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Grant-Date Fair Value
Balance, January 1, 2016	448,653	72,934	$ 25.52	784,034	$ 22.66	$ 5.83
Granted	(295,864)	60,102	34.96	235,762	34.19	7.18
Stock options exercised	—	—	—	(86,619)	19.20	5.43
Stock awards vested	—	(24,274)	24.45	—	—	—
Forfeited	81,328	(10,342)	26.28	(70,986)	26.15	5.96
Canceled/expired	5,179	—	—	(5,179)	20.59	5.98
Balance, December 31, 2016	239,296	98,420	$ 31.47	857,012	$ 25.91	$ 6.23

Other information regarding options outstanding and exercisable as of December 31, 2016 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life in Years	Number of Shares	Weighted-Average Exercise Price
$ 15.04 - 20.00	197,464	$ 16.26	3.89	197,464	$ 16.26
20.01 - 25.00	194,947	23.50	6.92	104,083	23.53
25.01 - 30.00	311,511	27.48	8.40	69,009	27.15
30.01 - 35.00	—	—	—	—	—
35.01 - 38.21	153,090	38.21	9.90	—	—
Total	857,012	$ 25.91	7.29	370,556	$ 20.33

The total intrinsic value of outstanding in-the-money stock options and outstanding in-the-money exercisable stock options was $10.2 million and $6.4 million at December 31, 2016, respectively. The weighted-average remaining contractual life of options exercisable at December 31, 2016 was 5.12 years.

The total intrinsic value of stock options exercised during the years ended December 31, 2016, 2015 and 2014 was $1.3 million, $119,000 and $1.0 million, respectively.

Cash received from stock option exercises for the years ended December 31, 2016, 2015 and 2014 was $1.7 million, $236,000 and $1.2 million, respectively. The tax benefit realized for the deductions related to stock awards was $332,000 and $75,000 for the years ended December 31, 2016 and 2015, respectively. The tax expense related to stock awards was $76,000 for the year ended December 31, 2014.

12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Our hedging policy allows the use of interest rate derivative instruments to manage our exposure to interest rate risk or hedge specified assets and liabilities. These instruments may include interest rate swaps and interest rate caps and floors. All derivative instruments are carried on the balance sheet at their estimated fair value and are recorded in other assets or other liabilities, as appropriate.

Derivative instruments may be designated as cash flow hedges of variable rate assets or liabilities, or as cash flow hedges of forecasted transactions. Derivative instruments designated as cash flow hedges are recorded in accumulated other comprehensive income to the extent that they are effective. The amount recorded in other comprehensive income is reclassified to earnings in the same periods as the hedged cash flows impact earnings. The ineffective portion of changes in fair value is reported in current earnings.

During the fourth quarter of 2015 and continuing into the first half of 2016, we entered into certain interest rate swap contracts on specific variable-rate advance agreements with the FHLB having a total notional amount of $250.0 million at December 31, 2016. These interest rate swap contracts were designated as hedging instruments in cash flow hedges under ASC Topic 815, “Derivatives and Hedging.” The objective of the interest rate swap contracts is to manage the expected future cash flows on our $250.0 million of variable-rate advance agreements with the FHLB. The cash flows of the swap are expected to be effective in hedging the variability in expected future cash flows attributable to fluctuations in the one-month LIBOR interest rate.

From time to time, we may enter into certain interest rate swaps, cap, and floor contracts that are not designated as hedging instruments. These interest rate derivative contracts relate to transactions in which we enter into a interest rate swap, cap, or floor with a customer while concurrently entering into an offsetting interest rate swap, cap, or floor with a third-party financial institution. We agree to pay interest to the customer on a notional amount at a variable rate and receive interest from the customer on a similar notional amount at a fixed interest rate. At the same time, we agree to pay a third-party financial institution the same fixed interest rate on the same notional amount and receive the same variable interest rate on the same notional amount. These interest rate derivatives contracts allow our customers to effectively convert a variable rate loan to a fixed rate. The changes in the fair value of the underlying derivative contracts primarily offset each other and do not significantly impact our results of operations. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in current earnings during the period of change.

The notional amounts of the derivative instruments represent the contractual cash flows pertaining to the underlying agreements. These amounts are not exchanged and are not reflected in the consolidated balance sheets. The fair value of the interest rate swaps are presented at net in other assets and other liabilities when a right of offset exists, based on transactions with a single counterparty that are subject to a legally enforceable master netting agreement.

At December 31, 2016, net derivative assets included $7.2 million of cash collateral received from counterparties under master netting agreements. At December 31, 2016, we had $886,000 of cash collateral payable that was not offset against derivative assets.

The following tables present the notional and estimated fair value amount of derivative positions outstanding (in thousands):

	December 31, 2016			December 31, 2015		
		Estimated Fair Value			Estimated Fair Value	
	Notional Amount [(1)]	Asset Derivative	Liability Derivative	Notional Amount [(1)]	Asset Derivative	Liability Derivative
Derivatives designated as hedging instruments						
Interest rate contracts:						
Swaps-Cash Flow Hedge-Financial institution counterparties	$ 250,000	$ 7,069	$ —	$ 20,000	$ —	$ 1
Derivatives designated as non-hedging instruments						
Interest rate contracts:						
Swaps-Financial institution counterparties	2,182	85	—	—	—	—
Swaps-Customer counterparties	2,182	—	85	—	—	—
Gross derivatives		7,154	85		—	1
Offsetting derivative assets/liabilities		—	—		—	—
Cash collateral received/posted		(7,154)	—		—	—
Net derivatives included in the consolidated balance sheets [(2)]		$ —	$ 85		$ —	$ 1

(1) Notional amounts, which represent the extent of involvement in the derivatives market, are used to determine the contractual cash flows required in accordance with the terms of the agreement. These amounts are typically not exchanged, significantly exceed amounts subject to credit or market risk and are not reflected in the consolidated balance sheets.

(2) Net derivative assets are included in "other assets" and net derivative liabilities are included in "other liabilities" on the consolidated balance sheets. Included in the fair value of net derivative assets and net derivative liabilities are credit valuation adjustments reflecting counterparty credit risk and our credit risk. We had no credit exposure at December 31, 2016 or December 31, 2015.

The summarized expected weighted average remaining maturity of the notional amount of interest rate swaps and the weighted average interest rates associated with the amounts expected to be received or paid on interest rate swap agreements are presented below (in thousands):

	December 31, 2016				December 31, 2015			
		Weighted Average				Weighted Average		
	Notional Amount	Remaining Maturity (in years)	Receive Rate [(1)]	Pay Rate	Notional Amount	Remaining Maturity (in years)	Receive Rate [(1)]	Pay Rate
Swaps-Cash Flow Hedge								
Financial institution counterparties	$ 250,000	5.4	0.68%	1.31%	$ 20,000	4.9	0.29%	1.53%
Swaps-Non-Hedging								
Financial institution counterparties	2,182	9.7	0.62	1.57	—	—	—	—
Customer counterparties	2,182	9.7	1.57	0.62	—	—	—	—

(1) Variable rates received on pay fixed swaps are based on one-month LIBOR rates in effect at December 31, 2016 and December 31, 2015.

13. FAIR VALUE MEASUREMENT

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

Valuation techniques including the market approach, the income approach and/or the cost approach are utilized to determine fair value. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Valuation policies and procedures are determined by our investment department and reported to our Asset/Liability Committee ("ALCO") for review. An entity must consider all aspects of nonperforming risk, including the entity's own credit standing, when measuring fair value of a liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. A fair value hierarchy for valuation inputs gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

> *Level 1 Inputs* – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
>
> *Level 2 Inputs* – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.
>
> *Level 3 Inputs* –- Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Level 3 assets recorded at fair value on a nonrecurring basis at December 31, 2016 and 2015, included loans for which a specific allowance was established based on the fair value of collateral and commercial real estate for which fair value of the properties was less than the cost basis. For both asset classes, the unobservable inputs were the additional adjustments applied by management to the appraised values to reflect such factors as non-current appraisals and revisions to estimated time to sell. These adjustments are determined based on qualitative judgments made by management on a case-by-case basis and are not quantifiable inputs, although they are used in the determination of fair value.

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

Certain financial assets are measured at fair value in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of fair value accounting or write-downs of individual assets. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with our monthly and/or quarterly valuation process. There were no transfers between Level 1 and Level 2 during the year ended December 31, 2016.

Securities Available for Sale – U.S. Treasury securities and other equity securities are reported at fair value utilizing Level 1 inputs. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, we obtain fair value measurements from independent pricing services. 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.

We review the prices supplied by the independent pricing services for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In addition, we obtain an understanding of their underlying pricing methodologies and their Statement on Standards for Attestation Engagements-Reporting on Controls of a Service Organization ("SSAE 16"). We validate prices supplied by the independent pricing services by comparison to prices obtained from, in most cases, three additional third party sources. For securities where prices are outside a reasonable range, we further review those securities to determine what a reasonable price estimate is for that security, given available data.

Derivatives – Derivatives are reported at fair value utilizing Level 2 inputs. We obtain fair value measurements from three sources including an independent pricing service and the counterparty to the derivatives designated as hedges. The fair value measurements consider observable data that may include dealer quotes, market spreads, the U.S. Treasury yield curve, live trading levels, trade execution data, credit information and the derivatives' terms and conditions, among other things. We review the prices supplied by the sources for reasonableness. In addition, we obtain a basic understanding of their underlying pricing methodology. We validate prices supplied by the sources by comparison to one another.

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis, which means that the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and financial liabilities measured at fair value on a nonrecurring basis included foreclosed assets and impaired loans at December 31, 2016 and 2015.

Foreclosed Assets – Foreclosed assets are initially recorded at fair value less costs to sell. The fair value measurements of foreclosed assets can include Level 2 measurement inputs such as real estate appraisals and comparable real estate sales information, in conjunction with Level 3 measurement inputs such as cash flow projections, qualitative adjustments, and sales cost estimates. As a result, the categorization of foreclosed assets is Level 3 of the fair value hierarchy. In connection with the measurement and initial recognition of certain foreclosed assets, we may recognize charge-offs through the allowance for loan losses.

Impaired Loans – Certain impaired loans may be reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 3 inputs based on customized discounting criteria or appraisals. At December 31, 2016 and 2015, the impact of loans with specific reserves based on the fair value of the collateral was reflected in our allowance for loan losses.

Certain nonfinancial assets and nonfinancial liabilities measured at fair value on a recurring basis include reporting units measured at fair value and tested for goodwill impairment.

The following tables summarize assets measured at fair value on a recurring and nonrecurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

	As of December 31, 2016:			
		Fair Value Measurements at the End of the Reporting Period Using		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Investment Securities:				
U.S. Treasury	$ 70,069	$ 70,069	$ —	$ —
State and Political Subdivisions	385,197	—	385,197	—
Other Stocks and Bonds	6,651	—	6,651	—
Other Equity Securities	5,920	5,920	—	—
Mortgage-backed Securities: [1]				
Residential	627,508	—	627,508	—
Commercial	384,255	—	384,255	—
Derivative assets:				
Interest rate swaps	7,154	—	7,154	—
Total asset recurring fair value measurements	$ 1,486,754	$ 75,989	$ 1,410,765	$ —
Derivative liabilities:				
Interest rate swaps	$ 85	$ —	$ 85	$ —
Total liability recurring fair value measurements	$ 85	$ —	$ 85	$ —
Nonrecurring fair value measurements				
Foreclosed assets	$ 388	$ —	$ —	$ 388
Impaired loans [2]	9,693	—	—	9,693
Total asset nonrecurring fair value measurements	$ 10,081	$ —	$ —	$ 10,081

	As of December 31, 2015:			
		Fair Value Measurements at the End of the Reporting Period Using		
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Investment Securities:				
U.S. Treasury	$ 103,587	$ 103,587	$ —	$ —
State and Political Subdivisions	244,246	—	244,246	—
Other Stocks and Bonds	12,790	—	12,790	—
Other Equity Securities	6,016	6,016	—	—
Mortgage-backed Securities: (1)				
Residential	588,502	—	588,502	—
Commercial	505,351	—	505,351	—
Total recurring fair value measurements	$ 1,460,492	$ 109,603	$ 1,350,889	$ —
Nonrecurring fair value measurements				
Foreclosed assets	$ 808	$ —	$ —	$ 808
Impaired loans (2)	24,283	—	—	24,283
Total nonrecurring fair value measurements	$ 25,091	$ —	$ —	$ 25,091

(1) All mortgage-backed securities are issued and/or guaranteed by U.S. government agencies or U.S. government-sponsored enterprises.

(2) Impaired loans represent collateral-dependent loans with a specific valuation allowance. Losses on these loans represent charge-offs which are netted against the allowance for loan losses.

Disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, is required when it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other estimation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Such techniques and assumptions, as they apply to individual categories of our financial instruments, are as follows:

Cash and cash equivalents – The carrying amount for cash and cash equivalents is a reasonable estimate of those assets' fair value.

Investment and mortgage-backed securities held to maturity – Fair values for these securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services.

FHLB stock and other investments – The carrying amount of FHLB stock and other investments is a reasonable estimate of the fair value of those assets.

Loans receivable – For adjustable rate loans that reprice frequently and with no significant change in credit risk, the carrying amounts are a reasonable estimate of those assets' fair value. The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Nonperforming loans are estimated using discounted cash flow analyses or the underlying value of the collateral where applicable.

Loans held for sale – The fair value of loans held for sale is determined based on expected proceeds, which are based on sales contracts and commitments.

Deposit liabilities – The fair value of demand deposits, savings accounts, and certain money market deposits is the amount on demand at the reporting date, which is the carrying value. Fair values for fixed rate CDs are estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities.

Federal funds purchased and repurchase agreements – Federal funds purchased generally have original terms to maturity of one day and repurchase agreements generally have terms of less than one year, and therefore both are considered short-term borrowings. Consequently, their carrying value is a reasonable estimate of fair value.

FHLB advances – The fair value of these advances is estimated by discounting the future cash flows using rates at which advances would be made to borrowers with similar credit ratings and for the same remaining maturities.

Subordinated notes - The fair value of the subordinated notes is estimated by discounting future cash flows using estimated rates at which long-term debt would be made to borrowers with similar credit ratings and for the remaining maturities.

Long-term debt – The fair value of the long-term debt is estimated by discounting future cash flows using estimated rates at which long-term debt would be made to borrowers with similar credit ratings and for the remaining maturities.

The following tables present our financial assets, financial liabilities, and unrecognized financial instruments measured on a nonrecurring basis at both their respective carrying amounts and estimated fair value (in thousands):

		Estimated Fair Value			
December 31, 2016	Carrying Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$ 169,654	$ 169,654	$ 169,654	$ —	$ —
Investment Securities:					
Held to maturity, at carrying value	425,810	429,912	—	429,912	—
Mortgage-backed Securities:					
Held to maturity, at carrying value	511,677	514,370	—	514,370	—
FHLB stock, at cost, and other investments	66,592	66,592	—	66,592	—
Loans, net of allowance for loan losses	2,538,626	2,630,009	—	—	2,630,009
Loans held for sale	7,641	7,641	—	7,641	—
Financial Liabilities:					
Deposits	$ 3,533,076	$ 3,293,352	$ —	$ 3,293,352	$ —
Federal funds purchased and repurchase agreements	7,097	7,097	—	7,097	—
FHLB advances	1,309,646	1,331,517	—	1,331,517	—
Subordinated notes, net of unamortized debt issuance costs	98,100	101,627	—	101,627	—
Long-term debt, net of unamortized debt issuance costs	60,236	45,147	—	45,147	—

		Estimated Fair Value			
December 31, 2015	Carrying Amount	Total	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	$ 80,975	$ 80,975	$ 80,975	$ —	$ —
Investment Securities:					
Held to maturity, at carrying value	385,496	397,194	—	397,194	—
Mortgage-backed Securities:					
Held to maturity, at carrying value	398,800	402,569	—	402,569	—
FHLB stock, at cost, and other investments	56,509	56,509	—	56,509	—
Loans, net of allowance for loan losses	2,412,017	2,364,968	—	—	2,364,968
Loans held for sale	3,811	3,811	—	3,811	—
Financial Liabilities:					
Deposits	$ 3,455,407	$ 3,449,002	$ —	$ 3,449,002	$ —
Federal funds purchased and repurchase agreements	2,429	2,429	—	2,429	—
FHLB advances	1,147,688	1,143,218	—	1,143,218	—
Long-term debt, net of unamortized debt issuance costs	60,231	43,615	—	43,615	—

The fair value estimate of financial instruments for which quoted market prices are unavailable is dependent upon the assumptions used. Consequently, those estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented in the above fair value table do not necessarily represent their underlying value.

14. SHAREHOLDERS' EQUITY

Cash dividends declared and paid were $1.01, $1.00 and $0.96 per share for the years ended December 31, 2016, 2015 and 2014, respectively. Future dividends will depend on our earnings, financial condition and other factors which the board of directors considers to be relevant. Our dividend policy requires that any cash dividend payments made may not exceed consolidated earnings for that year.

On December 6, 2016, we entered into an underwriting agreement, pursuant to which we sold 2,185,000 shares of our common stock at a price of $36.50 per share. We received $76.0 million in net proceeds, after deducting underwriting discounts and costs. These net proceeds were used primarily for general corporate purposes.

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

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1, Tier 1 and Total Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 Capital (as defined) to average assets (as defined). At December 31, 2016, we exceeded all regulatory minimum capital requirements.

As of December 31, 2016, the most recent notification from the FDIC categorized us as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized we must maintain minimum Common Equity Tier 1 risk-based, Tier 1 risk-based, Total risk-based and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed our category.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Actions Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(dollars in thousands)			
As of December 31, 2016:						
Common Equity Tier 1 (to Risk Weighted Assets)						
Consolidated	$ 461,158	14.64%	$ 141,759	4.50%	N/A	N/A
Bank Only	$ 566,423	17.98%	$ 141,734	4.50%	$ 204,726	6.50%
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	$ 515,831	16.37%	$ 189,013	6.00%	N/A	N/A
Bank Only	$ 566,423	17.98%	$ 188,978	6.00%	$ 251,971	8.00%
Total Capital (to Risk Weighted Assets)						
Consolidated	$ 633,289	20.10%	$ 252,017	8.00%	N/A	N/A
Bank Only	$ 585,781	18.60%	$ 251,971	8.00%	$ 314,964	10.00%
Tier 1 Capital (to Average Assets) (1)						
Consolidated	$ 515,831	9.46%	$ 218,029	4.00%	N/A	N/A
Bank Only	$ 566,423	10.40%	$ 217,892	4.00%	$ 272,365	5.00%
As of December 31, 2015:						
Common Equity Tier 1 (to Risk Weighted Assets)						
Consolidated	$ 368,865	12.71%	$ 130,549	4.50%	N/A	N/A
Bank Only	$ 416,378	14.36%	$ 130,446	4.50%	$ 188,422	6.50%
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	$ 422,513	14.56%	$ 174,065	6.00%	N/A	N/A
Bank Only	$ 416,378	14.36%	$ 173,928	6.00%	$ 231,904	8.00%
Total Capital (to Risk Weighted Assets)						
Consolidated	$ 443,106	15.27%	$ 232,087	8.00%	N/A	N/A
Bank Only	$ 436,971	15.07%	$ 231,904	8.00%	$ 289,881	10.00%
Tier 1 Capital (to Average Assets) (1)						
Consolidated	$ 422,513	8.61%	$ 196,347	4.00%	N/A	N/A
Bank Only	$ 416,378	8.49%	$ 196,209	4.00%	$ 245,261	5.00%

(1) Refers to quarterly average assets as calculated in accordance with policies established by bank regulatory agencies.

Our payment of dividends is limited under regulation. The amount that can be paid in any calendar year without prior approval of our regulatory agencies cannot exceed the lesser of net profits (as defined) for that year plus the net profits for the preceding two calendar years, or retained earnings.

15. DIVIDEND REINVESTMENT AND COMMON STOCK REPURCHASE PLAN

We have a Dividend Reinvestment Plan funded by stock authorized but not yet issued. Proceeds from the sale of the common stock will be used for general corporate purposes and could be directed to our subsidiaries. For the year ended December 31, 2016, 44,575 shares were sold under this plan at an average price of $31.65 per share, reflective of other trades at the time of each sale. For the year ended December 31, 2015, 49,908 shares were sold under this plan at an average price of $27.46 per share, reflective of other trades at the time of each sale.

Our board continually evaluates the Company's capital needs and those of Southside Bank and may, at their discretion, initiate, modify or discontinue an authorized repurchase plan. During 2016, 443,426 shares of common stock were purchased under an authorized stock repurchase plan at a cost of $10.2 million. There were no purchases of shares of common stock under a stock repurchase plan during 2015 or 2014.

16. INCOME TAXES

The income tax expense (benefit) included in the accompanying statements of income consists of the following (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Current income tax expense (benefit)	$ 8,557	$ 10,671	$ (1,239)
Deferred income tax expense (benefit)	1,768	(3,392)	(925)
Income tax expense (benefit)	$ 10,325	$ 7,279	$ (2,164)

The components of the net deferred tax asset (liability) as of December 31, 2016 and 2015 are summarized below (in thousands):

	Assets	Liabilities
Allowance for loan losses	$ 6,269	$
Retirement and other benefit plans		(2,707)
Premises and equipment		(5,273)
Core deposit intangible		(1,576)
Unrealized losses on securities available for sale	12,286	
Effective hedging derivatives		(2,474)
Fair value adjustment on loans	1,404	
Alternative minimum tax credit	8,776	
Unfunded status of defined benefit plan	10,436	
State business tax credit	604	
Stock-based compensation	995	
Other	151	
Gross deferred tax assets (liabilities)	40,921	(12,030)
Net deferred tax asset at December 31, 2016	$ 28,891	
Allowance for loan losses	$ 6,907	$
Retirement and other benefit plans		(2,220)
Unrealized gains on securities available for sale		(1,298)
Premises and equipment		(5,797)
Core deposit intangible		(2,213)
Fair value adjustment on loans	5,143	
Fair value adjustment on time deposits	302	
Alternative minimum tax credit	7,465	
Unfunded status of defined benefit plan	9,931	
State business tax credit	622	
Stock-based compensation	841	
Other	220	
Gross deferred tax assets (liabilities)	31,431	(11,528)
Net deferred tax asset at December 31, 2015	$ 19,903	

A reconciliation of tax at statutory rates and total tax expense is as follows (dollars in thousands):

	Years Ended December 31,					
	2016		2015		2014	
	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income
Statutory tax expense	$ 20,886	35.0 %	$ 17,946	35.0 %	$ 6,348	34.0 %
Increase (decrease) in taxes from:						
Tax exempt interest	(9,879)	(16.6)%	(9,975)	(19.5)%	(9,942)	(53.3)%
Bank owned life insurance	(915)	(1.5)%	(914)	(1.8)%	(451)	(2.4)%
Share-based compensation	—	— %	(75)	(0.1)%	766	4.1 %
Acquisition costs	—	— %	—	— %	787	4.2 %
State business tax	71	0.1 %	—	— %	146	0.8 %
Other, net	162	0.3 %	297	0.6 %	182	1.0 %
Income tax expense (benefit)	$ 10,325	17.3 %	$ 7,279	14.2 %	$ (2,164)	(11.6)%

We file income tax returns in the U.S. federal jurisdiction and in certain states. We are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2013. No valuation allowance for deferred tax assets was recorded at December 31, 2016 or 2015 as management believes it is more likely than not that all of the deferred tax assets will be realized in future years. Unrecognized tax benefits were not material at December 31, 2016 or 2015.

17. OFF-BALANCE-SHEET ARRANGEMENTS, COMMITMENTS AND CONTINGENCIES

Financial Instruments with Off-Balance-Sheet Risk. In the normal course of business, we are a party to certain financial instruments with off-balance-sheet risk to meet the financing needs of our customers. These off-balance-sheet instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the financial statements. The contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss that we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require the payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers and similarly do not necessarily represent future cash obligations.

Financial instruments with off-balance-sheet risk were as follows (in thousands):

	At December 31, 2016	At December 31, 2015
Unused commitments:		
Commitments to extend credit	$ 665,663	$ 546,660
Standby letters of credit	9,075	7,752
Total	$ 674,738	$ 554,412

We apply the same credit policies in making commitments and standby letters of credit as we do for on-balance-sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

Lease Commitments. We lease certain branch facilities and office equipment under operating leases. It is expected that certain leases will be renewed, or equipment replaced with new leased equipment, as these leases expire. During the year ended December 31, 2016, we terminated the lease associated with our Fort Worth operations center. The termination resulted in $1.5 million in lease termination expense and a loss of $310,000 on retirement of assets.

Future minimum rental commitments due under non-cancelable operating leases at December 31, 2016 were as follows (in thousands):

2017	$	1,467
2018		1,195
2019		892
2020		615
2021		343
2022 and thereafter		287
	$	4,799

Rent expense for branch facilities was $3.9 million, $2.5 million, and $1.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Rent expense for leased equipment was $261,000, $297,000, and $235,000 for the years ended December 31, 2016, 2015, and 2014, respectively.

We acquired a 202,000 square-foot office building in Fort Worth, Texas upon completion of the Omni acquisition that is used for a branch location and certain bank operations. We occupy approximately 43,000 square feet of the building and lease the remaining space to various tenants. Gross rental income from these leases of $3.1 million, $2.8 million, and $116,000 was recognized for the years ended December 31, 2016, 2015, and 2014, respectively. At December 31, 2016, non-cancelable operating leases for the building with future minimum lease payments are as follows (in thousands):

2017	$	2,997
2018		2,706
2019		2,340
2020		2,248
2021		1,430
2022 and thereafter		6,742
	$	18,463

It is expected that certain leases will be renewed, or equipment replaced with new leased equipment, as these leases expire.

Securities. In the normal course of business we buy and sell securities. There were $160,000 and $19.4 million of unsettled trades to purchase securities at December 31, 2016 and December 31, 2015, respectively. There were no unsettled trades to sell securities as of December 31, 2016. As of December 31, 2015, there were $9.3 million of unsettled trades to sell securities.

Deposits. There were no unsettled issuances of brokered CDs at December 31, 2016 or December 31, 2015.

Litigation. We are involved with various litigation in the normal course of business. Management, after consulting with our legal counsel, believes that any liability resulting from litigation will not have a material effect on our financial position, results of operations or liquidity.

18. SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK

Although we have a diversified loan portfolio, a significant portion of our loans are collateralized by real estate. Repayment of these loans is in part dependent upon the economic conditions in the market area. See “Item 1. Business – Market Area.” Part of the risk associated with real estate loans has been mitigated since 32.5% of this group represents loans collateralized by residential dwellings that are primarily owner occupied. Losses on this type of loan have historically been less than those on speculative properties. Many of the remaining real estate loans are collateralized primarily with non owner-occupied commercial real estate. We currently have a concentration of credit risk greater than 10% of loans secured by retail investment real estate properties, such as shopping malls and strip centers.

The MBS we hold consist exclusively of U.S. agency pass-through securities which are either directly or indirectly backed by the full faith and credit of the United States Government or guaranteed by GSEs. The GNMA mortgage-backed securities are backed by the full faith and credit of the United States Government. The Fannie Mae and Freddie Mac U.S. agency GSE guaranteed MBS are not backed by the full faith and credit of the United States government.

19. PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information for Southside Bancshares, Inc. (parent company only) was as follows (in thousands, except share amounts):

CONDENSED BALANCE SHEETS	December 31,	
	2016	2015
ASSETS		
Cash and due from banks	$ 42,968	$ 1,766
Investment in bank subsidiaries at equity in underlying net assets	625,046	494,130
Investment in nonbank subsidiaries at equity in underlying net assets	2,554	1,826
Other assets	8,237	7,202
TOTAL ASSETS	$ 678,805	$ 504,924
LIABILITIES		
Subordinated notes, net of unamortized debt issuance costs	$ 98,100	$ —
Long-term debt, net of unamortized debt issuance costs	60,236	60,231
Other liabilities	2,195	631
TOTAL LIABILITIES	160,531	60,862
SHAREHOLDERS' EQUITY		
Common stock ($1.25 par, 40,000,000 shares authorized, 31,455,951 shares issued at December 31, 2016 and 27,865,798 shares issued at December 31, 2015)	39,320	34,832
Paid-in capital	535,240	424,078
Retained earnings	30,098	41,527
Treasury stock, at cost (2,913,064 at December 31, 2016 and 2,469,638 at December 31, 2015)	(47,891)	(37,692)
Accumulated other comprehensive loss	(38,493)	(18,683)
TOTAL SHAREHOLDERS' EQUITY	518,274	444,062
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 678,805	$ 504,924

CONDENSED STATEMENTS OF INCOME

	Years Ended December 31,		
	2016	2015	2014
INCOME			
Dividends from subsidiary	$ 30,000	$ 17,600	$ 177,000
Interest income	51	44	53
TOTAL INCOME	30,051	17,644	177,053
EXPENSE			
Interest expense	3,334	1,455	1,424
Other	3,227	3,193	16,144
TOTAL EXPENSE	6,561	4,648	17,568
Income before income tax expense	23,490	12,996	159,485
Income tax benefit	2,278	1,612	4,043
Income before equity in undistributed earnings of subsidiaries	25,768	14,608	163,528
Equity in undistributed earnings of subsidiaries	23,581	29,389	(142,695)
NET INCOME	$ 49,349	$ 43,997	$ 20,833

CONDENSED STATEMENTS OF CASH FLOW

	Years Ended December 31,		
	2016	2015	2014
OPERATING ACTIVITIES:			
Net Income	$ 49,349	$ 43,997	$ 20,833
Adjustments to reconcile net income to net cash provided by operations:			
Amortization	45	—	—
Equity in undistributed earnings of subsidiaries	(23,581)	(29,389)	142,695
(Increase) decrease in other assets	(1,035)	2,716	(6,477)
Increase (decrease) in other liabilities	1,564	(3,709)	3,904
Net cash provided by operating activities	26,342	13,615	160,955
INVESTING ACTIVITIES:			
Investment in subsidiaries	(126,000)	(10)	—
Net cash paid for acquisition	—	—	(136,078)
Net cash used in investing activities	(126,000)	(10)	(136,078)
FINANCING ACTIVITIES:			
Net proceeds from issuance of subordinated long-term debt	98,060	—	—
Purchase of common stock	(10,199)	—	—
Proceeds from issuance of common stock	78,962	1,536	2,287
Dividends paid	(25,963)	(25,071)	(17,919)
Payments for other financing activities	—	—	(599)
Net cash provided by (used in) financing activities	140,860	(23,535)	(16,231)
Net increase (decrease) in cash and cash equivalents	41,202	(9,930)	8,646
Cash and cash equivalents at beginning of period	1,766	11,696	3,050
Cash and cash equivalents at end of period	$ 42,968	$ 1,766	$ 11,696

20. QUARTERLY FINANCIAL INFORMATION OF REGISTRANT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(in thousands, except share amounts)

	2016			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest income	$ 43,680	$ 41,132	$ 41,089	$ 43,012
Interest expense	9,039	7,202	6,711	6,396
Net interest income	34,641	33,930	34,378	36,616
Provision for loan losses	2,065	1,631	3,768	2,316
Net (loss) gain on sale of securities available for sale	(2,676)	2,343	728	2,441
Noninterest income excluding net securities gains	9,389	9,389	8,642	9,155
Noninterest expense	25,877	28,425	25,813	29,407
Income before income tax expense	13,412	15,606	14,167	16,489
Income tax expense	1,839	2,741	2,772	2,973
Net income	11,573	12,865	11,395	13,516
Earnings per common share				
Basic	$ 0.43	$ 0.49	$ 0.43	$ 0.51
Diluted	$ 0.43	$ 0.49	$ 0.43	$ 0.51

	2015			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest income	$ 39,964	$ 38,211	$ 37,750	$ 38,607
Interest expense	5,267	4,926	4,845	4,816
Net interest income	34,697	33,285	32,905	33,791
Provision for loan losses	1,951	2,276	268	3,848
Net gain on sale of securities available for sale	204	875	105	2,476
Noninterest income excluding net securities gains	8,611	8,486	8,826	8,312
Noninterest expense	28,431	26,637	28,437	29,449
Income before income tax expense	13,130	13,733	13,131	11,282
Income tax expense	1,438	1,971	1,967	1,903
Net income	11,692	11,762	11,164	9,379
Earnings per common share				
Basic	$ 0.44	$ 0.44	$ 0.42	$ 0.35
Diluted	$ 0.44	$ 0.44	$ 0.42	$ 0.35

INDEX TO EXHIBITS

	Exhibit No.		
	2	–	Agreement and Plan of Merger, dated April 28, 2014, by and among Southside Bancshares, Inc., Omega Merger Sub, Inc. and OmniAmerican Bancorp, Inc. (filed as Exhibit 2 to the Registrant's Form 10-Q for the quarter ended March 31, 2014, and incorporated herein by reference).
	3 (a)	–	Restated Certificate of Formation of Southside Bancshares, Inc. effective May 2, 2014 (filed as Exhibit 3 (a) to the Registrant's Form 10-Q for the quarter ended March 31, 2014, and incorporated herein by reference).
	3 (b)(i)	–	Amended and Restated Bylaws of Southside Bancshares, Inc. effective November 20, 2014 (filed as Exhibit 3.1 to the Registrant's Form 8-K, filed November 24, 2014, and incorporated herein by
	4 (a)	–	Subordinated Indenture, dated as of September 19, 2016, by and between the Company and Wilmington Trust, National Association, as Trustee.
	4 (b)	–	First Supplemental Indenture, dated as of September 19, 2016 by and between the Company and Wilmington Trust, National Association, as Trustee, including the form of the Notes attached as Exhibit A thereto.
	4 (c)	–	Management agrees to furnish to the Securities and Exchange Commission, upon request, a copy of any other agreements or instruments of Southside Bancshares, Inc. and its subsidiaries defining the rights of holders of any long-term debt whose authorization does not exceed 10% of total assets.
**	10 (a)(i)	–	Deferred Compensation Plan for B. G. Hartley effective February 13, 1984, as amended June 28, 1990, December 15, 1994, November 20, 1995, December 21,1999 and June 29, 2001 (filed as Exhibit 10(a)(i) to the Registrant's Form 10-Q for the quarter ended June 30, 2001, and incorporated herein by reference).
**	10 (b)	–	Officers Long-term Disability Income Plan effective June 25, 1990 (filed as Exhibit 10(b) to the Registrant's Form 10-K for the year ended June 30, 1990, and incorporated herein by reference).
**	10 (c)	–	Retirement Plan Restoration Plan for the subsidiaries of SoBank, Inc. (now named Southside Bancshares, Inc.) (filed as Exhibit 10(c) to the Registrant's Form 10-K for the year ended December 31, 1992, and incorporated herein by reference).
**	10 (d)	–	Form of Deferred Compensation Agreements dated June 30, 1994 with each of Sam Dawson, Lee Gibson and Jeryl Story, as amended October 15, 1997 (filed as Exhibit 10(f) to the Registrant's Form 10-K for the year ended December 31, 1997, and incorporated herein by reference).
**	10 (e)	–	Split dollar compensation plan dated September 7, 2004 with Lee R. Gibson, III (filed as exhibit 10(i) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference).
**	10 (f)	–	Split dollar compensation plan dated August 27, 2004 with B. G. Hartley (filed as exhibit 10 (j) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference).
**	10 (g)	–	Split dollar compensation plan dated August 31, 2004 with Charles E. Dawson (filed as exhibit 10(k) to the Registrant's Form 8-K, filed October 19, 2004, and incorporated herein by reference).
**	10 (h)	–	Employment Agreement dated October 22, 2007, by and between Southside Bank and Lee R. Gibson (filed as exhibit 10 (l) to the Registrant's Form 8-K, filed October 26, 2007, and incorporated herein by reference).
**	10 (i)	–	Employment Agreement dated October 22, 2007, by and between Southside Bank and Sam Dawson (filed as exhibit 10 (m) to the Registrant's Form 8-K, filed October 26, 2007, and incorporated herein by reference).
**	10 (j)	–	Employment Agreement dated April 28, 2014, by and between Southside Bank, Southside Bancshares, Inc, and Tim Carter (filed as exhibit 10.2 to the Registrant's Amendment No. 1 to Form S-4, filed July 18, 2014, and incorporated herein by reference).

**	10 (k)	–	Master Software License Maintenance and Services Agreement dated February 4, 2008, by and between Southside Bank and Jack Henry & Associates, Inc. (filed as Item 1.01 to the Registrant's Form 8-K, filed February 8, 2008, and incorporated herein by reference).
**	10 (l)	–	Retirement Agreement dated November 7, 2008, by and between Southside Bank, Southside Bancshares, Inc. and B. G. Hartley (filed as exhibit 10 (o) to the Registrant's Form 10-Q, filed November 7, 2008, and incorporated herein by reference).
**	10 (m)	–	Southside Bancshares, Inc. 2009 Incentive Plan (filed as Exhibit 99.1 to the Registrant's Form 8-K, filed April 20, 2009, and incorporated herein by reference).
**	10 (n)	–	Form of Southside Bancshares, Inc. Nonstatutory Stock Option Award Certificate for purchase of Options pursuant to the Southside Bancshares, Inc. 2009 Incentive Plan (filed as Exhibit 10.1 to the Registrant's Form 10-Q filed August 8, 2011, and incorporated herein by reference).
**	10 (o)	–	Form of Southside Bancshares, Inc. Restricted Stock Unit Award Certificate for grant of Units pursuant to the Southside Bancshares, Inc. 2009 Incentive Plan (filed as Exhibit 10.2 to the Registrant's Form 10-Q filed August 8, 2011, and incorporated herein by reference).
*	21	–	Subsidiaries of the Registrant.
*	23.1	–	Consent of Independent Registered Public Accounting Firm
*	31.1	–	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*	31.2	–	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*	32	–	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*	101.INS	–	XBRL Instance Document.
*	101.SCH	–	XBRL Taxonomy Extension Schema Document.
*	101.CAL	–	XBRL Taxonomy Extension Calculation Linkbase Document.
*	101.LAB	–	XBRL Taxonomy Extension Label Linkbase Document.
*	101.PRE	–	XBRL Taxonomy Extension Presentation Linkbase Document.
*	101.DEF	–	XBRL Taxonomy Extension Definition Linkbase Document.

*Filed herewith.

**Compensation plan, benefit plan or employment contract or arrangement.

Southside Bank:
a part of your
past, a partner
for your future.

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