TEXAS CAPITAL BANCSHARES INC/TX
Form 10-K
February 14, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
ý Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the fiscal year ended December 31, 2018
¨ 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 001-34657
TEXAS CAPITAL BANCSHARES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	75-2679109
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2000 McKinney Avenue, Suite 700, Dallas, Texas, U.S.A.	75201
(Address of principal executive officers)	(Zip Code)

214/932-6600
(Registrant’s telephone number, including area code)
N/A
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)
Securities registered under Section 12(b) of the Exchange Act:
Common stock, par value $0.01 per share
(Title of class)
6.50% Non-Cumulative Perpetual Preferred Stock Series A, par value $0.01 per share
(Title of class)
The Nasdaq Stock Market LLC
(Name of Exchange on Which Registered)
Securities registered under Section 12(g) of the Exchange Act: NONE
Indicate by check mark if the issuer is a well-known seasoned issuer pursuant to Section 13 or Section 15(d) of the Securities Act. Yes ý No ¨
Indicate by check mark if the issuer is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act. Yes ¨ No ý
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý ¨ No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer x Accelerated Filer ¨ Non-Accelerated Filer ¨ Non-Accelerated Filer ¨

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

As of June 29, 2018, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the shares of common stock held by non-affiliates, based on the closing price per share of the registrant's common stock as reported on The Nasdaq Global Select Market, was approximately $4,567,174,000.

There were 50,239,639 shares of the registrant's common stock outstanding on February 13, 2018.

Documents Incorporated by Reference

Portions of the registrant's Proxy Statement relating to the 2019 Annual Meeting of Stockholders, which will be filed no later than March 7, 2019, are incorporated by reference into Part III of this Form 10-K.

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ITEM 1. BUSINESS

Background

The disclosures set forth in this item are qualified by Item 1A. Risk Factors and the section captioned "Forward-Looking Statements" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report and other cautionary statements set forth elsewhere in this report.

Texas Capital Bancshares, Inc. ("we", "us" or the "Company"), a Delaware corporation organized in 1996, is the parent of Texas Capital Bank, National Association (the "Bank"). The Company is a registered bank holding company and a financial holding company.

The Bank is headquartered in Dallas, with primary banking offices in Austin, Dallas, Fort Worth, Houston and San Antonio, the five largest metropolitan areas of Texas. Substantially all of our business activities are conducted through the Bank. We have focused on organic growth, maintenance of credit quality and recruiting and retaining experienced bankers with strong personal and professional relationships in their communities.

We serve the needs of commercial businesses and successful professionals and entrepreneurs located in Texas as well as operate several lines of business serving a regional or national clientele of commercial borrowers. We are primarily a secured lender, with the majority of our loans held for investment, excluding mortgage finance loans and other national lines of business, being made to businesses headquartered or with operations in Texas. Our national lines of business provide specialized lending products to businesses throughout the United States. We have benefitted from the success of our business model since inception, producing strong loan and deposit growth and favorable loss experience amidst a challenging environment for banking nationally.

Growth History

We have grown substantially in both size and profitability since our formation. The table below sets forth data regarding the growth of key areas of our business for the past five years:

	December 31,				
(in thousands)	2018	2017	2016	2015	2014
Loans held for sale	$1,969,474	$1,011,004	$968,929	$86,075	$ —
Loans held for investment, mortgage finance	5,877,524	5,308,160	4,497,338	4,966,276	4,102,125
Loans held for investment, net	16,690,550	15,366,252	13,001,011	11,745,674	10,154,887
Assets	28,257,767	25,075,645	21,697,134	18,903,821	15,900,034
Demand deposits	7,317,161	7,812,660	7,994,201	6,386,911	5,011,619
Total deposits	20,606,113	19,123,180	17,016,831	15,084,619	12,673,300
Stockholders' equity	2,500,394	2,202,721	2,009,557	1,623,533	1,484,190

The following table provides information about the growth of our loans held for investment ("LHI") portfolio by type of loan for the past five years:

	December 31,				
(in thousands)	2018	2017	2016	2015	2014
Commercial	$10,373,288	$9,189,811	$7,291,545	$6,672,631	$5,869,219
Total real estate	6,050,083	5,960,785	5,560,909	4,990,914	4,223,532
Construction	2,120,966	2,166,208	2,098,706	1,851,717	1,416,405
Real estate term	3,929,117	3,794,577	3,462,203	3,139,197	2,807,127
Mortgage finance	5,877,524	5,308,160	4,497,338	4,966,276	4,102,125
Equipment leases	312,191	264,903	185,529	113,996	99,495
Consumer	63,438	48,684	34,587	25,323	19,699

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The Texas Market

The Texas market for banking services is highly competitive. Texas' largest banking organizations are headquartered outside of Texas and are controlled by out-of-state organizations. We also compete with other providers of financial services, such as non-bank lenders, commercial finance and leasing companies, consumer finance companies, financial technology, or fintech, companies, securities firms, insurance companies, full service brokerage firms and discount brokerage firms, credit unions and savings and loan associations. We believe that many middle market companies and successful professionals and entrepreneurs are interested in banking with a company headquartered in, and with decision-making authority based in, Texas and with established Texas bankers who have the expertise to act as trusted advisors to customers with regard to their banking needs.

Our banking centers in our target markets are served by experienced bankers with lending expertise in the specific industries found in their market areas and established community ties. We believe our Bank can offer customers more responsive and personalized service than our competitors. By providing effective service to these customers, we believe we will be able to establish long-term relationships and provide multiple products to our customers, thereby enhancing our profitability.

National Lines of Business

While the Texas market continues to be central to the growth and success of our company, we have developed several lines of business, including mortgage finance, mortgage correspondent aggregation ("MCA"), homebuilder finance, insurance premium finance, lender finance and asset-based lending, that offer specialized loan and deposit products to businesses regionally and throughout the nation. We believe this helps us mitigate our geographic concentration risk in Texas. We continue to seek opportunities to develop additional lines of business that leverage our capabilities and are consistent with our business strategy.

Business Strategy

Drawing on the business and community ties of our management and their banking experience, our strategy is to continue growing an independent bank that focuses primarily on middle market business customers and successful professionals and entrepreneurs in each of the five major metropolitan markets of Texas as well as our national lines of business. To achieve this, we employ the following strategies:

- offering a premier and differentiated banking experience to middle market businesses and successful professionals and entrepreneurs who value a broad relationship with our Bank;
- growing our loan and deposit base in our existing markets by hiring additional experienced bankers in our different lines of business;
- developing lines of business that leverage our strengths and complement our existing lines of business;
- continuing our emphasis on credit policy to maintain credit quality consistent with long-term objectives;
- leveraging our existing infrastructure with improvements in technology and processes to gain efficiencies to support a larger volume of business;
- maintaining effective internal approval processes for capital and operating expenditures;
- continuing our extensive use of outsourcing to provide cost-effective and more efficient operational support and service levels consistent with large-bank operations; and
- extending our reach within our target markets and lines of business through service innovation and service excellence.

Products and Services

We offer a variety of loan, deposit account and other financial products and services to our customers.

Business Customers. We offer a full range of products and services oriented to the needs of our business customers, including:

- commercial loans for general corporate purposes including financing for working capital, internal growth, acquisitions and financing for business insurance premiums;
- real estate term and construction loans;
- mortgage warehouse lending;
- mortgage correspondent aggregation;
- equipment finance and leasing;
- treasury management services, including online banking and debit and credit card services; and

•letters of credit.

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Individual Customers. We also provide complete banking services for our individual customers, including:
- personal wealth management and trust services;
- certificates of deposit and IRAs;
- interest-bearing and non-interest-bearing checking accounts;
- traditional money market and savings accounts;
- loans, both secured and unsecured; and
- online and mobile banking.

Lending Activities

We target our lending to middle market businesses and successful professionals and entrepreneurs that meet our credit standards. The credit standards are set by our standing Credit Policy Committee with the assistance of our Bank’s Chief Credit Officer, who is charged with ensuring that credit standards are met by loans in our portfolio. Our Credit Policy Committee is comprised of senior Bank officers including our Bank’s Texas President/Chief Lending Officer, our Bank's Chief Risk Officer and our Bank’s Chief Credit Officer, and is subject to oversight by the Risk Committee of the Company's board of directors. We believe we maintain an appropriately diversified loan portfolio. Credit policies and underwriting guidelines are tailored to address the unique risks associated with each industry represented in the portfolio.

Our credit standards for commercial borrowers reference numerous criteria with respect to the borrower, including historical and projected financial information, strength of management, acceptable collateral and associated advance rates, and market conditions and trends in the borrower’s industry. In addition, prospective loans are also analyzed based on current industry concentrations in our loan portfolio to prevent an unacceptable concentration of loans in any particular industry. We believe our credit standards are consistent with achieving our business objectives in the markets we serve and are an important part of our risk mitigation. We believe that our Bank is differentiated from its competitors by its focus on and targeted marketing to our core customers and by its ability to fit its products to the individual needs of our customers.

We generally extend variable rate loans in which the interest rate fluctuates with a specified reference rate such as the United States prime rate or the London Interbank Offered Rate (LIBOR) and frequently provide for a minimum floor rate. Our use of variable rate loans is designed to protect us from risks associated with interest rate fluctuations since the rates of interest earned will automatically reflect such fluctuations.

Deposit Products

We offer a variety of deposit products and services to our customers upon terms, including interest rates, which are competitive with other banks. Our business deposit products include commercial checking accounts, lockbox accounts, cash concentration accounts and other treasury management services, including online banking. Our treasury management online system offers information services, wire transfer initiation, ACH initiation, account transfer and service integration. Our consumer deposit products include checking accounts, savings accounts, money market accounts and certificates of deposit. We also allow our consumer deposit customers to access their accounts, transfer funds, pay bills and perform other account functions through online and mobile banking.

Wealth Management and Trust

Our wealth management and trust services include wealth strategy, financial planning, investment management, personal trust and estate services, custodial services, retirement accounts and related services. Our investment management professionals work with our clients to define objectives, goals and strategies for their investment portfolios. We assist the customer with the selection of an investment manager and work with the client to tailor the investment program accordingly. We also offer retirement products such as individual retirement accounts and administrative services for retirement vehicles such as pension and profit sharing plans. Our wealth management and trust services are primarily focused on serving the needs of our banking clients and depend on close cooperation and support between our banking relationship managers and our investment management professionals.

Employees

As of December 31, 2018, we had 1,641 full-time employees. None of our employees is represented by a collective bargaining agreement and we consider our relations with our employees to be good.

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Regulation and Supervision

General. We and our Bank are subject to extensive federal and state laws and regulations that impose specific requirements on us and provide regulatory oversight of virtually all aspects of our operations. These laws and regulations generally are intended for the protection of depositors, the deposit insurance fund ("DIF") of the Federal Deposit Insurance Corporation (“FDIC”) and the stability of the U.S. banking system as a whole, rather than for the protection of our stockholders and creditors.

The following discussion summarizes certain laws, regulations and policies to which we and our Bank are subject. It does not address all applicable laws, regulations and policies that affect us currently or might affect us in the future. This discussion is qualified in its entirety by reference to the full texts of the laws, regulations and policies described.

The Company’s activities are governed by the Bank Holding Company Act of 1956, as amended (“BHCA”). We are subject to regulation, supervision and examination by the Board of Governors of the Federal Reserve System (the “Federal Reserve”) pursuant to the BHCA. We file quarterly reports and other information with the Federal Reserve. We file reports with the Securities and Exchange Commission (“SEC”) and are subject to its regulation with respect to our securities, financial reporting and certain governance matters. Our securities are listed on the Nasdaq Global Select Market, and we are subject to Nasdaq rules for listed companies.

Our Bank is organized as a national banking association under the National Bank Act, and is subject to regulation, supervision and examination by the Office of the Comptroller of the Currency (the “OCC”), the FDIC and the Consumer Financial Protection Bureau (“CFPB”) as well as being subject to regulation by certain other federal and state agencies. The OCC has primary supervisory responsibility for our Bank and performs a continuous program of examinations concerning safety and soundness, the quality of management and oversight by our board of directors, information technology and compliance with applicable laws and regulations. Our Bank files quarterly reports of condition and income with the FDIC, which provides insurance for certain of our Bank’s deposits.

Bank Holding Company Regulation. The BHCA limits our business to banking, managing or controlling banks and other activities that the Federal Reserve has determined to be closely related to banking. We have elected to register with the Federal Reserve as a financial holding company. This authorizes us to engage in any activity that is either (i) financial in nature or incidental to such financial activity, as determined by the Federal Reserve, or (ii) complementary to a financial activity, so long as the activity does not pose a substantial risk to the safety and soundness of our Bank or the financial system generally, as determined by the Federal Reserve. Examples of non-banking activities that are financial in nature include securities underwriting and dealing, insurance underwriting and making merchant banking investments.

We are not at this time exercising the powers authorized for a financial holding company at the parent company level. We, through our Bank, engage in traditional banking activities that are deemed financial in nature. In order for us to undertake new activities permitted by the BHCA, we and our Bank must be considered "well capitalized" (as defined below) and well managed, our Bank must have received a rating of at least satisfactory in its most recent examination under the Community Reinvestment Act and we must notify the Federal Reserve within thirty days of engaging in the new activity. We do not currently expect to engage in any non-banking activities at the holding company level.

Under Federal Reserve policy, now codified by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), we are expected to act as a source of financial and managerial strength to our Bank and commit resources to its support. Such support may be required at times when, absent this Federal Reserve policy, a holding company may not be inclined to provide it. We could in certain circumstances be required to guarantee the capital plan of our Bank if it became undercapitalized.

It is the policy of the Federal Reserve that financial holding companies may pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. The policy provides that financial holding companies may not pay cash dividends in an amount that would undermine the holding company’s ability to serve as a source of strength to its banking subsidiary.

With certain limited exceptions, the BHCA and the Change in Bank Control Act, together with regulations promulgated thereunder, prohibit a person or company or a group of persons deemed to be “acting in concert” from, directly or indirectly, acquiring more than 10% (5% if the acquirer is a bank holding company) of any class of our voting stock or obtaining the ability to control in any manner the election of a majority of our directors or otherwise direct the management or policies of our company without prior notice or application to and the approval of the Federal Reserve.

If, in the opinion of the applicable federal bank regulatory authorities, a depository institution or holding company is engaged in or is about to engage in an unsafe or unsound practice (which could include the payment of dividends), such authority may require, generally after notice and hearing, that such institution or holding company cease and desist such practice. The federal banking agencies have indicated that paying dividends that deplete a depository institution’s or holding company’s capital base to an inadequate level would be such an unsafe or unsound banking practice. Moreover, the Federal Reserve and the FDIC have issued policy statements providing that financial holding companies and insured depository institutions generally should only pay dividends out of current operating earnings.

Regulation of Our Bank by the OCC. National banks the size of our Bank are subject to continuous regulation, supervision and examination by the OCC. The OCC regulates or monitors all areas of a national bank's operations, including security devices and procedures, adequacy of capitalization and loss reserves, accounting treatment and impact on capital determinations, loans, investments, borrowings, deposits, liquidity, mergers, issuances of securities, payment of dividends, interest rate risk management, establishment of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe and sound lending and deposit gathering practices. The OCC requires national banks to maintain specified capital ratios and imposes limitations on their aggregate investment in real estate, bank premises and furniture and fixtures. National banks are required by the OCC to file quarterly reports of their financial condition and results of operations and to obtain an annual audit of their financial statements in compliance with minimum standards and procedures prescribed by the OCC.

Regulation of Our Bank by the CFPB. The CFPB has regulation, supervision and examination authority over our Bank with respect to substantially all federal statutes and regulations protecting the interests of consumers of financial services, including but not limited to the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act, the Truth in Savings Act, the Right to Financial Privacy Act and the Electronic Funds Transfer Act and their respective related regulations. Penalties for violating these laws and regulations could subject our Bank to lawsuits and administrative penalties, including civil monetary penalties, payments to affected consumers and orders to halt or materially change our consumer banking activities. The CFPB has broad authority to pursue enforcement actions, including investigations, civil actions and cease and desist proceedings, and can refer civil and criminal findings to the Department of Justice for prosecution. The Bank is also subject to other federal and state consumer protection laws and regulations that, among other things, prohibit unfair, deceptive and abusive, corrupt or fraudulent business practices, untrue or misleading advertising and unfair competition.

Capital Adequacy Requirements. Federal banking regulators have adopted a system using risk-based capital guidelines to evaluate the capital adequacy of banks and bank holding companies that is based upon the 1988 capital accord of the Bank for International Settlements' Basel Committee on Banking Supervision (the "Basel Committee"), a committee of central banks and bank regulators from the major industrialized countries that coordinates international standards for bank regulation. Under the guidelines, specific categories of assets and off-balance-sheet activities such as letters of credit are assigned risk weights, based generally on the perceived credit or other risks associated with the asset. Off-balance-sheet activities are assigned a credit conversion factor based on the perceived likelihood that they will become on-balance-sheet assets. These risk weights are multiplied by corresponding asset balances to determine a "risk weighted" asset base which is then measured against various forms of capital to produce capital ratios.

An organization's capital is classified in one of two tiers, Core Capital, or Tier 1, and Supplementary Capital, or Tier 2. Tier 1 capital includes common stock, retained earnings, qualifying non-cumulative perpetual preferred stock, minority interests in the equity of consolidated subsidiaries, a limited amount of qualifying trust preferred securities and qualifying cumulative perpetual preferred stock at the holding company level, less goodwill and most intangible assets. Tier 2 capital includes perpetual preferred stock and trust preferred securities not meeting the Tier 1 definition, mandatory convertible debt securities, subordinated debt, and allowances for loan and lease losses. Each category is subject to a number of regulatory definitional and qualifying requirements.

The Basel Committee in 2010 released a set of international recommendations for strengthening the regulation, supervision and risk management of banking organizations, known as Basel III. In July 2013, the Federal Reserve published final rules for the adoption of the Basel III regulatory capital framework (the "Basel III Capital Rules"). The Basel III Capital Rules became effective for us on January 1, 2015, with certain transition provisions phasing in over a period that ended on January 1, 2019.

The Basel III Capital Rules, among other things, (i) specify a capital measure called "Common Equity Tier 1" ("CET1"), (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) require that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) define the scope of the deductions/adjustments to the capital measures. Our

Series A 6.5% Non-Cumulative Perpetual Preferred Stock constitutes Additional Tier 1 capital and our subordinated notes constitute Tier 2 capital.

The Basel III Capital Rules set the risk-based capital requirement and the total risk-based capital requirement to a minimum of 6.0% and 8.0%, respectively, plus a capital conservation buffer of 2.5% producing targeted ratios of 8.5% and 10.5%, respectively, which are fully phased-in as of January 1, 2019 and for subsequent years. The leverage ratio requirement under the Basel III Capital Rules is 4.0%. In order to be well capitalized under the rules now in effect, our Bank must maintain CET1, Tier 1 and total capital ratios that are equal to or greater than 7.0%, 8.5% and 10.5%, respectively, and a leverage ratio equal to or greater than 5.0%. See “Selected Consolidated Financial Data - Capital and Liquidity Ratios.”

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Additionally, the Basel III Capital Rules specify a capital conservation buffer with respect to each of the CET1, Tier 1 and total capital to risk-weighted assets ratios, which provides for capital levels that exceed the minimum risk-based capital adequacy requirements. The capital conservation buffer is subject to a three year phase-in period that began on January 1, 2016 and was fully phased-in on January 1, 2019 and for subsequent years at 2.5%. The required phase-in capital conservation buffer during 2018 was 1.875%. A financial institution with a conservation buffer of less than the required amount is subject to limitations on capital distributions, including dividend payments and stock repurchases, and certain discretionary bonus payments to executive officers.

We have met the capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis since we commenced filing applicable reports with the FDIC and OCC. At December 31, 2018 our Bank's CET1 ratio was 8.62% and its total risk-based capital ratio was 10.77% and, as a result, it is currently classified as "well capitalized" for purposes of the OCC's prompt corrective action regulations.

Because we had less than $15 billion in total consolidated assets as of December 31, 2009, we are allowed to continue to classify our trust preferred securities, all of which were issued prior to May 19, 2010, as Tier 1 capital. We have elected to exclude the effects of accumulated other comprehensive income items included in stockholders’ equity from the determination of capital ratios under the Basel III Capital Rules.

Regulators may change capital and liquidity requirements, including previous interpretations of practices related to risk weights, which could require an increase to the allocation of capital to assets held by our Bank. Regulators could also require us to make retroactive adjustments to financial statements to reflect such changes. A regulatory capital ratio or category may not constitute an accurate representation of the Bank’s overall financial condition or prospects. Our regulatory capital status is addressed in more detail under the heading “Liquidity and Capital Resources” within Management’s Discussion and Analysis of Financial Condition and Results of Operations and in Note 13 - Regulatory Restrictions in the accompanying notes to the consolidated financial statements included elsewhere in this report.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) established a system of prompt corrective action regulations and policies to resolve the problems of undercapitalized insured depository institutions. Under this system, insured depository institutions are ranked in one of five capital categories as described below. Regulators are required to take mandatory supervisory actions and are authorized to take other discretionary actions of increasing severity with respect to insured depository institutions in the three undercapitalized categories. The five capital categories for insured depository institutions under the prompt corrective action regulations consist of:

- Well capitalized - equals or exceeds a 10% total risk-based capital ratio, 8% Tier 1 risk-based capital ratio, and 5% leverage ratio and is not subject to any written agreement, order or directive requiring it to maintain a specific level for any capital measure;
- Adequately capitalized - equals or exceeds an 8% total risk-based capital ratio, 6% Tier 1 risk-based capital ratio, and 4% leverage ratio;
- Undercapitalized - total risk-based capital ratio of less than 8%, or a Tier 1 risk-based ratio of less than 6%, or a leverage ratio of less than 4%;
- Significantly undercapitalized - total risk-based capital ratio of less than 6%, or a Tier 1 risk-based capital ratio of less than 4%, or a leverage ratio of less than 3%; and
- Critically undercapitalized-a ratio of tangible equity to total assets equal to or less than 2%.

The prompt corrective action regulations provide that an institution may be downgraded to the next lower category if its regulator determines, after notice and opportunity for hearing or response, that the institution is in an unsafe or unsound condition or 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.

Federal bank regulatory agencies are required to implement arrangements for prompt corrective action for institutions failing to meet minimum requirements to be at least adequately capitalized. FDICIA imposes an increasingly stringent array of restrictions, requirements and prohibitions as an organization’s capital levels deteriorate. A bank rated "adequately capitalized" may not accept, renew or roll over brokered deposits. A "significantly undercapitalized" institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The OCC has only very limited discretion in dealing with a "critically undercapitalized" institution and generally must appoint a receiver or conservator (the FDIC) if the capital deficiency is not corrected promptly.

Under the Federal Deposit Insurance Act ("FDIA"), "critically undercapitalized" banks may not, beginning 60 days after becoming critically undercapitalized, make any payment of principal or interest on their subordinated debt (subject to certain limited exceptions). In addition, under Section 18(i) of the FDIA, banks are required to obtain the advance consent of the FDIC to retire any part of their subordinated notes. Under the FDIA, a bank may not pay interest on its subordinated notes if such

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interest is required to be paid only out of net profits, or distribute any of its capital assets, while it remains in default on any assessment due to the FDIC.

Federal bank regulators may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve and OCC guidelines provide that banking organizations experiencing significant growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets. Concentration of credit risks, interest rate risk (imbalances in rates, maturities or sensitivities) and risks arising from non-traditional activities, as well as an institution’s ability to manage these risks, are important factors taken into account by regulatory agencies in assessing an organization’s overall capital adequacy.

The OCC and the Federal Reserve also use a leverage ratio as an additional tool to evaluate the capital adequacy of banking organizations. The leverage ratio is a company’s Tier 1 capital divided by its average total consolidated assets. A minimum leverage ratio of 3.0% is required for banks and bank holding companies that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority’s risk-adjusted measure for market risk. All other banks and bank holding companies are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. In order to be considered well capitalized the leverage ratio must be at least 5.0%.

Our Bank’s leverage ratio was 9.53% at December 31, 2018 and, as a result, it is currently classified as “well capitalized” for purposes of the OCC’s prompt corrective action regulations.

The risk-based and leverage capital ratios established by federal banking regulators are minimum supervisory ratios generally applicable to banking organizations that meet specified criteria, assuming that they otherwise have received the highest regulatory ratings in their most recent examinations. Banking organizations not meeting these criteria are expected to operate with capital positions in excess of the minimum ratios. Regulators can, from time to time, change their policies or interpretations of banking practices to require changes in risk weights assigned to our Bank's assets or changes in the factors considered in order to evaluate capital adequacy, which may require our Bank to obtain additional capital to support existing asset levels or future growth or reduce asset balances in order to meet minimum acceptable capital ratios.

Liquidity Requirements. U.S. bank regulators in September 2014 issued a final rule implementing the Basel III liquidity framework for certain U.S. banks - generally those having more than $50 billion of assets or whose primary federal banking regulator determines compliance with the liquidity framework is appropriate based on the organization's size, level of complexity, risk profile, scope of operations, U.S. or non-U.S. affiliations or risk to the financial system. One of the liquidity tests included in the new rule, referred to as the liquidity coverage ratio (“LCR”), is designed to ensure that a banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity’s expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario.

The other test, referred to as the net stable funding ratio (“NSFR”), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements encourage the covered banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets, and also to increase the use of long-term debt as a funding source.

While the LCR and NSFR tests are not currently applicable to our Bank, these measures are monitored by management and, along with other relevant measures of liquidity, are reported to our board of directors. Regulators may change capital and liquidity requirements, including previous interpretations of practices related to risk weights, which could require an increase in liquid assets or in the necessary capital to support the assets held by our Bank. Regulators could also require us to make retroactive adjustments to financial statements and reported capital ratios to reflect such changes.

Stress Testing. Pursuant to the Dodd-Frank Act and regulations published by the Federal Reserve and OCC, institutions with average total consolidated assets greater than $10 billion were required to conduct an annual “stress test” of capital and consolidated earnings and losses under a base case and two severely adverse stress scenarios provided by bank regulatory agencies. In response to this requirement we have developed dedicated staffing, economic models, policies and procedures to implement stress testing on an annual basis using scenarios released by the agencies, the results of which were published on our website, as well as conducting stress tests for internal use based upon economic scenarios we developed. On May 24, 2018 the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Regulatory Relief Act") was signed into law, which amended portions of the Dodd-Frank Act and immediately raised the asset threshold for stress testing from $10 billion to $100 billion for bank holding companies. On December 18, 2018, the OCC proposed regulations that would raise the stress testing threshold for national banks from $10 billion to $250 billion. As a result we, as well as the Bank, are no longer subject to stress test regulations or any requirement to publish the results of our stress testing. We will continue to perform certain stress tests internally and incorporate the economic models and information developed through our stress testing program into our risk management and business planning activities.

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Gramm-Leach-Bliley Financial Modernization Act of 1999 ("Gramm-Leach-Bliley Act"). The Gramm-Leach-Bliley Act:

- allows bank holding companies meeting management, capital and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than was permissible prior to enactment, including insurance underwriting and making merchant banking investments in commercial and financial companies;
- allows insurers and other financial services companies to acquire banks;
- removes various restrictions that applied to bank holding company ownership of securities firms and mutual fund advisory companies; and
- establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

The Gramm-Leach-Bliley Act also modifies other current financial laws, including laws related to financial privacy. The financial privacy provisions generally prohibit financial institutions, including us, from disclosing non-public personal financial information to non-affiliated third parties unless customers have the opportunity to “opt out” of the disclosure.

Community Reinvestment Act. The Community Reinvestment Act of 1977 (“CRA”) requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit, making investments and providing community development services to low- and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a financial holding company to commence new activity permitted by the BHCA, each insured depository institution subsidiary of the financial holding company must have received a rating of at least “satisfactory” in its most recent examination under the CRA. Our Bank's strategic focus on serving commercial customers in regional and national markets from a limited number of branches makes it more challenging for us to satisfy CRA requirements as compared to banks of comparable size that focus on providing retail banking services in markets where they maintain a network of full-service branches.

The USA Patriot Act, the International Money Laundering Abatement and Financial Anti-Terrorism Act and the Bank Secrecy Act. A major focus of U.S. government policy regarding financial institutions in recent years has been combating money laundering, terrorist financing and other illegal payments. The USA Patriot Act of 2001 and the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 substantially broadened the scope of United States anti-money laundering laws and penalties, specifically related to the Bank Secrecy Act of 1970, and expanded the extra-territorial jurisdiction of the U.S. government in this area. Regulations issued under these laws impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and other suspicious activity and to verify the identity of their customers and apply additional scrutiny to customers considered to present greater than normal risk. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with relevant laws or regulations, could have serious legal, reputational and financial consequences for the institution. Because of the significance of regulatory emphasis on these requirements, we have expended and expect to continue to expend significant staffing, technology and financial resources to maintain programs designed to ensure compliance with applicable laws and regulations and an effective audit function for testing our compliance with the Bank Secrecy Act on an ongoing basis.

Office of Foreign Assets Control. The U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”) is responsible for administering and enforcing economic and trade sanctions against specified foreign parties, including countries and regimes, foreign individuals and other foreign organizations and entities. OFAC publishes lists of prohibited parties that are regularly consulted by our Bank in the conduct of its business in order to assure compliance. We are responsible for, among other things, blocking accounts of, and transactions with, prohibited parties identified by OFAC, avoiding unlicensed trade and financial transactions with such parties and reporting blocked transactions after their occurrence. Failure to comply with OFAC requirements could have serious legal, financial and reputational consequences for our Bank.

Safe and Sound Banking Practices; Enforcement. Banks and bank holding companies are prohibited from engaging in unsafe and unsound banking practices. Bank regulators have broad authority to prohibit and penalize activities of bank holding companies and their subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws, regulations or written directives of or agreements with regulators. Regulators have considerable discretion in identifying what they deem to be unsafe and unsound practices and in pursuing enforcement actions in response to them.

The FDIA requires federal bank regulatory agencies to prescribe, by regulation or guideline, operational and managerial standards for all insured depository institutions that relate to, among other things: (i) internal controls, information systems and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate exposure; (v) asset growth and quality; and (vi) compensation and benefits. Federal banking agencies have adopted regulations and Interagency Guidelines Prescribing Standards for Safety and Soundness to implement these requirements, which regulators use to identify and address problems at insured depository institutions before capital becomes impaired. If a regulator determines that a bank fails to meet any standards prescribed by the guidelines, the bank may be required to submit an acceptable plan to achieve compliance, and agree to specific deadlines for the submission to and review by the regulator of reports confirming progress in implementing the safety and soundness compliance plan. Failure to implement such a plan may result in an enforcement action against the bank.

Enforcement actions against us, our Bank and our officers and directors may include the issuance of a written directive, the issuance of a cease-and-desist order that can be judicially enforced, the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against officers or other institution-affiliated parties, the imposition of restrictions and sanctions under prompt corrective action regulations, the termination of deposit insurance (in the case of our Bank) and the appointment of a conservator or receiver for our Bank. Civil money penalties can be as high as $1.0 million for each day a violation continues.

Transactions with Affiliates and Insiders. Our Bank is subject to Section 23A of the Federal Reserve Act which places limits on, among other covered transactions, the amount of loans or extensions of credit to affiliates that may be made by our Bank. Extensions of credit to affiliates must be adequately collateralized by specified amounts and types of collateral. Section 23A also limits the amount of loans or advances by our Bank to third party borrowers which are collateralized by our securities or obligations or those of our subsidiaries. Our Bank also is subject to Section 23B of the Federal Reserve Act, which, among other things, prohibits an institution from engaging in transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with non-affiliates.

We are subject to restrictions on extensions of credit to executive officers, directors, principal stockholders and their related interests. These restrictions are contained in the Federal Reserve Act and Federal Reserve Regulation O and apply to all insured institutions as well as their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such loans can be made. There is also an aggregate limitation on all loans to insiders and their related interests, which cannot exceed the institution’s total unimpaired capital and surplus, unless the FDIC determines that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions. Additional restrictions on transactions with affiliates and insiders are discussed in the Dodd-Frank Act section below.

Restrictions on Dividends and Repurchases. The sole source of funding of our parent company financial obligations has consisted of proceeds of capital markets transactions and cash payments from our Bank for debt service and dividend payments with respect to our Bank's preferred stock issued to the Company. We may in the future seek to rely upon receipt of dividends paid by our Bank to meet our financial obligations. Our Bank is subject to statutory dividend restrictions. Under such restrictions, national banks may not, without the prior approval of the OCC, declare dividends in excess of the sum of the current year’s net profits plus the retained net profits from the prior two years, less any required transfers to surplus. The Basel III Capital Rules further limit the amount of dividends that may be paid by our Bank. In addition, under the FDICIA, our Bank may not pay any dividend if it is undercapitalized or if payment would cause it to become undercapitalized.

Limits on Compensation. The Federal Reserve, OCC and FDIC in 2010 issued comprehensive final guidance on incentive compensation policies for executive management of banks and bank holding companies. This guidance was intended to ensure that the incentive compensation policies of banking organizations do not undermine their safety and soundness by encouraging excessive risk-taking. The objective of the guidance is to assure that incentive compensation arrangements (i) provide incentives that do not encourage excessive risk-taking, (ii) are compatible with effective internal controls and risk management and (iii) are supported by strong corporate governance, including oversight by the board of directors. In 2016, the Federal Reserve and the FDIC proposed rules that would, depending upon the assets of the institution, directly regulate incentive compensation arrangements and would require enhanced oversight and recordkeeping. As of December 31, 2018, these rules have not been implemented.

The Dodd-Frank Act. The Dodd-Frank Act became law in 2010 and has had a broad impact on the financial services industry, imposing significant regulatory and compliance changes. A significant volume of financial services regulations required by the Dodd-Frank Act have not yet been finalized by banking regulators, Congress continues to consider legislation that would make significant changes to the law and courts are addressing significant litigation arising under the Act, making it difficult to predict the ultimate effect of the Dodd-Frank Act on our business. The following discussion provides a brief summary of certain provisions of the Dodd-Frank Act that may have an effect on us.

The Dodd-Frank Act significantly reduces the ability of national banks to rely upon federal preemption of state consumer financial laws and permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations. Although the OCC, as the primary regulator of national banks, has the ability to make preemption determinations where certain conditions are met, the broad rollback of federal preemption has the potential to create a patchwork of federal and state compliance obligations and enforcement. This may result in significant state regulatory requirements applicable to us and certain of our lending activities, with potentially significant changes in our operations and increases in our compliance costs.

The Dodd-Frank Act made permanent the general $250,000 insurance limit for insured deposits. Amendments to the FDIA also revised the assessment base against which an insured depository institution's deposit insurance premiums paid to the DIF are calculated. The assessment base now consists of average consolidated total assets less average tangible equity capital and an amount the FDIC determines is necessary to establish assessments consistent with the risk-based assessment system found in the FDIA, which assigns insured institutions to risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. As of July 1, 2017, minimum and maximum assessment rates (inclusive of possible adjustments) for institutions the size of our Bank range from 3 to 30 basis points of average consolidated total assets less average tangible capital. These changes contributed to an increase in the FDIC deposit insurance premiums we paid in 2017 and 2018. In November 2018, the FDIC announced that the Deposit Insurance Fund Reserve reached 1.36%, exceeding the statutorily required minimum reserve ratio of 1.35% ahead of the September 30, 2020 deadline required by the Dodd-Frank Act. Upon reaching the minimum, surcharges on us and other insured depository institutions with total consolidated assets of $10 billion or more ceased.

The Dodd-Frank Act generally enhances the restrictions on transactions with affiliates under Sections 23A and 23B of the Federal Reserve Act, including an expansion of the definition of "covered transactions" and an increase in the amount of time for which collateral requirements regarding covered credit transactions must be satisfied. Insider transaction limitations are expanded through the strengthening of restrictions on loans to insiders and the expansion of the types of transactions subject to the various limits, including derivatives transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution's board of directors.

The Dodd-Frank Act increases the risk of "secondary actor liability" for lenders that provide financing or other services to customers offering financial products or services to consumers, as our Bank does in our mortgage finance, mortgage correspondent aggregation and lender finance lines of business. The Dodd-Frank Act can impose liability on a service provider for knowingly or recklessly providing substantial assistance to a customer found to have engaged in unfair, deceptive or abusive practices that injure a consumer. This exposure contributes to increased compliance and other costs in connection with the administration of credit extended to entities engaged in providing financial products and services to consumers.

The Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent compliance, capital, liquidity and leverage requirements or otherwise adversely affect our business. These developments may also require us to invest significant management attention and resources to evaluate and make changes to our business as necessary to comply with new and changing statutory and regulatory requirements.

The Volcker Rule. The Dodd-Frank Act amended the BHCA to require the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading in designated types of financial instruments and from investing in and sponsoring certain hedge funds and private equity funds. The Volcker Rule has not had a material effect on our operations since we do not engage in the businesses prohibited by the Volcker Rule. Unanticipated effects of the Volcker Rule's provisions or future interpretations may have an adverse effect on our business or services provided to our Bank by other financial institutions.

Available Information

Under the Securities Exchange Act of 1934, we are required to file annual, quarterly and current reports, proxy statements and other information with the SEC. The SEC maintains a website at www.sec.gov that contains reports, proxy and information statements and other information that we file electronically with the SEC.

We make available, free of charge through our website, our reports on Forms 10-K, 10-Q and 8-K, and amendments to those reports, as soon as reasonably practicable after such reports are filed with or furnished to the SEC. Additionally, we have adopted and posted on our website a code of ethics that applies to our principal executive officer, principal financial officer and principal accounting officer. The address for our website is www.texascapitalbank.com. Any amendments to, or waivers from, our code of ethics applicable to our executive officers will be posted on our website within four days of such amendment or waiver. We will provide a printed copy of any of the aforementioned documents to any requesting stockholder.

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ITEM 1A. RISK FACTORS

Our business is subject to risk. The following discussion, along with management's discussion and analysis and our financial statements and footnotes, sets forth the most significant risks and uncertainties that we believe could adversely affect our business, financial condition or results of operations. Additional risks and uncertainties that management is not aware of or that management currently deems immaterial may also have a material adverse effect on our business, financial condition or results of operations. There is no assurance that this discussion covers all potential risks that we face. The occurrence of the described risks could cause our results to differ materially from those described in our forward-looking statements included elsewhere in this report or in our other filings with the SEC and could have a material adverse impact on our business, financial condition or results of operations.

Risk Factors Associated With Our Business

We must effectively manage our credit risk. The risk of non-payment of loans is inherent in commercial banking. Increased credit risk may result from many factors, including:

- Adverse changes in local, U.S. and global economic and industry conditions;
- Declines in the value of collateral, including asset values that are directly or indirectly related to external factors such as commodity prices, real estate values or interest rates;
- Concentrations of credit associated with specific loan categories, industries or collateral types; and
- Exposures to individual borrowers and to groups of entities that may be affiliated on some basis that individually and/or collectively represent a larger percentage of our total loans or capital than might be considered common at other banks of similar size.

We rely heavily on information provided by third parties when originating and monitoring loans. If this information is intentionally or negligently misrepresented and we do not detect such misrepresentations, the credit risk associated with the transaction may be increased. Although we attempt to manage our credit risk by carefully monitoring the concentration of our loans within specific loan categories and industries and through prudent loan approval and monitoring practices in all categories of our lending, we cannot assure you that our approval and monitoring procedures will reduce these lending risks. Our significant number of large credit relationships (above $20 million) could exacerbate credit problems precipitated by a regional or national economic downturn. Competitive pressures could erode underwriting standards leading to a decline in general credit quality and increases in credit defaults and non-performing asset levels. If our credit administration personnel, policies and procedures are not able to adequately adapt to changes in economic, competitive or other conditions that affect customers and the quality of the loan portfolio, we may incur increased losses that could adversely affect our financial results and lead to increased regulatory scrutiny, restrictions on our lending activity or financial penalties.

A significant portion of our assets consists of commercial loans. We generally invest a greater proportion of our assets in commercial loans to business customers than other banking institutions of our size, and our business plan calls for continued efforts to increase our assets invested in these loans. At December 31, 2018, approximately 46% of our LHI portfolio was comprised of commercial loans. Commercial loans may involve a higher degree of credit risk than other types of loans due, in part, to their larger average size, the effects of changing economic conditions on the businesses of our commercial loan customers, the dependence of borrowers on operating cash flow to service debt and our reliance upon collateral which may not be readily marketable. Due to the greater proportion of these commercial loans in our portfolio and because the balances of these loans are, on average, larger than other categories of loans, losses incurred on a relatively small number of commercial loans could have a materially adverse impact on our results of operations and financial condition.

A significant portion of our loans are secured by commercial and residential real estate. At December 31, 2018, approximately 53% of our loans held for investment portfolio was comprised of loans with real estate as the primary component of collateral. Our real estate lending activities, and our exposure to fluctuations in real estate collateral values, are significant and may increase as our assets increase. The market value of real estate can fluctuate significantly in a relatively short period of time as a result of market conditions in the geographic area in which the real estate is located, in response to factors such as economic downturns, changes in the economic health of industries heavily concentrated in a particular area and in response to changes in market interest rates, which influence capitalization rates used to value revenue-generating commercial real estate. If the value of real estate serving as collateral for our loans declines materially, a significant part of our loan portfolio could become under-collateralized and losses incurred upon borrower defaults would increase. Conditions in certain segments of the real estate industry, including homebuilding, lot development and mortgage lending, may have an effect on values of real estate pledged as collateral for our loans. The inability of purchasers of real estate, including residential real estate, to obtain financing may weaken the financial condition of our borrowers who are dependent on the sale or refinancing of property to repay their loans. Changes in the economic health of certain industries can have a significant impact on other sectors or industries which are directly or indirectly associated with those industries, and may impact the value of real estate in areas where such industries are concentrated.

Our future profitability depends, to a significant extent, upon our middle market business customers. Our future profitability depends, to a significant extent, upon revenue we receive from middle market business customers, and their ability to continue to meet their loan obligations. Adverse economic conditions or other factors affecting this market segment, and our failure to timely identify and react to unexpected economic downturns, may have a greater adverse effect on us than on other financial institutions that have a more diversified customer base. Additionally, our inability to grow our middle market business customer base in a highly competitive market could affect our future growth and profitability.

We must maintain an appropriate allowance for loan losses. Our experience in the banking industry indicates that some portion of our loans will become delinquent, and some may only be partially repaid or may never be repaid at all. We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense each quarter, that is consistent with management’s assessment of the collectability of the loan portfolio in light of the amount of loans committed and outstanding and current economic conditions and market trends. When specific loan losses are identified, the amount of the expected loss is removed, or charged-off, from the allowance. Our methodology for establishing the appropriateness of the allowance for loan losses depends on our subjective application of risk grades as indicators of each borrower’s ability to repay specific loans, together with our assessment of how actual or projected changes in competitor underwriting practices, competition for borrowers and depositors and other conditions in our markets are likely to impact improvement or deterioration in the collectability of our loans as compared to our historical experience.

Our business model makes our Bank more vulnerable to changes in underlying business credit quality than other banks with which we compete. We have a substantially larger percentage of commercial, real estate and other categories of business loans relative to total assets than most other banks in our market and our individual loans are generally larger as a percentage of our total earning assets than other banks. While we have substantially increased our liquidity in recent years, these funds are invested in low-yielding deposits with federal agencies and other financial institutions. A substantially smaller portion of our assets consists of securities and other earning asset categories that can be less vulnerable to changes in local, regional or industry-specific economic trends, causing our potential for credit losses to be more severe than other banks. Our business model has focused on growth in various loan categories that can be more sensitive to changes in economic trends. We believe our ability to maintain an above-peer rate of growth in commercial loans is dependent on maintaining above-peer credit quality metrics. The failure to do so would have a material adverse impact on our growth and profitability. Historically, we have sought to take action prior to economic downturns by slowing growth rates and decreasing the risk level of our assets by, among other things, allowing runoff of loans that we believe may not perform well during a weakening or declining economic environment.

If our assessment of inherent risk and losses in our loan portfolio is inaccurate, or economic and market conditions or our borrowers' financial performance experience material unanticipated changes, the allowance may become inadequate, requiring larger provisions for loan losses that can materially decrease our earnings. Certain of our loans individually represent a significant percentage of our total allowance for loan losses. Adverse collection experience in a relatively small number of these loans could require an increase in the provision for loan losses. Federal regulators periodically review our allowance for loan losses and, based on their judgments, which may be different than ours, may require us to change classifications or grades of loans, increase the allowance for loan losses or recognize further loan charge-offs. Any increase in the allowance for loan losses or in the amount of loan charge-offs required by our methodology or regulatory agencies could have a negative effect on our results of operations and financial condition.

The Financial Accounting Standards Board adopted a new accounting standard for determining the amount of our allowance for credit losses (ASU 2016-13 Financial Instruments - Credit Losses (Topic 326) that will be effective for our fiscal year ending December 31, 2020, referred to as Current Expected Credit Loss ("CECL"). Implementation of CECL will require that we determine periodic estimates of lifetime expected future credit losses on loans in the provision for loan losses in the period when the loans are booked. We are currently unable to reasonably estimate the impact of adopting CECL on our future reported financial results. We believe that the impact of the adoption of CECL will be significantly influenced by the composition, characteristics and quality of our loan portfolio, as well as the prevailing economic conditions and forecasts, as of the adoption date. The implementation of CECL may require us to increase our allowance for loan losses, decreasing our reported income, and may introduce additional volatility into our reported earnings.

Our business is concentrated in Texas; our energy industry exposure could adversely affect our performance. A majority of our customers are located in Texas. As a result, our financial condition and results of operations may be strongly affected by any prolonged period of economic recession or other adverse business, economic or regulatory conditions affecting Texas businesses and financial institutions. Although more than 50% of our loan exposure is outside of Texas and more than 50% of our deposits are sourced outside of Texas, our Texas concentration remains significant compared to other peer banks. While the Texas economy is more diversified than in the 1980's, the energy sector continues to play an important role. At December 31, 2018 our outstanding energy loans represented 8% of total loans. Our energy loans consist primarily of producing reserve-based loans to exploration and production companies with a smaller portion of our loan balances attributable to royalty owners, midstream operators, saltwater disposal and other service companies whose businesses primarily relate to production, not exploration and development, of oil and gas. These businesses have been significantly affected by volatility in oil and natural

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gas prices and material declines in the level of drilling and production activity in Texas and in other areas of the United States. We experienced an increase in non-performing assets and higher charge-offs primarily related to energy loans during 2016, and while those levels have moderated in 2017 and 2018, they still remain elevated compared to the overall loan portfolio. There is no assurance that we will not be materially adversely impacted by the direct and indirect effects of current and future conditions in the energy industry in Texas and nationally.

Our business faces unpredictable economic and business conditions. Our business is directly impacted by general economic and business conditions in Texas, the United States and internationally. The credit quality of our loan portfolio necessarily reflects, among other things, the general economic conditions in the areas in which we and our customers conduct our respective businesses. Our continued financial success can be affected by other factors that are beyond our control, including:

- national, regional and local economic conditions;
- the value of the U.S. Dollar in relation to the currencies of other advanced and emerging market countries;
- the performance of both domestic and international equity and debt markets and valuation of securities traded on recognized domestic and international exchanges;
- general economic consequences of international conditions, such as weakness in European sovereign debt and foreign currencies and the impact of that weakness on the US and global economies;
- legislative and regulatory changes impacting our industry;
- the financial health of our customers and economic conditions affecting them and the value of our collateral, including effects from continued price volatility of oil and gas and other commodities;
- the incidence of fraud, illegal payments, security breaches and other illegal acts among or impacting our Bank and our customers;
- structural changes in the markets for origination, sale and servicing of residential mortgages;
- changes in governmental economic and regulatory policies generally, including the extent and timing of intervention in credit markets by the Federal Reserve Board or withdrawal from that intervention;
- changes in the availability of liquidity at a systemic level; and
- material inflation or deflation.

Substantial deterioration in any of the foregoing conditions can have a material adverse effect on our prospects and our results of operations and financial condition. There is no assurance that we will be able to sustain our historical rate of growth or our profitability. Our Bank's customer base is primarily commercial in nature, and our Bank does not have a significant retail branch network or retail consumer deposit base. In periods of economic downturn, business and commercial deposits may be more volatile than traditional retail consumer deposits. As a result, our financial condition and results of operations could be adversely affected to a greater degree by these uncertainties than competitors having a larger retail customer base.

Future impacts of the Tax Cuts and Jobs Act (the "Tax Act") on us and our customers are unknown at present, creating uncertainty and risk related to our customers' future demand for credit and our future results. Increased economic activity expected to result from the continued decrease in tax rates on businesses generally could spur additional economic activity that would encourage additional borrowing. At the same time, some customers may elect to use their additional cash flow from lower taxes to fund their existing levels of activity, decreasing borrowing needs. The elimination of the federal income tax deductibility of business interest expense for a significant number of our customers effectively increases the cost of borrowing and makes equity or hybrid funding relatively more attractive. This could have a long-term negative impact on business customer borrowing. We realized a significant increase in our after-tax net income available to stockholders in 2018 but there is no guarantee that future years' results will have the same benefit. Some or all of this benefit could be lost to the extent that the banks and financial services companies we compete with elect to lower interest rates and fees and we are forced to respond in order to remain competitive. Additionally, the tax benefits could be repealed as a result of future regulatory actions. There is no assurance that presently anticipated benefits of the Tax Act for the Company will be realized in the future.

Our growth plans are dependent on the availability of capital and funding. Our historical ability to raise capital through the sale of capital stock and debt securities may be affected by economic and market conditions or regulatory changes that are beyond our control. Adverse changes in our operating performance or financial condition could make raising additional capital difficult or more expensive or limit our access to customary sources of funding, including inter-bank borrowings, repurchase agreements and borrowings from the Federal Reserve Bank ("FRB") or the Federal Home Loan Bank ("FLHB"). Unexpected changes in requirements for capital resulting from regulatory actions could require us to raise capital at a time, and at a price, that might be unfavorable, or could require that we forego continuing growth or reduce our current loan portfolio. We cannot offer assurance that capital and funding will be available to us in the future, in needed amounts, upon acceptable terms or at all. Our efforts to raise capital could require the issuance of securities at times and with maturities, conditions and rates that are disadvantageous, and which could have a dilutive impact on our current stockholders. Factors that could adversely affect our ability to raise additional capital or necessary funding include conditions in the capital markets, our financial performance, our credit ratings, regulatory actions and general economic conditions. Increases in our cost of capital, including dilution and increased interest or dividend requirements, could have a direct adverse impact on our operating performance and our ability to achieve our growth objectives. Trust preferred securities are no longer viable as a source of new long-term debt capital as a result of regulatory changes. The treatment of our existing trust preferred securities as capital may be subject to further regulatory change prior to their maturity, which could require the Company to seek additional capital.

Our mortgage finance business has experienced, and will likely continue to experience, highly variable usage of our funding capacity resulting from seasonal demands for credit, surges in consumer demand driven by changes in interest rates and month-end “spikes” of residential mortgage closings. These spikes could also result in our Bank having capital ratios that are below internally targeted levels or even levels that could cause our Bank to not be well capitalized and could affect liquidity levels. At the same time managing this risk by declining to respond fully to the needs of our customers could severely impact our business. We have responded to these variable funding demands by, among other things, increasing the extent of participations sold in our mortgage loan interests, as needed, and by maintaining a substantial borrowing relationship with the FHLB. Our mortgage finance customers have in recent periods provided significant low-cost deposit balances associated with the borrower escrow accounts created at the time certain mortgage loans are funded, which have benefitted our liquidity and net interest margin. Due to the rising rate environment and in response to competitive pressures, we have found it necessary to pay interest on some of these accounts, as regulations allow or require and this trend may continue, materially increasing our costs of funds. Individual escrow account balances also experience significant variability monthly as principal and interest payments, as well as ad valorem taxes and insurance premiums, are paid periodically. While the short average holding period of our mortgage interests of approximately 20 days will allow us, if necessitated by a funding shortfall, to rapidly decrease the size of the portfolio and its associated capital and funding requirements, any such action might significantly damage our business and important mortgage finance relationships.

We must effectively manage our liquidity risk. Our Bank requires liquidity in the form of available funds to meet its deposit, debt and other obligations as they come due, borrower requests to draw on committed credit facilities as well as unexpected demands for cash payments. While we are not subject to Basel III liquidity regulations, the adequacy of our liquidity is a matter of regulatory interest given the significant portion of our balance sheet represented by loans as opposed to securities and other more marketable investments. Our Bank’s principal source of funding consists of customer deposits, supplemented by our short-term and long-term borrowings, including Federal funds purchased and FHLB borrowings. We also rely on the availability of the mortgage secondary market provided by Ginnie Mae and the GSEs to support the liquidity of our residential mortgage assets. A substantial majority of our Bank’s liabilities consist of demand, savings, checking and money market deposits, which are payable on demand or upon relatively short notice. By comparison, a substantial portion of our assets are loans, most of which, excluding our mortgage finance loans and mortgage loans held for sale, cannot be collected or sold in so short a time frame, creating the potential for an imbalance in the availability of liquid assets to satisfy depositors and loan funding requirements.

We hold smaller balances of marketable securities than many of our competitors, limiting our ability to increase our liquidity by completing market sales of these assets. An inability to raise funds through deposits, borrowings, the sale of securities and loans and other sources, or an inability to access the capital markets, could have a substantial negative effect on our Bank’s liquidity. We actively manage our available sources of funds to meet our expected needs under normal and financially stressed conditions, but there is no assurance that our Bank will be able to make new loans, meet ongoing funding commitments to borrowers and replace maturing deposits and advances as necessary under all possible circumstances. Our Bank’s ability to obtain funding could be impaired by factors beyond its control, such as disruptions in financial markets, negative expectations regarding the financial services industry generally or in our markets or negative perceptions of our Bank, including our credit ratings.

Our Bank sources a significant volume of its demand deposits from financial services companies, mortgage finance customers and other commercial sources, resulting in a larger percentage of large deposits and a smaller number of sources of deposits than would be typical of other banks in our markets, creating concentrations of deposits that carry a greater risk of unexpected material withdrawals. In recent periods over half of our total deposits have been attributable to customers whose balances exceed the $250,000 FDIC insurance limit. Many of these customers actively monitor our financial condition and results of operations and could withdraw their deposits quickly upon the occurrence of a material adverse development affecting our Bank or their businesses. Significant deterioration in our credit quality or a downgrade in our credit ratings could affect funding sources such as financial institutions and broker dealers. In response to this risk we have increased our liquidity and developed more sophisticated techniques for monitoring and planning for changes in liquidity and capital over the past several years, but there is no assurance that we will maintain or have access to sufficient funding and capital to fully mitigate our liquidity risk.

One potential source of liquidity for our Bank consists of “brokered deposits” arranged by brokers acting as intermediaries, typically larger money-center financial institutions. We receive deposits provided by certain of our customers in connection with our delivery of other financial services to them or their customers which are subject to regulatory classification as “brokered deposits” even though we consider these to be relationship deposits and they are not subject to the typical risks or market pricing associated with conventional brokered deposits.

If we do not maintain our regulatory capital above the level required to be well capitalized we would be required to obtain FDIC consent for us to continue to accept deposits classified as brokered deposits, and there can be no assurance that the FDIC would consent under any circumstances. We could also be required to suspend or eliminate deposit gathering from any source classified as “brokered” deposits. The FDIC can change the definition of brokered deposits or extend the classification to deposits not currently classified as brokered deposits. These non-traditional deposits are subject to greater operational and reputational risk of unexpected withdrawal than traditional demand and time deposits, particularly those provided by consumers. A significant decrease in our balances of relationship brokered deposits could have a material adverse effect upon our financial condition and results of operations. See Management’s Discussion and Analysis of Financial Condition and Results of Operations below for further discussion of our liquidity.

We, our vendors and customers must effectively manage our information systems risk. We, our vendors and customers all rely heavily on communications and information systems to conduct our respective businesses and work effectively together. The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. Our ability to compete successfully depends in part upon our ability to use technology to provide products and services that will satisfy customer demands. Many of our larger competitors invest substantially greater resources in technological capabilities than we do. We may not be able to effectively protect, develop and manage mission critical systems and IT infrastructure to support strategic business initiatives, which could impair our ability to achieve financial, operational, compliance and strategic objectives and negatively affect our business, results of operations or financial condition.

Our communications and information systems and those of our vendors and customers remain vulnerable to unexpected disruptions, failures and cyber-attacks. The frequency and intensity of such attacks is escalating. Material failures or interruptions of these systems could impair our ability to serve our customers and to operate our business and could damage our reputation, result in a loss of business, subject us to additional regulatory scrutiny or enforcement or expose us to civil litigation and possible financial liability. While we have developed extensive recovery plans, we cannot assure that those plans will be effective to prevent adverse effects upon us and our customers resulting from system failures.

We collect and store sensitive data, including personally identifiable information of our customers and employees and in the ordinary course of business must allow certain of our vendors access to that data. Breaches of our systems or our vendors' or customers’ systems, thefts of data and other breaches and criminal activity may result in significant costs to respond, liability for customer losses if we or our vendors are at fault, damage to our customer relationships, regulatory scrutiny and enforcement and loss of future business opportunities due to reputational damage. Breaches can be perpetrated by unknown third parties, but could also be facilitated by employees either inadvertently or by consciously attempting to create disruption or certain acts of fraud. Although we, with the help of third-party service providers, will continue to implement information security technology solutions and establish operational procedures to protect sensitive data, there can be no assurance that these measures will be effective. We advise and provide training to our customers and evaluate and impose security requirements on our vendors regarding protection of their respective information systems, but there is no assurance that these actions will have the intended positive effects or will be effective to prevent losses. In some cases we may elect to contribute to the cost of responding to cybercrime against our customers, even when we are not at fault, in order to maintain valuable customer relationships. Successful cyber-attacks on our Bank, vendors or customers may affect the reputation of our Bank, and failure to meet customer expectations could have a material impact on our ability to attract and retain deposits as a primary source of funding.

Our operations rely extensively on a broad range of external vendors. We rely on a large number of vendors to provide products and services necessary to maintain our day-to-day operations, particularly in the areas of operations, treasury management systems, information technology and security. This reliance exposes us to the risk that these vendors will not perform as required by our agreements as well as risks resulting from disruptions in communications with our vendors, cyber-attacks and security breaches at our vendors, failure of a vendor to provide services for other reasons and poor performance of services. An external vendor’s failure to perform in any of these areas could be disruptive to our operations, which could have a material adverse impact on our business, financial condition and results of operations, as well as cause reputational damage. External vendors who must have access to our information systems in order to provide their services have been identified as significant sources of information technology security risk. While we have implemented an active program of oversight to address this risk, there can be no assurance that we will not experience material security breaches associated with our vendors.

We must effectively manage our interest rate risk. Our profitability is dependent to a large extent on our net interest income, which is the difference between the interest income paid to us on our loans and investments and the interest we pay to third parties such as our depositors, lenders and debtholders. Changes in interest rates can impact our profits and the fair values of certain of our assets and liabilities. Models that we use to forecast and plan for the impact of rising and falling interest rates may be incorrect or fail to consider the impact of competition and other conditions affecting our loans and deposits.

Recent periods of unusually low interest rates have had an adverse effect on our earnings by reducing yields on loans and other earning assets. The Federal Reserve began raising rates in late 2015 and 2016 and their benchmark rate and market rates

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continued to increase during 2017 and 2018, contributing to improvement in our net interest income as the increase in interest we receive on our assets exceeded the increase in interest we were required to pay our depositors. However there is substantial uncertainty regarding the extent to which interest rates may increase in 2019 and future periods and what the future effects of any such increases will be on our interest income and expense. Increases in market interest rates can negatively impact our business, including reducing our customers' desire to borrow money from us and their ability to repay their outstanding loans as their debt service obligations increase through the periodic reset of adjustable interest rate loans. If our borrowers' ability to pay their loans is impaired by increasing interest payment obligations, our level of non-performing assets would increase, producing an adverse effect on operating results. Asset values, especially commercial real estate collateral, securities or other fixed rate earning assets, can decline significantly with relatively minor changes in interest rates.

Increases in interest rates and economic conditions affecting consumer demand for housing can have a material impact on the volume of mortgage originations and refinancings, adversely affecting the profitability of our mortgage finance business. Interest rate risk can also result from mismatches between the dollar amounts of repricing or maturing assets and liabilities and from mismatches in the timing and rates at which our assets and liabilities reprice. We actively monitor and manage the balances of our maturing and repricing assets and liabilities to reduce the adverse impact of changes in interest rates, but there can be no assurance that we will be able to avoid material adverse effects on our net interest margin in all market conditions.

Rising interest rates have increased our interest expense, with a commensurate adverse effect on our net interest income and may continue to do so. In a rising rate environment, competition for cost-effective deposits has increased and may continue to increase, making it more costly for us to fund loan growth. There can be no assurance that we will not be materially adversely affected by future changes in interest rates.

We are subject to extensive government regulation and supervision. We, as a bank holding company and financial holding company, and our Bank as a national bank, are subject to extensive federal and state regulation and supervision, and the potential for regulatory enforcement actions, that impact our business on a daily basis. See the discussion above at Business - Regulation and Supervision. These regulations affect our lending practices, permissible products and services and their terms and conditions, customer relationships, capital structure, investment practices, accounting, financial reporting, operations and our ability to grow, among other things. These regulations also impose obligations to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identities of our customers.

Congress, state legislatures, 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. Recent material changes in regulation and requirements imposed on financial institutions, such as the Dodd-Frank Act and the Basel III Capital Rules, result in additional costs, impose more stringent capital, liquidity and leverage requirements, limit the types of financial services and products we may offer and increase the ability of non-bank financial services providers to offer competing financial services and products, among other things. Such changes could result in new regulatory obligations which could prove difficult, expensive or competitively impractical to comply with if not equally imposed upon non-bank financial services providers with whom we compete.

We are subject to a continuous program of examinations by our regulators concerning, among other things, lending practices, reserve methodology, compliance with changing regulations and interpretations, our management of interest rate, liquidity, capital and operational risk, enterprise risk management, regulatory and financial accounting practices and policies and related matters, which can divert management's time and attention from focusing on our business. We devote a significant amount of management time and expense to enhancing the infrastructure to support our compliance obligations, which can pose significant regulatory enforcement, financial and reputational risks if not appropriately addressed.

The Regulatory Relief Act and regulations proposed or issued after its passage have provided a limited degree of regulatory relief, including discontinuing the stress testing requirements contained in the Dodd-Frank Act. Uncertainty regarding how our regulators will evaluate capital and liquidity planning going forward remains a risk. We have increased our capital and liquidity and expanded our regulatory compliance staffing and systems in recent years in

order to address continuing regulatory requirements. There is no assurance that our financial performance in future years will not be similarly burdened.
We expend substantial effort and incur costs to maintain and improve our systems, controls, accounting, operations, information security, compliance, audit effectiveness, analytical capabilities, staffing and training in order to satisfy regulatory requirements. We cannot offer assurance that these efforts will be accepted by our regulators as satisfying the legal and regulatory requirements applicable to us. Failure to comply with relevant laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While we have policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.
We must effectively execute our business strategy in order to continue our asset and earnings growth. Our core strategy is to develop our business principally through organic growth by offering a premier and differentiated banking experience to

companies in high-value business segments. Our prospects for continued growth must be considered in light of the risks, expenses and difficulties frequently encountered by growing companies. In order to execute our business strategy successfully, we must, among other things:

- continue to identify and expand into suitable markets and lines of business, in Texas, regionally and nationally;
- develop new products and services and execute our full range of products and services more efficiently and effectively;
- attract and retain qualified bankers in each of our targeted market segments to build our customer base;
- respond to market opportunities promptly and nimbly while balancing the demands of risk management and compliance with regulatory requirements;
- expand our loan portfolio in an intensely competitive environment while maintaining credit quality;
- attract sufficient deposits and capital to fund our anticipated loan growth and satisfy regulatory requirements;
- control expenses; and
- acquire and maintain sufficient qualified staffing and information technology and operational resources to support growth and compliance with regulatory requirements.

Failure to effectively execute our business strategy could have a material adverse effect on our business, future prospects, financial condition or results of operations.

We must be effective in developing and executing new lines of business and new products and services while managing associated risks. Our business strategy requires that we develop and grow new lines of business and offer new products and services within existing lines of business in order to compete successfully in offering a premier and differentiated client banking experience to ensure future client acquisition and retention of existing clients and realize our strategic priorities for both loans and deposits. Substantial costs, risks and uncertainties are associated with these efforts, particularly in instances where the markets are not fully developed. Developing and marketing new activities requires that we invest significant time and resources before new sources of revenues, funding and profits can be realized. Timetables for the development and launch of new activities may not be achieved and price and profitability targets may not prove feasible or their realization may be delayed. External factors, such as compliance with regulations, receipt of necessary licenses or permits, competitive alternatives and shifting market preferences, may also adversely impact the successful execution of new activities. New activities necessarily entail additional risks and may present additional risks to the effectiveness of our system of internal controls and risk management strategies. All service offerings, including current offerings and new activities, may become more risky due to changes in economic, competitive and market conditions beyond our control. Our regulators could determine that our risk management practices are not adequate or our capital levels are not sufficiently in excess of well-capitalized levels and take action to restrain our growth. Failure to successfully manage these risks, generally and to the satisfaction of our regulators, 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 must continue to attract, retain and develop key personnel. Our success depends to a significant extent upon our ability to attract, develop and retain experienced bankers in each of our lines of business and markets as well as managers in operational areas, compliance and other support areas to build and maintain the infrastructure and controls required to support continuing loan and deposit growth. Competition for the best people in our industry can be intense, and there is no assurance that we will continue to have the same level of success in this effort that has supported our historical results. Factors that affect our ability to attract, develop and retain key employees include our compensation and benefits programs, our profitability, our ability to establish appropriate succession plans for key talent, our reputation for rewarding and promoting qualified employees and market competition for employees with certain skills, including information systems development and security. The cost of employee compensation is a significant portion of our operating expenses and can materially impact our results of operations. The unanticipated loss of the services of key personnel could have an adverse effect on our business. Although we have entered into employment agreements with certain key employees, we cannot assure you that we will be successful in retaining them.

We compete with many banks and other financial service providers. Competition among providers of financial services in our markets, in Texas, regionally and nationally, is intense. We compete with other financial and bank holding companies, state and national commercial banks, savings and loan associations, consumer finance companies, credit unions, securities brokerages, insurance companies, mortgage banking companies, money market mutual funds, asset-based non-bank lenders, government sponsored or subsidized lenders and other financial services providers. Many of these competitors have substantially greater financial resources, lending limits and technological resources and larger branch networks than we do, and are able to offer a broader range of products and services than we can, including systems and services that could more effectively protect customers from cyber threats. Many competitors offer lower interest rates and more liberal loan terms that appeal to borrowers but adversely affect net interest margin and assurance of repayment. We are increasingly faced with competition in many of our products and services by non-bank providers who may have competitive advantages of size, access to potential customers and fewer regulatory requirements. Failure to compete effectively for deposit, loan and other banking customers in any of our lines of business could cause us to lose market share, slow or reverse our growth rate or suffer adverse effects on our financial condition and results of operations.

Our mortgage correspondent aggregation business subjects us to additional risks. We launched our mortgage correspondent aggregation business (“MCA”), a correspondent lending program that complements our mortgage warehouse lending business, in 2015. Volatility in the mortgage industry has caused uncertainty related to the pricing of the mortgage loans that we seek to purchase, as well as uncertainty in the pricing of those loans when they are sold or securitized. Similar uncertainty exists with respect to volatility in the value of mortgage servicing rights ("MSRs") on our balance sheet. This volatility may cause the actual returns on mortgage sales or securitization transactions to be less than anticipated, which could adversely affect our overall loans held for sale volumes and the profitability of this line of business. Fluctuations in the value of MSRs that we hold on our balance sheet could require that we recognize impairments in the value of such assets and/or actual losses on the disposition of such assets. Additionally, non-bank competitors may have a pricing advantage as they are not subject to the same capital maintenance requirements relative to mortgage loans and MSRs as our Bank.

Our MCA business subjects us to additional interest rate risk and price risk, which may have an adverse effect on our business. The persistent low interest rate environment and expectation of future higher rates has in certain cases resulted in an increase in the value of MSRs, causing other market participants and competitors who are planning to hold MSRs for a longer term to be more aggressive in their pricing of the underlying loan purchases than a participant like our Bank that does not plan to hold MSRs on a long-term basis. While we believe market and competitive conditions may improve in the future, a prolonged low interest rate environment could adversely affect the economics of our MCA business over a longer period of time. Conversely, an environment of rising interest rates could have a significant effect on loan volumes in our MCA business if refinancing and home purchase activities are reduced.

We have entered into loan purchase commitments and forward sales commitments in connection with the MCA business. While we believe that our hedging strategies will be successful in mitigating our exposure to interest rate risk associated with the purchase of mortgage loans held for sale, no hedging strategy can completely protect us. Poorly designed strategies, improperly executed transactions, or inaccurate assumptions regarding future interest rates or market conditions could have a material adverse effect on our financial condition and results of operations.

We are from time to time required to hold or repurchase mortgage loans or reimburse investors as a result of breaches in contractual representations and warranties under the agreements pursuant to which we purchase and sell mortgage loans. While our agreements with the originators and sellers of mortgage loans provide us with legal recourse against them that may allow us to recover some or all of our losses, these companies are frequently not financially capable of paying large amounts of damages and as a result we can offer no assurance that we will not bear all of the risk of loss.

We may incur other costs and losses as a result of actual or alleged violations of regulations related to the origination and purchase of residential mortgage loans. The origination of residential mortgage loans is governed by a variety of federal and state laws and regulations, which are frequently changing. We sell residential mortgage loans that we have purchased or that we have originated to various parties, including Ginnie Mae and GSEs such as Fannie Mae or Freddie Mac and other financial institutions that purchase mortgage loans for investment or private label securitization. We may also pool FHA-insured and VA-guaranteed mortgage loans which back securities issued by Ginnie Mae. Our accrued mortgage repurchase liability represents management’s best estimate of the probable loss that we may expect to incur for the representations and warranties in the contractual provisions of our sales of mortgage loans, but there is no assurance that our losses will not materially exceed such amounts.

Our accounting estimates and risk management processes rely on management judgment, which may prove inadequate or be adversely impacted by inaccurate assumptions or models. The processes we use to estimate probable credit losses for purposes of establishing the allowance for loan losses and to measure the fair value of financial instruments, certain of our liquidity and capital planning tools, as well as the processes we use to estimate the effects of changing interest rates and other market measures on our financial condition and results of operations, all depend upon management’s judgment. Management’s judgment and the data relied upon by management may be based on assumptions that prove to be inaccurate, particularly in times of market stress or other unforeseen circumstances.

Our risk management strategies and processes may not be effective; our controls and procedures may fail or be circumvented. We continue to invest in the development of risk management techniques, strategies, assessment methods and related controls and monitoring approaches on an ongoing basis. However, these risk management strategies and processes may not be fully effective in mitigating our risk exposure in all economic market environments or against all types of risk. Any failures in our risk management strategies and processes to accurately identify, quantify and monitor our risk exposure could limit our ability to effectively manage our risks. Management regularly reviews and updates our internal controls over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and management judgment and can provide only reasonable, not absolute, assurances that the objectives of the system are met. 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.

We must effectively manage our counterparty risk. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. Our Bank has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other financial market participants. Many of these transactions expose our Bank to credit risk in the event of a default by a counterparty or client. In addition, our Bank's credit risk may be increased when the collateral securing its loans cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of its credit or derivative exposure. Any such losses could have a material adverse effect on our business, financial condition and results of operations.

Our business is susceptible to fraud. Our business exposes us to fraud risk from our loan and deposit customers, the parties they do business with, as well as from our employees, contractors and vendors. We rely on financial and other data from new and existing customers which could turn out to be fraudulent when accepting such customers, executing their financial transactions and making and purchasing loans and other financial assets. In times of increased economic stress we are at increased risk of fraud losses. We believe we have underwriting and operational controls in place to prevent or detect such fraud, but we cannot provide assurance that these controls will be effective in detecting fraud or that we will not experience fraud losses or incur costs or other damage related to such fraud, at levels that adversely affect our financial results or reputation. Our lending 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.

We must maintain adequate regulatory capital to support our business objectives. Under regulatory capital adequacy guidelines and other regulatory requirements, we must satisfy capital requirements based upon quantitative measures of assets, liabilities and certain off-balance sheet items. Our satisfaction of these requirements is subject to qualitative judgments by regulators that may differ materially from management's and that are subject to being determined retroactively for prior periods. Additionally, regulators can make subjective assessments about the adequacy of capital levels, even if our Bank's reported capital exceeds the "well-capitalized" requirements. Our ability to maintain our status as a financial holding company and to continue to operate our Bank as we have in recent periods is dependent upon a number of factors, including our Bank qualifying as "well capitalized" and "well managed" under applicable prompt corrective action regulations and upon our company qualifying on an ongoing basis as "well capitalized" and "well managed" under applicable Federal Reserve regulations.

Failure to meet regulatory capital standards could have a material adverse effect on our business, including damaging the confidence of customers in us, adversely impacting our reputation and competitive position and retention of key personnel. Any of these developments could limit our access to:

- brokered deposits;
- the Federal Reserve discount window;
- advances from the FHLB;
- capital markets transactions; and
- development of new financial services.

Failure to meet regulatory capital standards may also result in higher FDIC assessments. If we fall below guidelines for being deemed "adequately capitalized" the OCC or Federal Reserve could impose restrictions on our activities and a broad range of regulatory requirements in order to effect "prompt corrective action." The capital requirements applicable to us are in a process of continuous evaluation and revision in connection with actions of the Basel Committee, our regulators and the requirements of the Dodd-Frank Act. We cannot predict the final form, or the effects, of these regulations on our business, but among the possible effects are requirements that we slow our rate of growth or obtain additional capital which could reduce our earnings or dilute our existing stockholders.

We are dependent on funds obtained from borrowing or capital transactions or from our Bank to fund our obligations. We are a financial holding company engaged in the business of managing, controlling and operating our Bank. We conduct no material business or other activity at the parent company level other than activities incidental to holding equity and debt investments in our Bank. As a result, we rely on the proceeds of capital transactions, borrowings under our revolving line of credit, payments of interest and principal on loans made to our Bank and dividends on preferred stock issued by our Bank to pay our operating expenses, to satisfy our obligations to debtholders and to pay dividends on our preferred stock. The profitability of our Bank is subject to fluctuation based upon, among other things, the cost and availability of funds, changes in interest rates and economic conditions in general. Our Bank's ability to pay dividends to us is subject to regulatory limitations that can, under certain

adverse circumstances, prohibit the payment of dividends to us. Our right to participate in any distribution from the liquidation or sale of our Bank's assets is subject to the prior claims of our Bank's creditors.
If we are unable to access funds from capital transactions, borrowing under our revolving line of credit or dividends or interest on loan payments from our Bank, we may be unable to satisfy our obligations to creditors or debtholders or pay dividends on our preferred stock. Changes in our Bank's operating results or capital requirements could require us to convert subordinated notes or preferred stock of our bank held by us into common equity, reducing our cash flow available to meet our obligations.
We are subject to claims and litigation in the ordinary course of our business, including claims that may not be covered by our insurers. Customers and other parties we engage with assert claims and take legal action against us on a regular basis and we regularly take legal action to collect unpaid borrower obligations, realize on collateral and assert our rights in commercial and other contexts. These actions frequently result in counter-claims against us. Litigation arises in a variety of contexts, including lending activities, employment practices, commercial agreements, fiduciary responsibility related to our wealth management services, intellectual property rights and other general business matters.
Claims and legal actions may result in significant legal costs to defend us or assert our rights and may result in reputational damage that adversely affects existing and future customer relationships. If claims and legal actions are not resolved in a manner favorable to us we may suffer significant financial liability or adverse effects upon our reputation, which could have a material adverse effect on our business, financial condition and results of operations. See Legal Proceedings below for additional disclosures regarding legal proceedings.
We purchase insurance coverage to mitigate a wide range of operating risks, including general liability, errors and omissions, professional liability, business interruption, cyber-crime, fraud and property loss, for events that may be materially detrimental to our Bank or customers. There is no assurance that our insurance will be adequate to protect us against material losses in excess of our coverage limits or that insurers will perform their obligations under our policies without attempting to limit or exclude coverage. We could be required to pursue legal actions against insurers to obtain payment of amounts we are owed, and there is no assurance that such actions, if pursued, would be successful.
We are subject to environmental liability risk associated with 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, and that we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value by limiting our ability to use or sell it. Although we have policies and procedures requiring environmental review before initiating any foreclosure action on 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. Future laws or regulations or more stringent interpretations or enforcement policies with respect to existing laws and regulations may increase our exposure to environmental liability.
Severe weather, earthquakes, other natural disasters, pandemics, acts of war or terrorism and other external events could significantly impact our business. Severe weather, earthquakes, other natural disasters, pandemics, 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. Recent hurricanes caused extensive flooding and destruction along the coastal areas of Texas and in other areas in the US, including communities where we conduct business. Although management has established disaster recovery policies and procedures, the occurrence of any such events could have a material adverse effect on our business, financial condition and results of operations.
Risks Relating to Our Securities
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 quarterly and annual results of operations;
- changes in recommendations by securities analysts;
- changes in composition and perceptions of the investors who own our stock and other securities;
- changes in ratings from national rating agencies on publicly or privately owned debt securities and deposits in our Bank;
- operating and stock price performance of other companies that investors deem comparable to us;

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- news reports relating to trends, concerns and other issues in the financial services industry, including regulatory actions against other financial institutions;
- actual or expected economic conditions that are perceived to affect our company such as changes in commodity prices, real estate values or interest rates;
- perceptions in the marketplace regarding us and/or our competitors;
- 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;
- changes in government regulations and interpretation of those regulations, changes in our practices requested or required by regulators and changes in regulatory enforcement focus; 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 traded on the Nasdaq Global Select Market, the trading volume in our common stock is less than that of other larger financial services companies. 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. In addition, a substantial majority of common stock outstanding is held by institutional shareholders, and trading activity involving large positions may increase volatility of the stock price. Concentration of ownership by institutional investors and inability to execute trades covering large numbers of shares can increase volatility of stock price. Changes in general economic outlook or perspectives on our business or prospects by our institutional investors, whether factual or speculative, can have a major impact on our stock price.

Our preferred stock is thinly traded. There is only a limited trading volume in our preferred stock due to the small size of the issue and its largely institutional holder base. Significant sales of our preferred stock, or the expectation of these sales, could cause the price of the preferred stock to fall substantially.

An investment in our securities is not an insured deposit. Our common stock, preferred stock and indebtedness are not bank deposits and, therefore, are 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 securities of any company. As a result, if you acquire our common stock, preferred stock or indebtedness, you may lose some or all of your investment.

The holders of our indebtedness and preferred stock have rights that are senior to those of our common stockholders. As of December 31, 2018, we had $111.0 million outstanding in subordinated notes issued by our holding company and $113.4 million outstanding in junior subordinated notes that are held by statutory trusts which issued trust preferred securities to investors. At December 31, 2018 our Bank had $175.0 million in subordinated notes outstanding. Payments of the principal and interest on our trust preferred securities are conditionally guaranteed by us to the extent not paid by each trust, provided the trust has funds available for such obligations.

Our subordinated notes and junior subordinated notes are senior to our shares of preferred stock and common stock in right of payment of dividends and other distributions. We must be current on interest and principal payments on our indebtedness before any dividends can be paid on our preferred stock or our common stock. In the event of our bankruptcy, dissolution or liquidation, the holders of our indebtedness must be satisfied before any distributions can be made to our preferred or common stockholders. If certain conditions are met, we have the right to defer interest payments on the junior subordinated debentures (and the related trust preferred securities) at any time or from time to time for a period not to exceed 20 consecutive quarters in a deferral period, during which time no dividends may be paid to holders of our preferred stock or common stock. Because our Bank’s subordinated notes are obligations of the Bank, they would in liquidation of our Bank or sale of its assets receive payment before any amounts would be payable to holders of our common stock, preferred stock or subordinated notes.

At December 31, 2018, we had issued and outstanding 6 million shares of our 6.50% Non-Cumulative Perpetual Preferred Stock, Series, A, having an aggregate liquidation preference of $150.0 million. Our preferred stock is senior to our shares of common stock in right of payment of dividends and other distributions. We must be current on dividends payable to holders of preferred stock before any dividends can be paid on our common stock. In the event of our bankruptcy, dissolution or liquidation, the holders of our preferred stock must be satisfied before any distributions can be made to our common stockholders.

We do not currently pay dividends on our common stock. We have not paid dividends on our common stock and we do not expect to do so for the foreseeable future. Our ability to pay dividends is limited by regulatory restrictions and the need to

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maintain sufficient consolidated capital. The ability of our Bank to pay dividends to us is limited by its obligation to maintain sufficient capital and by other regulatory restrictions as discussed above under the heading Supervision and Regulation.

Restrictions on ownership. The ability of a third party to acquire us is limited under applicable U.S. banking laws and regulations. The BHCA requires any bank holding company (as defined therein) to obtain the approval of the Federal Reserve prior to acquiring, directly or indirectly, more than 5% of our outstanding Common Stock. Any “company” (as defined in the BHCA) other than a bank holding company would be required to obtain Federal Reserve approval before acquiring “control” of us. “Control” generally means (i) the ownership or control of 25% or more of a class of voting securities, (ii) the ability to elect a majority of the directors or (iii) the ability otherwise to exercise a controlling influence over management and policies. A holder of 25% or more of our outstanding Common Stock, other than an individual, is subject to regulation and supervision as a bank holding company under the BHCA. In addition, under the Change in Bank Control Act of 1978, as amended, and the Federal Reserve’s regulations thereunder, any person, either individually or acting through or in concert with one or more persons, is required to provide notice to the Federal Reserve prior to acquiring, directly or indirectly, 10% or more of our outstanding common stock.

Anti-takeover provisions of our certificate of incorporation, bylaws and Delaware law may make it more difficult for you to receive a change in control premium. Certain provisions of our certificate of incorporation and bylaws could make a merger, tender offer or proxy contest more difficult, even if such events were perceived by many of our stockholders as beneficial to their interests. These provisions include advance notice for nominations of directors and stockholders' proposals, and authority to issue “blank check” preferred stock with such designations, rights and preferences as may be determined from time to time by our board of directors. In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law which, in general, prevents an interested stockholder, defined generally as a person owning 15% or more of a corporation's outstanding voting stock, from engaging in a business combination with our company for three years following the date that person became an interested stockholder unless certain specified conditions are satisfied.

Limitations on payment of subordinated notes. Under the FDIA, “critically undercapitalized” banks may not, beginning 60 days after becoming critically undercapitalized, make any payment of principal or interest on their subordinated debt (subject to certain limited exceptions). In addition, under Section 18(i) of the FDIA, our Bank is required to obtain the advance consent of the FDIC to retire any part of its subordinated notes. Under the FDIA, a bank may not pay interest on its subordinated notes if such interest is required to be paid only out of net profits, or distribute any of its capital assets, while it remains in default on any assessment due to the FDIC.

Our Bank’s subordinated indebtedness is unsecured and subordinate and junior in right of payment to the Bank’s obligations to its depositors, its obligations under banker’s acceptances and letters of credit, its obligations to any Federal Reserve Bank, certain obligations to the FDIC, and its obligations to its other creditors, whether now outstanding or hereafter incurred, except any obligations which expressly rank on a parity with or junior to the subordinated notes.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate headquarters is located in downtown Dallas, Texas. These facilities, which we lease, house our executive and primary administrative offices, as well as the principal banking headquarters of Texas Capital Bank. We also lease other facilities in our primary market regions of Dallas, Fort Worth, Houston, Austin and San Antonio, as well as in California, Illinois, Missouri and New York, some of which operate as full-service banking centers. We also lease an operations center in Richardson, Texas that houses our loan and deposit operations and our customer call center.

ITEM 3. LEGAL PROCEEDINGS

The Company is subject to various claims and legal actions that may arise in the course of conducting its business. Management does not expect the disposition of any of these matters to have a material adverse impact on the Company’s financial statements or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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

Our common stock is traded on The Nasdaq Global Select Market under the symbol “TCBI”. On February 13, 2018, there were approximately 172 holders of record of our common stock.

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Stock Performance Graph

The following table and graph sets forth the cumulative total stockholder return for the Company's common stock for the five-year period ending on December 31, 2018, compared to an overall stock market index (Russell 2000 Index) and the Company's peer group index (Nasdaq Bank Index). The Russell 2000 Index and Nasdaq Bank Index are based on total returns assuming reinvestment of dividends. The graph assumes an investment of $100 on December 31, 2013. The performance graph represents past performance and should not be considered to be an indication of future performance.

	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Texas Capital Bancshares, Inc.	$ 100.00	$ 87.35	$ 79.45	$ 126.05	$ 142.93	$ 82.14
Russell 2000 Index (RTY)	100.00	103.64	97.90	116.79	132.03	116.31
Nasdaq Bank Index (CBNK)	100.00	103.03	109.95	147.90	153.31	126.83

Source: Bloomberg

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

You should read the selected financial data presented below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes appearing elsewhere in this Form 10-K.

	At or For the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per share, average share and percentage data)				
Consolidated Operating Data					
Interest income	$1,164,193	$879,299	$703,408	$602,958	$514,547
Interest expense	249,333	117,971	63,594	46,428	37,582
Net interest income	914,860	761,328	639,814	556,530	476,965
Provision for credit losses	87,000	44,000	77,000	53,250	22,000
Net interest income after provision for credit losses	827,860	717,328	562,814	503,280	454,965
Non-interest income	78,024	74,256	60,780	47,738	42,511
Non-interest expense	525,096	465,876	382,397	326,523	285,114
Income before income taxes	380,788	325,708	241,197	224,495	212,362
Income tax expense	79,964	128,645	86,078	79,641	76,010
Net income	300,824	197,063	155,119	144,854	136,352
Preferred stock dividends	9,750	9,750	9,750	9,750	9,750
Net income available to common stockholders	$291,074	$187,313	$145,369	$135,104	$126,602
Consolidated Balance Sheet Data					
Total assets	$28,257,767	$25,075,645	$21,697,134	$18,903,821	$15,900,034
Loans held for sale	1,969,474	1,011,004	968,929	86,075	—
Loans held for investment (LHI)	16,690,550	15,366,252	13,001,011	11,745,674	10,154,887
Loans held for investment, mortgage finance loans	5,877,524	5,308,160	4,497,338	4,966,276	4,102,125
Liquidity assets(1)	2,865,874	2,727,581	2,725,645	1,681,374	1,233,990
Investment securities	120,216	23,511	24,874	29,992	41,719
Demand deposits	7,317,161	7,812,660	7,994,201	6,386,911	5,011,619
Total deposits	20,606,113	19,123,180	17,016,831	15,084,619	12,673,300
Federal funds purchased and repurchase agreements	641,174	365,040	109,575	143,051	92,676
Other borrowings	3,900,000	2,800,000	2,000,000	1,500,000	1,100,005
Subordinated notes	281,767	281,406	281,044	280,682	280,321
Trust preferred subordinated debentures	113,406	113,406	113,406	113,406	113,406
Stockholders' equity	2,500,394	2,202,721	2,009,557	1,623,533	1,484,190

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	At or For the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(In thousands, except per share, average share and percentage data)				
Other Financial Data					
Income per share					
Basic	$5.83	$ 3.78	$ 3.14	$ 2.95	$ 2.93
Diluted	5.79	3.73	3.11	2.91	2.88
Book value per share	46.82	41.35	37.56	32.12	29.17
Tangible book value per share(2)	46.45	40.97	37.17	31.69	28.72
Weighted average shares					
Basic	49,936,702	49,587,169	46,239,210	45,808,440	43,236,344
Diluted	50,272,870	50,259,834	46,765,902	46,437,872	44,003,256
Selected Financial Ratios					
Performance Ratios					
Net interest margin	3.78 %	3.49 %	3.14 %	3.14 %	3.78 %
Return on average assets	1.19 %	0.87 %	0.74 %	0.79 %	1.05 %
Return on average common equity	13.14 %	9.51 %	9.27 %	9.65 %	11.31 %
Efficiency ratio(3)	52.89 %	55.75 %	54.58 %	54.04 %	54.88 %
Non-interest expense to average earning assets	2.15 %	2.12 %	1.88 %	1.84 %	2.26 %
Asset Quality Ratios					
Allowance for loan losses to LHI	0.85 %	0.89 %	0.96 %	0.84 %	0.71 %
Net charge-offs (recoveries) to average LHI	0.37 %	0.16 %	0.29 %	0.07 %	0.05 %
Allowance for loan losses to non-accrual loans	2.4x	1.8x	1.0x	.8x	2.3x
Non-accrual loans to LHI	0.36 %	0.49 %	0.96 %	1.08 %	0.30 %
Total NPAs to LHI plus OREO	0.36 %	0.55 %	1.07 %	1.08 %	0.31 %
Capital and Liquidity Ratios(4)					
CET1	8.58 %	8.45 %	8.97 %	7.47 %	7.89 %
Total capital ratio	11.31 %	11.50 %	12.48 %	11.05 %	11.83 %
Tier 1 capital ratio	9.53 %	9.52 %	10.23 %	8.81 %	9.46 %
Tier 1 leverage ratio	9.87 %	9.15 %	9.34 %	8.92 %	10.76 %
Tangible common equity/total tangible assets(5)	8.26 %	8.11 %	8.49 %	7.69 %	8.26 %
Average LHI, net/average total deposits	102.74 %	97.56 %	95.82 %	101.71 %	111.57 %

(1) Liquidity assets include Federal funds sold and interest-bearing deposits in other banks.

(2) Stockholders' equity excluding preferred stock, less goodwill and intangibles, divided by shares outstanding at period end.

(3) Non-interest expense divided by the sum of net interest income and non-interest income.

(4) The Basel III Capital Rules specifying the CET1 ratio became effective on January 1, 2015.

(5) Stockholders' equity excluding preferred stock and accumulated other comprehensive income less goodwill and intangibles divided by total assets less accumulated other comprehensive income and goodwill and intangibles.

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

Forward-Looking Statements

Certain statements and financial analysis contained in this report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of federal securities laws. Forward-looking statements may also be contained in our future filings with SEC, in press releases and in oral and written statements made by us or with our approval that are not statements of historical fact. These forward-looking statements are based on our beliefs, assumptions and expectations of our future performance taking into account all information available to us at the time such statements are made. Words such as “believes,” “expects,” “estimates,” “anticipates,” “plans,” “goals,” “objectives,” “exp “intends,” “seeks,” “likely,” “targeted,” “continue,” “remain,” “will,” “should,” “may” and other similar expressions are intend identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements may include, among other things, statements about the credit quality of our loan portfolio, general economic conditions in the United States and in our markets, including the continued impact on our customers from volatility in oil and gas prices, the financial impact of the Tax Act on our results of operations, expectations regarding rates of default or loan losses, volatility in the mortgage industry, our business strategies and our expectations about future financial performance, future growth and earnings, the appropriateness of our allowance for loan losses and provision for loan losses, the impact of increased regulatory requirements and legislative changes on our business, increased competition, interest rate risk, new lines of business, new product or service offerings and new technologies.

Forward-looking statements are subject to various risks and uncertainties, which change over time, are based on management’s expectations and assumptions at the time the statements are made and are not guarantees of future results. Important factors that could cause actual results to differ materially from the forward-looking statements include, but are not limited to, the following:

- Deterioration of the credit quality of our loan portfolio or declines in the value of collateral related to external factors such as commodity prices, real estate values or interest rates, increased default rates and loan losses or adverse changes in the industry concentrations of our loan portfolio.
- Changes in the value of commercial and residential real estate securing our loans or in the demand for credit to support the purchase and ownership of such assets.
- Changing economic conditions or other developments adversely affecting our commercial, entrepreneurial and professional customers.
- Adverse economic conditions and other factors affecting our middle market customers and their ability to continue to meet their loan obligations.
- The failure to correctly assess and model the assumptions supporting our allowance for loan losses, causing it to become inadequate in the event of deteriorations in loan quality and increases in charge-offs, or increases to our allowance for loan losses as a result of the implementation of CECL.
- Changes in the U.S. economy in general or the Texas economy specifically resulting in deterioration of credit quality, increases in non-performing assets or charge-offs or reduced demand for credit or other financial services we offer, including the effects from declines in the level of drilling and production related to volatility in oil and gas prices.
- Adverse changes in economic or market conditions, in Texas, the United States or internationally, that could affect the credit quality of our loan portfolio or our operating performance.
- Unanticipated effects from the Tax Act may limit its benefits or adversely impact our business, which could include decreased demand for borrowing by our middle market customers or increased price competition that offsets the benefits of decreased federal income tax expense.
- Unexpected market conditions or regulatory changes that could cause access to capital market transactions and other sources of funding to become more difficult to obtain on terms and conditions that are acceptable to us.
- The inadequacy of our available funds to meet our deposit, debt and other obligations as they become due, or our failure to maintain our capital ratios as a result of adverse changes in our operating performance or financial condition, or changes in applicable regulations or regulator interpretation of regulations impacting our business or the characterization or risk weight of our assets.

- The failure to effectively balance our funding sources with cash demands by depositors and borrowers.
- The failure to manage information systems risk or to prevent cyber-attacks against us, our customers or our third party vendors, or to manage risks from disruptions or security breaches affecting us, our customers or our third party vendors.
- The failure to effectively manage our interest rate risk resulting from unexpectedly large or sudden changes in interest rates, maturity imbalances in our assets and liabilities, potential adverse effects to our borrowers including their

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inability to repay loans with increased interest rates and the impact to our net interest income from the increasing cost of interest-bearing deposits.

- Legislative and regulatory changes imposing further restrictions and costs on our business, a failure to remain well capitalized or well managed status or regulatory enforcement actions against us, and uncertainty related to future implementation and enforcement of regulatory requirements resulting from the current political environment.
- The failure to successfully execute our business strategy, which may include expanding into new markets, developing and launching new lines of business or new products and services within the expected timeframes and budgets or to successfully manage the risks related to the development and implementation of these new businesses, products or services.
- The failure to attract and retain key personnel or the loss of key individuals or groups of employees.
- Increased or more effective competition from banks and other financial service providers in our markets.
- Structural changes in the markets for origination, sale and servicing of residential mortgages.
- Uncertainty in the pricing of mortgage loans that we purchase, and later sell or securitize, as well as competition for the MSRs related to these loans and related interest rate risk or price risk resulting from retaining MSRs, and the potential effects of higher interest rates on our MCA loan volumes.
- Material failures of our accounting estimates and risk management processes based on management judgment, or the supporting analytical and forecasting models.
- Failure of our risk management strategies and procedures, including failure or circumvention of our controls.
- Credit risk resulting from our exposure to counterparties.
- An increase in the incidence or severity of fraud, illegal payments, security breaches and other illegal acts impacting our Bank and our customers.
- The failure to maintain adequate regulatory capital to support our business.
- Unavailability of funds obtained from borrowing or capital transactions or from our Bank to fund our obligations.
- Incurrence of material costs and liabilities associated with legal and regulatory proceedings and related matters with respect to the financial services industry, including those directly involving us or our Bank.
- Environmental liability associated with properties related to our lending activities.
- Severe weather, natural disasters, acts of war or terrorism and other external events.

Actual outcomes and results may differ materially from what is expressed in our forward-looking statements and from our historical financial results due to the factors discussed elsewhere in this report or disclosed in our other SEC filings. Forward-looking statements included herein speak only as of the date hereof and should not be relied upon as representing our expectations or beliefs as of any date subsequent to the date of this report. Except as required by law, we undertake no obligation to revise any forward-looking statements contained in this report, whether as a result of new information, future events or otherwise. The factors discussed herein are not intended to be a complete summary of all risks and uncertainties that may affect our businesses. Though we strive to monitor and mitigate risk, we cannot anticipate all potential economic, operational and financial developments that may adversely impact our operations and our financial results. Forward-looking statements should not be viewed as predictions and should not be the primary basis upon which investors evaluate an investment in our securities.

Overview of Our Business Operations

We commenced our banking operations in December 1998. An important aspect of our growth strategy has been our ability to effectively service and manage a large number of loans and deposit accounts in multiple markets in Texas, as well as several lines of business serving a regional or national clientele of commercial borrowers. Accordingly, we have created an operations infrastructure sufficient to support our lending and banking operations that we continue to build out as needed to serve a larger customer base and specialized industries.

The following discussion and analysis presents the significant factors affecting our financial condition as of December 31, 2018 and 2017 and results of operations for each of the three years ended December 31, 2018, 2017 and 2016. This discussion should be read in conjunction with our consolidated financial statements and notes to the financial statements appearing later in this report.

Year ended December 31, 2018 compared to year ended December 31, 2017

We reported net income of $300.8 million and net income available to common stockholders of $291.1 million, or $5.79 per diluted common share, for the year ended December 31, 2018, compared to net income of $197.1 million and net income available to common stockholders of $187.3 million, or $3.73 per diluted common share, for 2017. Return on average common equity ("ROE") was 13.14% and return on average assets ("ROA") was 1.19% for the year ended December 31, 2018,

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compared to 9.51% and 0.87%, respectively, for 2017. The year-over-year increases in net income and ROE were primarily the result of a $153.5 million increase in net interest income and a $48.7 million decrease in income tax expense offset by a $43.0 million increase in the provision for credit losses and a $59.2 million increase in non-interest expense.

Year ended December 31, 2017 compared to year ended December 31, 2016

We reported net income of $197.1 million and net income available to common stockholders of $187.3 million, or $3.73 per diluted common share, for the year ended December 31, 2017, compared to net income of $155.1 million and net income available to common stockholders of $145.4 million, or $3.11 per diluted common share, for 2016. ROE was 9.51% and ROA was 0.87% for the year ended December 31, 2017, compared to 9.27% and 0.74%, respectively, for 2016. The increase in ROE for 2017 compared to 2016 resulted primarily from an increase in net interest income and a decrease in the provision for loan losses, offset by increases in non-interest expense and income tax expense. The increase in income tax expense reflects a $17.6 million write-off of our net deferred tax asset ("DTA") in response to enactment of the Tax Act, which was recorded as additional income tax expense during the fourth quarter of 2017. As a result of the Tax Act our effective tax rate for 2017 increased to 40% from 36% for 2016. Net income increased $41.9 million for the year ended December 31, 2017 compared to 2016. The $41.9 million increase was primarily the result of a $121.5 million increase in net interest income and a $33.0 million decrease in the provision for credit losses, offset by an $83.5 million increase in non-interest expense and a $42.6 million increase in income tax expense.

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Consolidated Daily Average Balances, Average Yields and Rates

(in thousands except percentages)	Year ended December 31, 2018 Average Balance	Revenue / Expense	Yield / Rate	2017 Average Balance	Revenue / Expense	Yield / Rate	2016 Average Balance	Revenue / Expense	Yield / Rate
Assets									
Investment Securities—taxable	$24,142	$849	3.52 %	$51,751	$1,064	2.06 %	$26,619	$943	3.54 %
Investment Securities—non-taxable(2)	46,553	2,512	5.40 %	55	3	4.85 %	604	36	5.92 %
Federal funds sold and securities purchased under resale agreements	201,236	3,792	1.88 %	237,371	2,542	1.07 %	310,128	1,547	0.50 %
Interest-bearing Deposits in other banks	1,769,074	32,597	1.84 %	2,715,669	29,399	1.08 %	3,133,196	16,312	0.52 %
Loans held for sale	1,561,530	71,240	4.56 %	1,016,144	39,159	3.85 %	416,325	14,009	3.36 %
Loans held for investment, mortgage finance	4,875,860	181,438	3.72 %	4,136,653	143,275	3.46 %	4,292,942	134,747	3.14 %
Loans held for investment(1)(2)	16,075,007	877,688	5.46 %	14,040,965	670,265	4.77 %	12,371,634	536,031	4.33 %
Less reserve for loan losses	183,863	—	—	174,105	—	—	163,623	—	—
Loans held for investment, net	20,767,004	1,059,126	5.10 %	18,003,513	813,540	4.52 %	16,500,953	670,778	4.07 %
Total earning assets	24,369,539	1,170,116	4.80 %	22,024,503	885,707	4.02 %	20,387,825	703,625	3.45 %
Cash and other assets	828,150			680,345			558,900		
Total assets	$25,197,689			$22,704,848			$20,946,725		
Liabilities and stockholders' equity									
Transaction deposits	$3,044,300	$47,738	1.57 %	$2,159,375	$15,290	0.71 %	$2,199,292	$7,219	0.33 %
Savings deposits	7,986,135	114,255	1.43 %	7,495,318	61,230	0.82 %	6,403,306	27,028	0.42 %
Time deposits	1,292,864	23,123	1.79 %	478,513	3,366	0.70 %	493,128	2,928	0.59 %
Total interest-bearing deposits	12,323,299	185,116	1.50 %	10,133,206	79,886	0.79 %	9,095,726	37,175	0.41 %
Other borrowings	2,102,404	42,738	2.03 %	1,618,238	17,729	1.10 %	1,480,302	6,645	0.45 %
Subordinated notes	281,574	16,764	5.95 %	281,213	16,764	5.96 %	280,850	16,764	5.97 %
Trust preferred subordinated debentures	113,406	4,715	4.16 %	113,406	3,592	3.17 %	113,406	3,009	2.65 %
Total interest-bearing liabilities	14,820,683	249,333	1.68 %	12,146,063	117,971	0.97 %	10,970,284	63,593	0.58 %
Demand deposits	7,890,304			8,320,650			8,124,174		
Other liabilities	121,203			118,944			134,678		
Stockholders' equity	2,365,499			2,119,191			1,717,589		
Total liabilities and stockholders' equity	$25,197,689			$22,704,848			$20,946,725		
Net interest income(2)		$920,783			$767,736			$640,032	
Net interest margin			3.78 %			3.49 %			3.14 %
Net interest spread			3.12 %			3.05 %			2.87 %
Loan spread(3)			4.04 %			4.00 %			3.81 %

(1) The loan averages include non-accrual loans which are stated net of unearned income. Loan interest income includes loan fees totaling $71.0 million, $59.5 million and $50.0 million for the years ended December 31, 2018, 2017 and 2016, respectively.
(2) Taxable equivalent rates used where applicable.
(3) Yield on loans, net of reserves, less funding cost including all deposits and borrowed funds.

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Volume/Rate Analysis

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of earning assets and interest-bearing liabilities and the changes due to differences in the average interest rate on those assets and liabilities.

	Years Ended December 31,					
	2018/2017			2017/2016		
	Net	Change Due To(1)		Net	Change Due To(1)	
(in thousands)	Change	Volume	Yield/Rate(2)	Change	Volume	Yield/Rate(2)
Interest income:						
Investment Securities	$2,294	$722	$ 1,572	$88	$868	$ (780)
Loans held for sale	32,081	21,385	10,696	25,150	20,183	4,967
Loans held for investment, mortgage finance loans	38,163	25,541	12,622	8,528	(4,906)	13,434
Loans held for investment	207,423	96,521	110,902	134,234	72,328	61,906
Federal funds sold and securities purchased under resale agreements	1,250	(435)	1,685	995	(357)	1,352
Interest-bearing Deposits in other banks	3,198	(10,437)	13,635	13,087	(2,174)	15,261
Total	284,409	133,297	151,112	182,082	85,942	96,140
Interest expense:						
Transaction deposits	32,448	6,197	26,251	8,071	(131)	8,202
Savings deposits	53,025	3,382	49,643	34,202	4,609	29,593
Time deposits	19,757	6,181	13,576	438	(87)	525
Other borrowings	25,009	5,173	19,836	11,084	619	10,465
Long-term debt	1,123	20	1,103	583	—	583
Total	131,362	20,953	110,409	54,378	5,010	49,368
Net interest income	$153,047	$112,344	$ 40,703	$127,704	$80,932	$ 46,772

(1) Yield/rate and volume variances are allocated to yield/rate.

(2) Taxable equivalent rates used where applicable assuming a 21% tax rate.

Net Interest Income

Net interest income was $914.9 million for the year ended December 31, 2018 compared to $761.3 million for 2017. The increase was primarily due to an increase in earning assets of $2.3 billion and the effect of increases in interest rates on loan yields, offset by an increase in interest-bearing liabilities of $2.7 billion and the effect of increased funding costs. The increase in average earning assets included a $545.4 million increase in average loans held for sale, a $2.8 billion increase in average net loans held for investment and an $18.9 million increase in average investment securities, offset by a $982.7 million decrease in average liquidity assets. The increase in average interest-bearing liabilities included a $2.2 billion increase in interest-bearing deposits and a $484.2 million increase in other borrowings. Average demand deposits for the year ended December 31, 2018 decreased to $7.9 billion from $8.3 billion for 2017 as a result of the rising interest rate environment and the shift to interest-bearing deposits. Net interest margin for the year ended December 31, 2018 was 3.78% compared to 3.49% for 2017. The increase was primarily due to improved asset composition and the effect of increases in interest rates on loan yields attributed to our asset-sensitive balance sheet.

The yield on total loans held for investment increased to 5.10% for the year ended December 31, 2018 compared to 4.52% and the yield on earning assets increased to 4.80% for the year ended December 31, 2018 compared to 4.02% for 2017. The average cost of total deposits and borrowed funds increased to 1.02% for 2018 from 0.49% for 2017. The spread on total earning assets, net of the cost of deposits and borrowed funds, was 3.78% for 2018 compared to 3.53% for 2017. The increase resulted primarily from increases in interest rates and increases in the higher yielding loan components of earning assets. Total funding costs, including all deposits, long-term debt and stockholders' equity increased to 0.99% for 2018 compared to 0.52% for 2017.

Net interest income was $761.3 million for the year ended December 31, 2017 compared to $639.8 million for 2016. The increase was primarily due to an increase in average earning assets of $1.6 billion and the effect of increases in interest rates on loan yields, offset by an increase in interest-bearing liabilities of $1.2 billion and the effect of increased funding costs. The increase in average earning assets included a $599.8 million increase in average loans held for sale, a $1.5 billion increase in

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average net loans held for investment, and a $24.6 million increase in average securities, offset by a $490.3 million decrease in average liquidity assets. The increase in average interest-bearing liabilities included a $1.0 billion increase in interest-bearing deposits and a $137.9 million increase in other borrowings. Average demand deposits for the year ended December 31, 2017 increased to $8.3 billion from $8.1 billion. Net interest margin for year ended December 31, 2017 was 3.49% compared to 3.14% for 2016. The increase was primarily due to the effect of increases in interest rates on loan yields attributable to our asset-sensitive balance sheet.

The yield on total loans held for investment increased to 4.52% for the year ended December 31, 2017 compared to 4.07% for 2016 and the yield on earning assets increased to 4.02% for the year ended December 31, 2017 compared to 3.45% for 2016. The spread on total earning assets, net of the cost of deposits and borrowed funds, was 3.53% for 2017 compared to 3.22% for 2016. The increase resulted primarily from increases in interest rates and increases in the higher yielding loan components of earning assets. Total funding costs, including all deposits, long-term debt and stockholders' equity increased to 0.52% for 2017 compared to 0.30% for 2016.

Non-interest Income

	Year ended December 31,		
(in thousands)	2018	2017	2016
Service charges on deposit accounts	$12,787	$12,432	$10,341
Wealth management and trust fee income	8,148	6,153	4,268
Brokered loan fees	22,532	23,331	25,339
Servicing income	18,307	15,657	1,715
Swap fees	5,625	3,990	2,866
Gain/(Loss) on sale of loans held for sale	(15,934)	(2,387)	2,547
Other(1)	26,559	15,080	13,704
Total non-interest income	$78,024	$74,256	$60,780

(1) Other non-interest income includes such items as letter of credit fees, bank owned life insurance ("BOLI") income, dividends on FHLB and FRB stock and other general operating income.

Non-interest income increased by $3.8 million during the year ended December 31, 2018 to $78.0 million, compared to $74.3 million for 2017. Servicing income increased $2.7 million during 2018 compared to 2017 due to an overall increase in average MSR balances held during 2018 as compared to 2017. Wealth management and trust fee income increased $2.0 million during 2018 compared to 2017 due primarily to an increase in assets under management. Swap fees increased $1.6 million during 2018 compared to 2017. These fees are related to customer swap transactions, are received from the institution that is our counterparty on the transaction and fluctuate from time to time based on the number and volume of transactions closed during the year. Offsetting these increases was a decrease in gain/(loss) on sale of loans held for sale of $13.5 million during 2018 compared to 2017 due to losses on sale of loans held for sale through our MCA program.

Non-interest income increased by $13.5 million during the year ended December 31, 2017 to $74.3 million, compared to $60.8 million for 2016. This increase was primarily due to a $13.9 million increase in servicing income during 2017 compared to 2016 attributable to an increase in MSRs held during 2017 as compared to 2016. Service charges increased $2.1 million during 2017 compared to 2016 as a result of the increase in deposit balances and improved pricing of treasury services. Wealth management and trust fee income increased $1.9 million during 2017 compared to 2016 due to an increase in assets under management. Offsetting these increases were decreases of $4.9 million and $2.0 million in gain/(loss) on sale of loans held for sale and brokered loan fees, respectively, compared to 2016. The decrease in brokered loan fees during 2017 compared to 2016 resulted from a decrease in total mortgage finance volumes.

While management expects continued growth in certain components of non-interest income, the future rate of growth could be affected by increased competition from national and regional financial institutions and general economic conditions. In order to achieve continued growth in non-interest income, management from time to time evaluates new products, new lines of business or the expansion of existing lines of business. Any new product introduction or new market entry could place additional demands on capital and managerial resources and introduce new risks to our business.

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Non-interest Expense

(in thousands)	Year ended December 31, 2018	2017	2016
Salaries and employee benefits	$291,768	$264,231	$228,985
Net occupancy expense	30,342	25,811	23,221
Marketing	39,335	26,787	17,303
Legal and professional	42,990	29,731	23,326
Communications and technology	30,056	31,004	25,562
FDIC insurance assessment	24,307	23,510	24,440
Servicing related expenses	14,934	15,506	1,703
Allowance and other carrying costs for OREO	474	6,437	824
Other(1)	50,890	42,859	37,033
Total non-interest expense	$525,096	$465,876	$382,397

(1) Other expense includes such items as courier expenses, regulatory assessments other than FDIC insurance, insurance expenses and other general operating expenses.

Non-interest expense for the year ended December 31, 2018 increased $59.2 million compared to 2017. The increase is primarily due to increases in salaries and employee benefits, net occupancy expense, marketing, legal and professional and other non-interest expense, all of which were due to general business growth and continued build-out. Offsetting these increases was a $6 million decrease in the allowance and other carrying costs for OREO primarily related to a $6.1 million write-down of one OREO property taken in 2017.

Non-interest expense for the year ended December 31, 2017 increased 83.5 million compared to 2016. The increase was primarily due to increases in salaries and employee benefits, net occupancy expense, marketing, legal and professional, communications and technology and other non-interest expense, all of which were due to general business growth and continued build-out. Also contributing to the year-over-year increase in non-interest expense was a $13.8 million increase in servicing related expenses resulting from a $2.8 million impairment charge taken in 2017, as well as an increase in amortization and servicing expenses related to MSRs. Allowance and other carrying costs for OREO also increased primarily due to a $6.1 million write-down of one OREO property taken during the fourth quarter of 2017.

Analysis of Financial Condition

Loans Held for Investment

The following table summarizes our loans held for investment on a gross basis by portfolio segment:

(in thousands)	December 31, 2018	2017	2016	2015	2014
Commercial	$10,373,288	$9,189,811	$7,291,545	$6,672,631	$5,869,219
Mortgage finance	5,877,524	5,308,160	4,497,338	4,966,276	4,102,125
Construction	2,120,966	2,166,208	2,098,706	1,851,717	1,416,405
Real estate	3,929,117	3,794,577	3,462,203	3,139,197	2,807,127
Consumer	63,438	48,684	34,587	25,323	19,699
Equipment leases	312,191	264,903	185,529	113,996	99,495
Total loans held for investment	$22,676,524	$20,772,343	$17,569,908	$16,769,140	$14,314,070

Our total loans held for investment have grown at an annual rate of 9%, 18% and 5% in 2018, 2017 and 2016, respectively, reflecting the continued build-up of our lending operations. Our business plan focuses primarily on lending to middle market businesses and successful professionals and entrepreneurs, and as such, commercial, real estate and construction loans have comprised a majority of our loan portfolio, representing 73% of total loans held for investment at December 31, 2018. Consumer loans generally have represented 1% or less of the portfolio from December 31, 2014 to December 31, 2018. Mortgage finance loans relate to our mortgage warehouse lending operations in which we purchase mortgage loan ownership interests that are typically sold within 10 to 20 days. Volumes fluctuate based on the level of market demand for the product and the number of days between purchase and sale of the loans, which can be affected by changes in overall market interest rates, and tend to peak at the end of each month.

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We originate a substantial majority of all loans held for investment, excluding mortgage finance loans. We also participate in syndicated loan relationships, both as a participant and as an agent. As of December 31, 2018, we had $2.3 billion in syndicated loans, $538.1 million of which we administer as agent. All syndicated loans, whether we act as agent or participant, are underwritten to the same standards as all other loans we originate. As of December 31, 2018, $8.8 million of our syndicated loans were on non-accrual.

Portfolio Geographic and Industry Concentrations

Although more than 50% of our total loan exposure is outside of Texas and more than 50% of our deposits are sourced outside of Texas, our Texas concentration remains significant. As of December 31, 2018, a majority of our loans held for investment, excluding mortgage finance loans and other national lines of business, were to businesses with headquarters or operations in Texas. This geographic concentration subjects the loan portfolio to the general economic conditions within this area. We also make loans to these customers that are secured by assets located outside of Texas. The risks created by this concentration have been considered by management in the determination of the appropriateness of the allowance for loan losses.

The table below summarizes the industry concentrations of our loans held for investment on a gross basis at December 31, 2018.

(in thousands except percentage data)	Amount	Percent of Total Loans Held for Investment	
Industry type:			
Mortgage finance loans	$5,877,524	25.9	%
Real estate and construction	5,070,400	22.4	%
Financials excluding banks	4,829,665	21.3	%
Oil & gas and pipelines	1,841,815	8.1	%
Healthcare and pharmaceuticals	803,835	3.5	%
Retail	411,021	1.8	%
Machinery, equipment and parts manufacturing	462,382	2.0	%
Technology, telecom and media	396,165	1.7	%
Government and education	567,235	2.5	%
Commercial services	435,725	1.9	%
Materials and commodities	263,063	1.2	%
Consumer services	221,774	1.0	%
Transportation services	144,863	0.6	%
Entertainment and recreation	254,323	1.1	%
Food and beverage manufacturing and wholesale	131,153	0.6	%
Auto-related	97,681	0.4	%
Diversified or miscellaneous	867,900	4.0	%
Total loans held for investment	$22,676,524	100.0	%

Our largest concentration of loans held for investment, excluding mortgage finance, in any single industry is in real estate and construction. Loans extended to borrowers within the real estate and construction industries generally include market risk real estate loans. We extend market risk real estate loans, including both construction/development financing and limited term financing, to builders, professional real estate developers and owners/managers of commercial real estate projects and properties who have a demonstrated record of past success with similar properties. Collateral properties include office buildings, warehouse/distribution buildings, shopping centers, apartment buildings and residential and commercial tract development located primarily within our five major metropolitan markets in Texas. These loans are generally repaid through the borrower's sale or lease of the properties or through refinancing by other institutional sources offering long-term fixed rate financing. Loan amounts are determined in part from an analysis of pro forma cash flows. Loans are also underwritten to comply with product-type specific advance rates against both cost and market value. Borrowers represented within the real estate and construction category are largely owners and managers of both residential and non-residential commercial real estate properties, including homebuilders.

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Loans extended to borrowers in the financials excluding banks category are comprised largely of loans to companies who loan money to businesses and consumers for various purposes including, but not limited to, insurance, consumer goods and real estate. This category also includes loans to companies involved in investment management and securities and commodities trading.

We believe the loans we originate are appropriately collateralized under our credit standards. Approximately 96% of our loans held for investment are secured by collateral. Over 67% of the real estate collateral is located in Texas. The table below sets forth information regarding the distribution of our loans held for investment on a gross basis among various types of collateral at December 31, 2018:

(in thousands except percentage data)	Amount	Percent of Total Loans Held for Investment	
Collateral type:			
Business assets	$7,191,487	31.7	%
Real property	6,050,083	26.7	%
Mortgage finance loans	5,877,524	25.9	%
Energy	1,308,640	5.8	%
Municipal tax- and revenue-secured	593,683	2.6	%
Unsecured	844,650	3.7	%
Highly liquid assets	317,237	1.4	%
Other assets	431,651		